

**IN THE MATTER OF THE LAW COMMISSION
AND LEASEHOLD ENFRANCHISEMENT REFORM
AND THE COMPATIBILITY OF THE VARIOUS OPTIONS FOR REFORM
WITH ARTICLE 1 OF THE FIRST PROTOCOL
OF THE EUROPEAN CONVENTION ON HUMAN RIGHTS**

OPINION ON NON-LITIGATION COSTS

1. Following my advice on valuation dated 30 November 2019, my advice is sought on the compatibility with the European Convention on Human Rights (“ECHR”) of a further related proposed recommendation, running alongside the options for reforming valuation, namely, to remove the requirement for leaseholders to contribute towards their landlords’ transactional costs of dealing with an enfranchisement claim.

2. At present, leaseholders are required to contribute to landlords’ non-litigation costs of dealing with enfranchisement claims. Both the Leasehold Reform Act 1967 and the Leasehold Reform, Housing and Urban Development Act 1993 set out specific categories of work for which a landlord will be entitled to be paid his or her reasonably incurred transaction costs. The Law Commission has reached a provisional policy conclusion that:
 - (1) If the premium for enfranchisement claims is to be based on the market value of the landlord’s asset (that is, based on Option 2 in the Consultation Paper, and rates are prescribed in a manner intended to reflect market rates), non-litigation costs should not be recoverable;

 - (2) If the premium for enfranchisement claims is not based on the market value of the landlord’s asset (that is, it is not based on Option 2 in the Consultation Paper, or adopts prescribed rates that are deliberately lower than the market rate), non-litigation costs should be recoverable.

3. The Law Commission has also concluded that if non-litigation costs are to be recoverable, a fixed costs regime should be introduced. This would allow a landlord who has

participated in a completed enfranchisement claim to recover a fixed base sum (which could be the same for all types of enfranchisement claim, or might vary depending on the type of claim), and additional fixed sums in respect of prescribed categories of additional work undertaken as part of a claim, which are regarded as an integral part of the leaseholder's claim.

4. I am asked to consider whether these provisional proposals are compatible with Article 1 of the First Protocol to the ECHR ("A1P1"). The first question is whether A1P1 is engaged in relation to these proposals. Here, what is at stake is not interference with a landlord's freehold interest in real property, but removal of or limits on the landlord's ability to recover transactional costs associated with an enfranchisement claim. While the landlord's procedural costs are distinct from the premium that is to be paid to the landlord for his or her interest, I agree with the Law Commission that a requirement for leaseholders to pay any part of landlords' non-litigation procedural costs is properly to be considered to be part of the compensation to be paid in respect of compulsorily acquiring the landlords' asset. In any event, a person's financial resources are capable of being "possessions" within the meaning of A1P1,¹ so the intended proposals would amount to an interference with landlords' possessions for the purposes of A1P1. In addition, I note that the requirement to pay litigation costs has previously been held to amount to "contributions" within the meaning of the second paragraph of A1P1,² and the requirement to pay non-litigation costs is likely to be regarded in a similar way. I therefore consider that A1P1 would be engaged by the removal of or imposition of limits on landlords' current ability to recover their transactional legal costs associated with enfranchisement claims.

5. In determining whether these proposals comply with A1P1, it is necessary to put them in their proper context. The Law Commission has observed, in its written instructions to counsel, that under current enfranchisement law, the premium to be paid on enfranchisement is calculated by reference to valuations carried out on an open market basis; there is no deduction made to reflect the leaseholder's obligation to contribute to the landlord's transaction costs. As a result, the current law of enfranchisement allows the landlord to recover more than he or she would on an open market transaction: the landlord

¹ See *AXA v HM Advocate* [2012] 1 AC 868 at [26] per Lord Hope; *In Re Medical Costs* [2015] AC 1016 at [41] per Lord Mance.

² See *Antoniades v UK* (App No. 15434/89); *Perdigão v Portugal* (App No. 24768/06).

recovers both the premium that would be received on an open market transaction and a contribution to his or her costs, which would not be paid by a third-party on the open market. In essence, the payment of the landlords' transactional costs under the current system is a windfall.

6. The question then becomes whether the compulsory nature of an enfranchisement transaction provides a sufficient justification for this more favourable treatment. In this regard, it is to be noted that a person whose property is to be acquired by means of a compulsory purchase order is entitled to receive compensation which includes payment for legal costs and other professional fees. However, the analogy between enfranchisement claims and compulsory purchase orders appears to be a weak one. In contrast with ordinary properties which are purchased under compulsory purchase order, the inherent limitations of a leasehold tenure mean that a leaseholder is compelled to extend the term or acquire the freehold to avoid the property reverting to the landlord at the end of the term, and to do so at an early stage to ensure that purchasers reliant on mortgage finance are able to acquire it. It is also difficult to argue that leaseholders have voluntarily chosen leasehold tenure. Flats and maisonettes are almost universally owned on a leasehold basis, so there is effectively no choice other than to purchase these properties as leasehold. In addition, it is widely acknowledged that in the early 2000s, the residential property market featured a historically high proportion of leasehold houses as a result of the adoption of leasehold by the financial sector as a dependable asset class. As a result, for many leaseholders, enfranchisement is a commercial necessity rather than a choice. The obverse is that most current landlords would have acquired their own interests knowing they were subject to enfranchisement rights; and indeed, the prospect of an enfranchisement claim being made would often be a significant attraction for investors in leasehold reversions.
7. Therefore, there would appear to be little justification for departing from the position that applies to non-litigation costs in open market transactions. On this basis, I consider that the UK and Strasbourg Courts are likely to conclude that, in a context where the landlord already receives adequate compensation for his or her interest in a property, it would strike a fair balance and be proportionate to remove the landlord's ability to recover his or her non-litigation costs from the leaseholder. However, this argument is less likely to hold if the Government adopts valuation options that clearly depart from an attempt to capture market value.

8. The Law Commission has sought to draw a sharp distinction between valuation options which it considers attempt to capture market value (Options 2) (in respect of which it recommends that non-litigation costs should not be recoverable) and those which it considers do not (Options 1) (in respect of which it recommends that non-litigation costs should be recoverable, in fixed sums). I prefer to apply a sliding scale; in other words, the further away the premium for enfranchisement claims is from the market value of the landlord's asset, the more likely it is that non-litigation costs should be recoverable, in order for the overall package of compensation to be regarded as proportionate and compatible with A1P1. Otherwise, the risk increases that depriving landlords of their non-litigation costs will tip the balance, and mean that landlords are shouldering an excessive burden.

9. I therefore consider that the removal of the current ability of a landlord to recover his or her non-litigation costs of dealing with an enfranchisement claim from the leaseholder, in the event that the premium for enfranchising is based on the market value of the landlord's asset, is likely to be compatible with A1P1. The risk of a successful challenge to this aspect of the scheme is Medium Low (although I consider it unlikely that this aspect would be challenged separately). Conversely, in the event that the premium for enfranchising is not based on the market value of the landlord's asset, then at the very least, non-litigation costs should be recoverable on the basis of the proposed fixed costs regime. I consider that the risk of a successful challenge to a fixed costs regime in these circumstances is Medium Low (although again, I consider it unlikely that this aspect would be challenged separately). The bigger risk would be the risk posed by the extent to which the premium payable departed from the market value of the property.

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