UPPER TRIBUNAL (LANDS CHAMBER)

UT Neutral citation number: [2013] UKUT 0211 (LC)
UTLC Case Number: LRA/23/2012

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – Flat – collective enfranchisement under the Leasehold Reform, Housing and Urban Development Act 1993 – valuation of the freeholder's interest under paragraph 3 of Schedule 6 – marriage value under paragraph 4

IN THE MATTER OF AN APPEAL AGAINST A DECISION OF THE LEASEHOLD VALUATION TRIBUNAL FOR THE LONDON RENT ASSESSMENT PANEL

BETWEEN:

(1) MR J MONEY **Appellants**
(2) MR C CAREY- MORGAN
(3) MR J R DAVIES

and

CADOGAN HOLDINGS LTD **Respondent**

Re: 15 Tite Street
London SW3 4JR

Before: The President, Sir Keith Lindblom and Mr N. J. Rose F.R.I.C.S.

Sitting at: 43-45 Bedford Square, London WC1B 3AS
on 11 April 2013

Mr Timothy Dutton Q.C., instructed by Wilson Barca Solicitors, for the appellants
Ms Ellodie Gibbons, instructed by Pemberton Greenish LLP, solicitors, for the respondent

The following cases are referred to in this decision:

Earl Cadogan v Pitts and another and *Earl Cadogan v Sportelli and another* [2008] UKHL 71
Maryland Estates Ltd v Abbathure Flat Management Co Ltd [1999] 1 EGLR 100
Sinclair Gardens Investments (Kensington) Ltd v Franks (1998) 76 P. & C.R. 230
Forty-Five Holdings Ltd v Grosvenor (Mayfair) Estate [2009] UKUT 234 (LC)
Smith v Jafton Properties [2011] EWCA Civ 1251
Van Dal Footwear v Ryman [2009] EWCA Civ 1478
James v United Kingdom (1986) 8 E.H.R.R 123

DECISION

Introduction

1. This is an appeal, by way of review, against the decision of the Leasehold Valuation Tribunal ("the LVT"), dated 13 December 2011, in a collective enfranchisement claim, by which, under section 24 of the Leasehold Reform, Housing and Urban Development Act 1993 ("the 1993 Act"), it determined the terms of acquisition of the freehold and intermediate leasehold interests in premises at 15 Tite Street, London SW3 ("the building"). The LVT determined the enfranchisement price as £995,500, of which the freeholder's share was £836,400 and the head lessees' £159,100. The appeal is concerned with only one aspect of the LVT's decision. The appellants, Mr J. Money, Mr C. Carey-Morgan and Mr J. R. Davies, contend that the LVT was wrong to hold that the respondent, Cadogan Holdings Limited, was entitled to receive a sum, which the LVT determined as £161,750, for the additional value attributable to the absence of a restriction in the transfer limiting the use of the basement flat in the building to use as a caretaker's flat.

2. The appellants were represented in the appeal, as they had been before the LVT, by Mr Timothy Dutton Q.C., the respondent by Ms Ellodie Gibbons, who did not appear below.

The facts

3. The relevant facts are not in dispute. In the light of the LVT's decision and the other documents the parties have put before us, we take the following facts to be agreed, at least for the purposes of this appeal.

4. The building is a six-storey terraced house in a residential street in Chelsea. It contains four flats and a maisonette: the flats in the basement and on each of the ground, first and second floors, the maisonette on the third and fourth floors.

5. When the claim for enfranchisement was made, in November 2010, the respondent was the freehold owner of the building. The freehold was reversionary to two headleases: a long lease of the basement flat dated 3 November 2010, for a term running from the date of the lease until 25 March 2133 ("the 2010 New Lease"), to which the LVT referred in its decision as "Headlease 2", and a long lease of the remainder of the building dated 23 March 1984 ("the 1984 Headlease"), to which the LVT referred as "Headlease 1". As granted, the 1984 Headlease included the whole of the building, including the basement flat. The basement flat was removed from this title upon the grant of the 2010 New Lease. The 1984 Headlease was reversionary to long leases of the ground and first floor flats as well as the maisonette. The second floor flat was occupied by right of the 1984 Headlease.

6. A restriction on the use of the basement flat had initially been imposed by the tenant covenants in the 1984 Headlease. Clause 2(10) of the 1984 Headlease restricted the use of the basement flat to use as "A Caretaker[']s flat". In the 2010 New Lease there were tenant covenants against the basement flat being used otherwise than as a caretaker's flat

(in clause 4.8.1), and against assignment (in clause 4.16.1), which provided, respectively, as follows:

> "4.8.1 Not to carry on or permit to be carried on upon the Demised Premises or any part thereof any trade business or profession and not to use or permit the Demised Premises or any part thereof to be used for any illegal or immoral purpose or otherwise than
>
> 4.8.1.1 Until and including 25 March 2043 as a caretaker's flat in accordance with the obligations on the part of the tenant set out in clauses 2(10) and 2(11)(c) of the Existing Lease; and
>
> 4.8.1.2 Thereafter as a single private dwelling house in one family occupation only"

and

> "4.16.1 Up to and including 25 March 2043 not to assign transfer underlet or part with possession of any interest whether legal or equitable in the whole of the Demised Premises except by way of a simultaneous assignment with the Existing Lease to the same assignee and otherwise in accordance with the provisions of clause 4.16.3 hereof".

7. The 2010 New Lease of the basement flat was granted to Mr Money and Mr Carey-Morgan, the LVT having decided its terms on 1 June 2009 in a determination under section 48 of the 1993 Act ("the section 48 determination"). In paragraph 12 of the section 48 determination the respondent's valuer, Mr Dharmasena, was recorded as having said in his evidence that if Mr Money and Mr Carey-Morgan were later to succeed in a collective enfranchisement claim they would be able to alter the terms of the 2010 New Lease as then proposed, "which would unlock significant value". This, in Mr Dharmasena's view, was likely to happen as Mr Money and Mr Carey-Morgan now also had a long leasehold interest in the second floor flat. The LVT acknowledged, however, that it would be possible and appropriate to assess this "other compensation" in "the future enfranchisement proceedings which have only just been started" (paragraph 56 of the section 48 determination).

8. The claim for collective enfranchisement was issued on 4 November 2010. The appellants were identified as the nominee purchaser, the respondent as the reversioner. The appellants were all "participating tenants" for the purposes of the 1993 Act. The first and second appellants (Mr Money and Mr Carey-Morgan) were entitled to participate both as owners of the 1984 Headlease, by which they were qualifying tenants of the second floor flat, and as qualifying tenants of the basement flat under the 2010 New Lease. The third appellant was entitled to participate as qualifying tenant of the ground floor flat, by an underlease of that flat.

9. The right to enfranchise was admitted, but the terms of acquisition were not agreed.

10. On 23 March 2011 the appellants made an application under section 91 of the 1993 Act for the terms of acquisition to be determined.

11. The appellants' application came before the LVT on 11 October 2011.

12. One of the matters in dispute before the LVT was:

> "Whether the transfer should contain a restriction on the use of the Basement Flat restricting its use to use as a caretaker's flat until 2043, that being the restriction on use in the current lease"

(paragraph 6 under the heading "The Terms of the Transfer" in the part of the decision recording "Matters in Dispute"). The LVT decided that the transfer should not contain such a restriction (paragraph 4 under the heading "The Terms of the Transfer"). It explained why (ibid.):

> "The transfer should not contain a restriction on the use of the basement flat to use as a caretaker's flat until 2043.
>
> While there was some disagreement between the parties as to the extent of the Respondents' ownership in the area the parties agreed that the Respondents do not own the properties immediately adjoining the Property but that they do own properties in the neighbourhood. Accordingly there were properties that might benefit from the restriction.
>
> While there are restrictions in the Headleases of the Property restricting the use of the basement flat to use as a caretaker's flat until 2043 the Respondent has not provided the Tribunal with any evidence that these restrictions actually benefit other property nor that they materially enhance the value of other property, as required by Paragraph 5.1(b)(i) [of Schedule 7 to the 1993 Act].
>
> The Respondents provided no evidence that this further restriction would not interfere with the reasonable enjoyment of the premises (a requirement of Paragraph 5.1(c)(i) [of Schedule 7]) nor that it would materially enhance the value of the Respondent's "other" property.
>
> The Tribunal adopts the view taken by the Upper Tribunal in the Vale Court case that evidence is required to establish that the restriction will materially enhance the value of other property of the freeholder, although quantification of such enhancement of value is not needed.
>
> Accordingly the Tribunal determines that the requirements of neither Paragraph 5.1(b)(i) nor Paragraph 5.1(c)(i) are met and there is no requirement for the transfer to contain this restriction."

There is no appeal from that part of the LVT's decision.

13. As to valuation, the parties agreed the date of valuation (4 November 2010), the freehold and leasehold vacant possession values, and the capitalisation and deferment rate for the freeholder's head rental income, the deferment rate for the freehold reversion, and several other elements of the valuation (paragraph 2 under the heading "Matters Agreed"). Five issues arose for the LVT to decide (paragraphs 7 to 11 under the heading "Valuation Issues"), one of which was this:

> "Whether the Respondent is entitled to receive an additional sum (and if so how much) by way of compensation if there is no restriction in the transfer as to the use of the basement flat as a caretaker's flat"
>
> (paragraph 11 under the heading "Valuation Issues" in the part of the decision recording "Matters in Dispute"). This issue was live because the LVT decided that the transfer should not contain such a restriction.

14. In section 8 of his proof of evidence for the hearing before the LVT the respondent's valuation witness, Mr Julian Mansfield Clark M.R.I.C.S., considered the valuation implications of relaxing "the user covenant" in the transfer. He made plain (in paragraph 8.1) the respondent's contention that it was "entitled to import into the freehold transfer the [restriction] … in the extended lease of the basement flat that that flat may not be used other than as a caretaker's flat until 25 March 2043". But he nevertheless went on (in paragraphs 8.16 to 8.20) to provide his view on the valuation implications of that contention being rejected. He said:

> "8.16 In relation to the use of the Basement Flat, I have been asked to comment on the valuation implications of the user clause in the freehold transfer being relaxed from the current restriction in the lease for that flat, [i.e.] for use as a caretaker's flat until 25 March 2043, to permit an open user as [a] single family dwelling from the day the freehold transfer completes. I refer to my Valuation JMC 4. In the event that the user clause is relaxed as suggested by the Nominee Purchasers, then they will have the freedom to dispose of a near freehold interest in the basement flat on the open market for £778,000 assuming prices in November 2010 (see row 20). In the event that the user restriction remains in accordance with the extended lease for that flat, then I calculate that value of the Nominee Purchaser's interest after enfranchisement will be £315,776 (see row 49). That figure comprises the freehold value of £778,000 deferred until March 2043 (present value £155,468 – see row 32) plus the income in respect of the apportioned notional rental value of the [caretaker's] flat recoverable through the service charge from the tenants of the Ground Floor Flat and the Third & Fourth Floor Flat, being £63,262 and £97,046 respectively (see rows 42 and 48). It follows from this that the potential gain to the Nominee Purchaser, upon the enfranchisement, solely attributable to the relaxation of the user clause for the basement flat is £778,000 less £315,776, coming to £462,224, say £462,200.
>
> 8.17 Due to the 80 year rule applying to the marriage value calculation, I understand that it is not possible to incorporate this uplift in value in the Schedule 6 marriage value calculation. The reason for this is that although the tenant of the Basement Flat is participating in the freehold purchase, the lease for that flat has 122 years un-expired and as such the flat is excluded from the Schedule 6 marriage value calculation.
>
> 8.18 Nevertheless, the potential gain in value to the lessee/Nominee Purchaser of circa £462,200 is not something that in the normal course of voluntary negotiations, the vendor of the current freehold interest would [willingly] forgo in return for relaxing the user restriction as the freeholder would wish to participate in the gain in value. In my view, it is more than likely that the

> freeholder would not voluntarily relax the user restriction without securing at least 50% of the gain in return, which would be £231,100, say £231,000, in this case.
>
> 8.19 I understand that it will be argued for [the respondent] that if the LVT hold that the user restriction for the caretaker's flat should be relaxed from the outset of the completion of the freehold transfer then the sum of £231,000 should be paid to [the respondent] in addition to its share of the underlying proceeds assuming the restriction remains, which is £714,050 in accordance with my Valuation JMC 2, [i.e.] coming to £945,050 overall.
>
> 8.20 If it is held that the intermediate leaseholder can recover a notional rental value in respect of the [caretaker's] flat from all the private tenants, then the value of the Nominee Purchaser's interest, assuming the user restriction remains post enfranchisement and applies until 2043, will be increased accordingly, thus reducing the potential gain should the user restriction be relaxed on the transfer. The corresponding gain in value to the Nominee Purchaser would be £323,600 as shown in my alternative Valuation JMC 5, of which the freeholder would require 50%, [i.e.] £162,000. Added to the freeholder's Schedule 6 proceeds of £705,700 on this basis shown by my Alternative Schedule 6 Valuation JMC 3, the overall amount payable to [the respondent] would be £867,700."

15. In paragraph 8 of the part of its decision headed "Evidence" the LVT summarized the submissions it had heard on the consequences of the restriction on the use of the basement flat being removed:

> "The parties agreed that the absence of a restriction requiring the basement flat to be used as a caretaker's flat will make a difference to the future value of that flat. In his closing submissions Mr Dutton submitted that there was no statutory basis on which an "additional premium" might be payable and that Mr Munro [who was counsel for the respondent] had made no submissions on this point because there was no basis for the payment of such additional compensation. Mr Dutton considered that it formed part of the marriage value but that by statute no marriage value was payable in respect of the basement flat because it was held on a lease for a term exceeding 80 years."

16. In valuing the freeholder's interest the LVT concluded that, given the absence of a restriction in the transfer limiting the use of the basement flat to use as a caretaker's flat, the respondent was entitled to receive an additional sum by way of compensation. It stated (in paragraph 7 under the heading "Valuation"):

> "The Tribunal have determined that the transfer should not restrict the use of the basement flat to use as a caretaker's flat and therefore need to consider the effect on value of the absence of such a restriction.
>
> By paragraph 3(2) of Part II of Schedule 6 the Tribunal may make such assumptions as to matters (other than those referred to in the preceding sub-paragraph 3(1)) where those matters are appropriate for determining the amount which at the valuation date the freeholder's interest in the specified premises might be expected to realise if sold.

> There is no obligation in any of the occupational leases that will require the freeholders to continue the use of the basement flat as a caretaker's flat if the nominee purchasers, as freeholders, and the head lessees agree to vary the Headleases to remove the present obligation from the headlessees to the freeholder. The value of the basement flat is greater without the restriction and the Tribunal consider that the nominee purchasers and headleaseholders (given their respective identities) are likely to vary the Headleases to remove the restriction.
>
> The Tribunal therefore considered it appropriate to assume the likely removal of the restriction from the Headleases when valuing the freeholder's interest[.]
>
> In the absence of any contrary proposal by the Applicants the Tribunal have adopted the approach adopted by Mr Clark in his Appendices 4 and 5 of his Proof of Evidence, that 50% of the additional value should be apportioned to the freeholder. This additional value has nothing to do with marriage value."

The LVT determined the payment representing this part of its valuation in the sum of £161,750 (page 5 of the valuation appended to the decision).

The issues in the appeal

17. As we have said, the only aspect of the LVT's decision challenged in the appeal is its inclusion of the additional sum of £161,750 in its determination of the price to be paid for the freehold of the building, in view of the fact that the transfer was not going to restrict the use of the basement flat to use as a caretaker's flat.

18. The appellants' grounds of appeal raise two main issues:

(1) whether the sum of £161,750 ought properly to have been regarded as marriage value within the provisions of paragraphs 4(2) of Schedule 6 to the 1993 Act, which, under paragraph 4(2A), should have been disregarded in the valuation exercise (paragraphs 3.a.i. and ii. and 3.b. of the appellants' grounds of appeal);

and

(2) whether the LVT was wrong to include this element of value when valuing the freeholder's interest under paragraph 3 of Schedule 6, because

(i) it is a form of hope value excluded by paragraph 3(1) of Schedule 6 (see the House of Lords' decision in the conjoined appeals in *Earl Cadogan v. Pitts and another* and *Earl Cadogan v Sportelli and another* [2008] UKHL 71) (paragraph 3.c.i. of the grounds of appeal), and

(ii) being contrary to the provisions of paragraph 3(1), the valuation assumption made by the LVT was neither within the ambit of "other matters" nor "appropriate", and was therefore an assumption it was not entitled to make under paragraph 3(2) (paragraph 3.c.ii.(a) and (b) of the grounds of appeal).

The law

The statutory provisions

19. The calculation of the price to be paid on enfranchisement is provided for in section 32 and Schedule 6 of the 1993 Act.

20. Paragraph 2 in Part II of Schedule 6 sets the statutory basis for assessing the price to be paid for the freehold of "specified premises". Paragraph 2(1) provides:

> "Subject to the provisions of this paragraph, where the freehold of the whole of the specified premises is owned by the same person the price payable by the nominee purchaser for the freehold of those premises shall be the aggregate of –
>
> (a) the value of the freeholder's interest in the premises as determined in accordance with paragraph 3,
> (b) the freeholder's share of the marriage value as determined in accordance with paragraph 4, and
> (c) any amount of compensation payable to the freeholder under paragraph 5.
>
> …".

21. Under the heading "Value of freeholder's interest" paragraph 3(1) of Schedule 6 provides:

> "Subject to the provisions of this paragraph, the value of the freeholder's interest in the specified premises is the amount which at the relevant date that interest might be expected to realise if sold on the open market by a willing seller (with no person who falls within sub-paragraph (1A) buying or seeking to buy) on the following assumptions –
>
> (a) on the assumption that the vendor is selling for an estate in fee simple –
>
> (i) subject to any leases subject to which the freeholder's interest in the premises is to be acquired by the nominee purchaser, but
>
> (ii) subject also to any intermediate or other leasehold interests in the premises which are to be acquired by the nominee purchaser;
>
> (b) on the assumption that this Chapter and Chapter II confer no right to acquire any interest in the specified premises or to acquire any new lease … ;
>
> (c) on the assumption that any increase in the value of any flat held by a participating tenant which is attributable to an improvement carried out at his own expense by the tenant or by any predecessor in title is to be disregarded; and
>
> (d) on the assumption that (subject to paragraphs (a) and (b)) the vendor is selling with and subject to the rights and burdens with and subject to which

the conveyance to the nominee purchaser of the freeholder's interest is to be made, and in particular with and subject to such permanent or extended rights and burdens as are to be created in order to give effect to Schedule 7."

22. Paragraph 3(1A) provides:

> "A person falls within this sub-paragraph if he is –
>
> (a) the nominee purchaser, or
>
> (b) a tenant of premises contained in the specified premises, or
>
> (ba) an owner of an interest which the nominee purchaser is to acquire in pursuance of section 1(2)(a), or
>
> (c) an owner of an interest which the nominee purchaser is to acquire in pursuance of section 2(1)(b)."

23. Paragraph 3(2) provides:

> "It is hereby declared that the fact that sub-paragraph (1) requires assumptions to be made as to the matters specified in paragraphs (a) to (d) of that sub-paragraph does not preclude the making of assumptions as to other matters where those assumptions are appropriate for determining the amount which at the relevant date the freeholder's interest in the specified premises might be expected to realise if sold as mentioned in that sub-paragraph."

24. Under the heading "Freeholder's share of marriage value" paragraph 4(1) of Schedule 6 provides:

> "The marriage value is the amount referred to in sub-paragraph (2), and the freeholder's share of the marriage value is 50 per cent of that amount."

25. Paragraph 4(2) defines "marriage value" as being

> "… any increase in the aggregate value of the freehold and every intermediate leasehold interest in the specified premises, when regarded as being (in consequence of their being acquired by the nominee purchaser) interests under the control of the participating tenants, as compared with the aggregate value of those interests when held by the persons from whom they are to be so acquired, being an increase in value –
>
> (a) which is attributable to the potential ability of the participating tenants, once those interests have been so acquired, to have new leases granted to them without payment of any premium and without restriction as to length of term, and

(b) which, if those interests were being sold to the nominee purchaser on the open market by willing sellers, the nominee purchaser would have to agree to share with the sellers in order to reach agreement as to price."

26. Paragraph 4(2A) provides:

> "Where at the relevant date the unexpired term of the lease held by any of those participating tenants exceeds eighty years, any increase in the value of the freehold or any intermediate leasehold interest in the specified premises which is attributable to his potential ability to have a new lease granted to him as mentioned in sub-paragraph (2)(a) is to be ignored."

27. Paragraph 4(3) provides:

> "For the purposes of sub-paragraph (2) the value of the freehold or any intermediate leasehold interest in the specified premises when held by the person from whom it is to be acquired by the nominee purchaser and its value when acquired by the nominee purchaser –
>
> (a) shall be determined on the same basis as the value of the interest is determined for the purposes of paragraph 2(1)(a) or (as the case may be) paragraph 6(1)(b)(i); and
>
> (b) shall be so determined at the relevant date."

28. Paragraph 4(4) provides:

> "Accordingly, in so determining the value of an interest when acquired by the nominee purchaser –
>
> (a) the same assumptions shall be made under paragraph 3(1) (or, as the case may be, under paragraph 3(1) as applied by paragraph 7(1)) as are to be made under that provision in determining the value of the interest when held by the person from whom it is to be acquired by the nominee purchaser, and
>
> (b) any merger or other circumstances affecting the interest on its acquisition by the nominee purchaser shall be disregarded."

Decisions of the Tribunal

29. In *Maryland Estates Ltd v Abbathure Flat Management Co Ltd* [1999] 1 EGLR 100 the Tribunal (Mr Anthony Dinkin Q.C. and Mr Peter Clarke F.R.I.C.S.) had to consider the assessment of marriage value as defined by paragraph 4 of Schedule 6. The Tribunal held that all the incidents associated with the participating tenants' control of the freehold interest should be taken into account provided that they arose from the potential ability to obtain new leases without restriction as to term or any premium being payable. In this context the Tribunal acknowledged (at p.102G-H) seven factors that could be taken into account for the purpose of determining marriage value in the valuation of the

post-enfranchisement freehold interest. These were (1) the ability of the tenants to extend their leases at no premium, (2) their ability to vary the terms of the leases, (3) their ability effectively to extinguish the ground rent, (4) their ability to manage the property themselves and control management charges, (5) their ability to carry out repairs of their own choosing and control costs, (6) their ability to eliminate possible disputes with the landlord, and (7) their ability to grant themselves new rights over the property. The Tribunal recorded a concession made by counsel for the nominee purchaser in that case (at p.102B-C):

> "As to the ability to vary the terms of the leases, [counsel] accepted that this factor could be taken into account because it is implicit that tenants have the right to correct any defects in title on the grant of the new leases as was recognised in *Sinclair Gardens Investments (Kensington) Ltd v Franks* [(1998) 76 P. & C.R. 230]. …".

The correct approach in the Tribunal's view was to consider whether any of the seven factors flowed from the participating tenants' "ability to have new leases unrestricted as to length of term" (p.102G-H). The essential point was that the participating tenants would be in effective control of the freehold interest through the nominee purchaser and able to "secure the grant to themselves of new leases" (ibid.). What had to be determined was "the increase in value, if any, of the freehold interest when it passes into the tenants' control in that way" (ibid.). The Tribunal then added this (ibid.):

> "As we have pointed out, although certain assumptions are expressly to be made by virtue of paras 4(3) and 4(4), this does not prevent any other appropriate assumptions being made in order to determine the market value of the freehold under para 3(2)."

30. In *Forty-Five Holdings Ltd v Grosvenor (Mayfair) Estate* [2009] UKUT 234 (LC) the issue for the Tribunal (H.H.J. Huskinson) was whether the potential to unlock development value by adding a storey to a block of flats could properly be regarded as marriage value that ought to be reflected in the purchase price to be paid upon enfranchisement. Before enfranchisement there was no such value because the development was precluded by covenants in the long leases prohibiting alterations to the premises. It was submitted on behalf of the nominee purchaser that the Tribunal had been wrong in *Sinclair Gardens Investments (Kensington) Ltd* and in *Maryland Estates Ltd* to hold that the tenants' ability to obtain new leases on different terms from those of their existing leases could be entertained in the calculation of marriage value. H.H.J. Huskinson rejected that submission. He said (in paragraphs 27 and 28 of his decision):

> "27. As regards [counsel's] argument that the new leases contemplated under paragraph 4(2)(a) must be assumed to be on the same terms as the old leases save only as regards duration and premium, I reject that argument. The words are perfectly general. What one is concerned with is any increase in value attributable to the potential ability of the participating tenants "to have new leases granted to them without payment of any premium and without restriction as to length of term". If it had been intended to be a valuation assumption that these new leases should be assumed to be on the same terms as the old, then this would need to have been expressly provided for. It would be a remarkable assumption to make, namely to see what value was attributable to the prospect of

> new leases being granted but being granted upon terms which might well be (indeed would be likely to be) wholly different from the terms on which such new leases would actually be granted. It is unlikely that the new leases would be granted on precisely the same terms as the old in circumstances where the old leases had been granted many years ago and it will be particularly unlikely for this to occur if, for instance, the terms of the old leases were badly drafted and had caused problems over the years. To carry out the valuation exercise under paragraph 4(2) on an assumption that something will happen when it plainly will not happen is something the draftsman could have provided for by express words, but the draftsman should not be assumed to have made such a remarkable provision in the absence of such words. The fact that the draftsman did not intend such a result is confirmed by the fact that the draftsman did make express provision as to the terms of any new lease granted by way of an extension, see section 57, whereas in contrast there is no such limitation on the terms of the notional new leases under paragraph 4(2)(a) of Schedule 6.
>
> 28. I respectfully conclude that the Lands Tribunal was correct in the *Sinclair* case and the *Maryland* case in proceeding upon the basis that one of the factors that can be taken into account under paragraph 4(2) of the 6th Schedule when calculating marriage value is the potential ability to vary the terms of the leases."

The relationship between hope value and marriage value

31. Those decisions of the Tribunal must now be read in the light of the jurisprudence in *Cadogan v Sportelli*. In that case the House of Lords had to consider whether in a claim for collective enfranchisement the price payable for the freehold could include "hope value" representing the possibility of non-participating tenants seeking new leases of their own flats. Lord Hoffmann, in his dissenting opinion, made these observations about the relationship between hope value and marriage value (at paragraph 4):

> " … [The] value of the reversion to the tenant will be greater than to a third party who buys purely for the investment value of the rental stream and the right to possession on the expiry of the term. Furthermore, even if there is some reason (for example, lack of funds) why the particular tenant would not buy at the valuation date, the marriage value to him will be obvious to everyone in the market and it will, as I have said, cast a shadow in the form of hope value to other purchasers who take into account the possibility that sooner or later they may be able to sell to the tenant. It is, of course, impossible for both marriage value and hope value to form part of the same valuation. Marriage value represents the additional value to the tenant which supplies the reason why he would bid a sum higher than the pure investment value. Hope value represents that additional value to a third party who contemplates a future sale to the tenant. Taking into account marriage value assumes that the hypothetical purchaser is the tenant, while taking hope value into account assumes that the hypothetical purchaser is not the tenant. These two hypotheses cannot be entertained simultaneously."

32. In paragraph 13 of his opinion Lord Hoffmann noted that the formula in paragraph 3 of Schedule 6 to the 1993 Act, in which one sees the words "not buying or seeking to

buy", does not say what it is the tenants must be taken not to be buying or seeking to buy; this is "left to implication". But in his view it "must mean that the tenants are excluded from the market for any interest in the premises which is reversionary upon their leases".

33. Lord Hoffmann was unable to accept that, as he put it (at paragraph 25), "the apparent mismatch between the inclusion of marriage value (for participating tenants only) and exclusion of hope value (for all tenants) produces such an obvious injustice as to require heroic methods of construction to avoid it".

34. Lord Hope of Craighead (at paragraph 31 in his opinion) agreed with Lord Walker of Gestingthorpe and Lord Neuberger of Abbotsbury that paragraph 3 of Schedule 6 to the 1993 Act "permits hope value to be taken into account in the valuation in so far as it is attributable to the possibility of non-participating tenants seeking new leases of their own flats". He observed (at paragraph 27) that none of the statutory provisions that were in issue in the case referred to "hope value". But he went on to say (ibid.):

> "…The fact that any special, or enhanced, value that would otherwise be attributed to the fact that the tenant is the actual purchaser is to be disregarded does not seem to me to require the valuer to disregard any of the other elements that would normally be taken into account in a transaction with a third party purchaser."

and (at paragraph 28)` that hope value "… looks in an entirely general way into the future and to a transaction which may or may not occur to which persons who cannot yet be identified may be parties".

35. Lord Walker said (at paragraph 35 in his opinion) that in the 1993 Act Parliament had "adopted a hybrid technique, combining a mandatory formula (in Schedule 6, para 2 and Schedule 13, para 2) followed by provisions which take open market value as a starting-point, but subject it to some far-reaching statutory assumptions (and the puzzling possibility of further unspecified but "appropriate" assumptions under Schedule 6, para 3(2) or Schedule 13, para 3(4))". It was, he said (ibid.) "not surprising that valuers and lawyers have found these provisions difficult".

36. Lord Walker concluded (at paragraph 42):

> "… Marriage value as between the freeholder and the participating tenants, so far as attributable to their control of the freehold and their ability to grant themselves advantageous leases (see Schedule 6, para 4(2) and especially para 4(2)(a)) is dealt with exclusively by para 4, as under Schedule 13. But there is to my mind no good reason why any hope value in respect of future deals that may possibly be negotiated between the freehold owner and non-participating tenants (other than those who have actually served section 42 notices before the valuation date) should be disregarded. The possibility of gain (whether large or small) from such negotiated deals will pass from the original freeholder to the nominee purchaser. It is not dealt with in para 4. …."

37. Lord Neuberger remarked (at paragraph 111 in his opinion) that "the interpretation of Schedule 6 is difficult"; that "[the] poorness of the drafting means that … it is safer to

construe the paragraphs as they now stand, rather than seeking to identify what purpose or errors may be revealed at earlier stages". He added that "the inept drafting of the 1993 Act is unfair on landlords, who are being deprived of their property, and on residential tenants, the very people who are intended to benefit from the legislation".

38. On the issues in the appeal Lord Neuberger said (at paragraph 66):

> "… [Where] the landlord is selling his interest when the tenant is not in the market, a potential purchaser may well think that, in addition to its investment value, the freehold interest carries with it the potential benefit of a possible future sale of the freehold to the present tenant or a successor in title (or indeed the acquisition of the leasehold interest), thereby enabling a release of the marriage value in the future. In such a case, therefore, it can be said that, even though the tenant is not in the market at the time of the sale, the value of the freehold subject to the lease is greater than the aggregate of the capitalised rental stream and the deferred right to possession at the end of the term, and that something should be added for the possibility of a purchaser benefiting from a release of the marriage value. That additional sum is known as "hope value"."

and (at paragraph 96):

> "It … seems clear from the wording of sub-paras (a) and (b) of para 2(1), the opening part of para 4(2), and the unambiguous terms of para 4(2)(a) that marriage value can only be taken into account in so far as it is attributable to the ability of the participating tenants, through the nominee purchaser, to grant new long leases of their respective flats to themselves. The way in which paras 2(1)(a) and (b) are worded also confirm that the only aspect of marriage value in respect of which the landlord can claim is that identified in para 4. But that does not necessarily exclude hope value: as I have explained, it may be similar to, and based on the existence of, marriage value, its inclusion may serve to reduce any marriage value and it may be assessed by reference to marriage value, but it is not marriage value."

39. Lord Neuberger accepted (at paragraph 103) that "the bracketed words in the opening part of para 3(1), when read together with para 3(1A), exclude all flat tenants from the market"; (at paragraph 104) that "[the] words "buying" and "buy" in para 3(1) must cover seeking a 999-year lease at a peppercorn or any similar interest" and that "the bracketed words would extend to buying (or acquiring a 999-year lease at a peppercorn of) all but a small part of the building"; and (at paragraph 105) that those words should be given "a wide meaning" and that "any cutting down of that wide meaning must be on a principled and clear basis, and must be justified by the provisions of [Schedule 6]".

40. In paragraph 112 of his opinion Lord Neuberger said this:

> "Where does the conclusion that hope value as against non-participating tenants in respect of their flats may be taken into account leave hope value in relation to participating tenants and their flats? If, as I have concluded, the bracketed words in the opening part of para 3(1) do not exclude the possibility of taking into account hope value arising from non-participating tenants seeking new leases of their flats, the same conclusion must apply to participating tenants. However, the

effect of para 4 means that, for the reasons I have given when considering hope value under section 9(1A), it is not possible to include hope value in relation to participating tenants' flats under para 3, as it has already been subsumed into the marriage value exercise mandated by para 4. That is clear not only as a matter of commercial sense and justice, but also because para 2 envisages the purchase price consisting of the aggregate of the sums in sub-paras (a) and (b), and it cannot have been envisaged that the same sum be included under both sub-paragraphs."

Submissions

Submissions for the appellants

41. As Mr Dutton acknowledged, there was no evidence before the LVT that the restriction on the use of the basement flat enhances the value of any other property held by the respondent. The restriction does no more, he submitted, than depress the value of the appellants' leasehold interest in the basement flat. Its only value to the respondent is the ability to extract some payment in return for releasing or modifying the covenant.

42. Mr Dutton recognized that the enfranchisement will enable the appellants to vary the terms of the 2010 New Lease of the basement flat and thus remove the restriction. However, he submitted, the LVT was wrong to increase the enfranchisement price to reflect this prospect. Relying on the Tribunal's decision in *Maryland Estates Ltd*, he argued that the advantage to a participating tenant in his being able to remove onerous user provisions in his lease forms part of the marriage value generated by the collective enfranchisement. However, under paragraph 4(2A) of Schedule 6 to the 1993 Act, because the unexpired term of the 2010 New Lease exceeded 80 years, any element of additional value reflecting the benefits described in *Maryland Estates Ltd* had to be ignored when the amount the participating tenants are to pay on enfranchisement is determined.

43. Mr Dutton said the language of paragraph 4 of Schedule 6 has been criticized (see, for example, paragraph 27-09 of Hague on Leasehold Enfranchisement (fifth edition)). But, he said, several things are clear in the provisions of paragraph 4:

(1) Marriage value includes the value to the landlord of being able to negotiate new leases with the participating tenants. It will reflect the value of the ability to require a premium for the grant of that new lease.

(2) The new leases contemplated by paragraph 4(2)(a) need not be assumed to be on the same terms as the leases which the participating tenants currently hold (see *Forty-Five Holdings Ltd*, at paragraph 27). Therefore, if a participating tenant's lease currently contains an onerous provision, marriage value will reflect the premium the landlord would be able to extract in return for the grant of a substitute lease omitting that provision. As is acknowledged in paragraph 5 of the appellants' reply to the respondent's statement of case, leasehold covenants can be discharged or modified in various ways, and not just by re-granting the lease on different terms.

(3) But marriage value does not merely reflect the landlord's ability to command a premium for the grant of a new lease. Paragraph 4(2)(a) refers to the "potential ability" to grant such leases. The concept of marriage value is therefore wide enough to encompass the aggregate value of all the benefits the participating tenants will enjoy when the freehold comes under their control (as summarized in "Emmet and Farrand on Title", at paragraph 28.320). Marriage value under paragraph 4 includes the value to the landlord of being able to extract payment for releasing a participating tenant from an onerous leasehold covenant – and it does not matter whether this is achieved by a surrender and re-grant or by a variation of an existing lease.

44. In support of his argument that the only value in the restriction on the use of the basement flat lies in the prospect of money being paid by one or more of the participating tenants for it to be removed, Mr Dutton made three points:

(1) The only person who has an incentive to pay for the release or modification of the user restrictions affecting the basement flat is the leasehold owner of that flat – the person who currently holds the 2010 New Lease. The 2010 New Lease is held by the first and second appellants (Mr Money and Mr Carey-Morgan), both of whom are participating tenants.

(2) The parties' statements of case reveal a disagreement between them as to whether the restriction imposed by the 1984 Headlease survived the grant of the 2010 New Lease. But this dispute does not matter. The respondent has contended (in paragraph 5 of its statement of case) that the surrender of the 1984 Headlease as it related to the basement flat did not release the lessee from the obligation in clause 2(10) not to use the basement flat otherwise than as a caretaker's flat. If this were so, the restrictions affecting the basement flat would be binding on the first and second appellants not only as owners of the 2010 New Lease but also as owners of the 1984 Headlease. Since the first and second appellants are qualifying tenants by right of both leases, the respondent's point goes nowhere.

(3) In any case the respondent's point is not right. The grant of the 2010 New Lease achieved a partial surrender of the 1984 Headlease (see Woodfall, paragraphs 17.023 and 17.032). Since the 1984 Headlease preceded the coming into force of the Landlord and Tenant (Covenants) Act 1995, the effect of its partial surrender is to be considered at common law. At common law the effect of an assignment of part is that the tenant ceases to be in privity of estate with its landlord as to the part assigned (see *Smith v Jafton Properties* [2011] EWCA Civ 1251, at paragraph 39). The position is the same in the case of a surrender of part. Thus the first and second appellants are now bound by user restrictions affecting the basement flat, but only those imposed by the 2010 New Lease, by which they are qualifying tenants. The enfranchisement will not itself discharge the covenants and remove the restrictions. But on enfranchisement the benefit of the covenant will become vested in the appellants as nominee purchaser. They will thus have the prospect of the covenant being discharged or modified and the respondent will lose its ability to consent or withhold its consent to this, or to receive a payment of compensation for any such modification or discharge.

For those reasons, Mr Dutton submitted, there can be no doubt that what the LVT was valuing here fell within paragraph 4(2) of Schedule 6. Were it not for the fact that paragraph 4(2A) applies, the value would have formed part of the marriage value determined under paragraph 4.

45. As for the provisions of paragraph 3(1) of Schedule 6, Mr Dutton submitted that the words in parenthesis – "with no person who falls within sub-paragraph (1A) buying or seeking to buy" – are critical, because they expressly require the freehold to be valued on the basis that the participating tenants are "not in the market". The effect of this express requirement is not merely to exclude from the freehold value any marriage value but also any value attributable to the hope of realizing such value at some point in the future (see *Cadogan v Sportelli*). Mr Dutton developed this part of his argument in four submissions:

(1) Because it is attributable to the matters set out in paragraph 4(2) of Schedule 6, such value was not capable of forming part of the value of the freeholder's interest payable under paragraph 2(1)(a) of Schedule 6.

(2) The LVT was wrong to regard the benefit as affecting the present value of the freeholder's interest under paragraph 3 of Schedule 6. The value identified by the LVT was truly hope value – i.e. a sum reflecting the additional price someone would pay for the freehold estate in the hope of being able to negotiate a variation of the lease under which an existing tenant occupies his flat. Since the lease in question is held by a participating tenant, rather than by a non-participant, the effect of paragraph 3(1) of Schedule 6 is to preclude such hope value (see *Cadogan v Sportelli*).

(3) Being contrary to paragraph 3(1) of Schedule 6, the valuation assumption made by the LVT was not one it was entitled to make under paragraph 3(2). Paragraph 3(2) only permits assumptions as to "other matters" if they are "appropriate". It cannot be appropriate to adopt an assumption in conflict with the provisions in paragraph 3(1). Paragraph 3(1) refers to a sale "on the open market by a willing seller (with no person who falls within sub-paragraph (1A) buying or seeking to buy)". The only additional assumptions warranted by paragraph 3(2) are assumptions that supplement those in paragraph 3(1)(a) to (d) and leave intact the mandatory assumption about who is in the market and who is not.

(4) The LVT's assumption seems to have been simply that somebody was likely to pay for the prospect of the restriction on use being removed from the headleases. But if that is right the LVT made an error of valuation principle when it increased the purchase price by the sum of £161,750. This sum represents the price that, in the view of the LVT, the owners of the headleases would pay to have the restriction removed, and not the price the hypothetical purchaser of the freehold interest would pay for the likelihood of receiving such a price at some point in the future. No sensible purchaser of the freehold would pay £161,750 now if all he was getting was the chance of receiving £161,750 in the future. He would want a return on his money, and he would want a discount to reflect risk. If the LVT assumed that payment for the removal of the restriction would be secured straight away, it was wrong to do so. Such an assumption clashes with the reasoning of the Court of Appeal in *Van Dal Footwear v. Ryman* [2009] EWCA Civ 1478. In that case, in

the context of the provisions of section 18(1) of the Landlord and Tenant Act 1927, it was held that what the court had to do was "to value the bundle of rights that the landlord actually had on the valuation date" (see the judgment of Lewison J., as he then was, at paragraphs 10 and 11).

Submissions for the respondent

46. Ms Gibbons submitted that the premium paid for the 2010 New Lease was necessarily less than it would have been had it not contained the restrictions on user and alienation at clauses 4.8.1.1 and 4.16.1. When they acquire the freehold, however, the appellants stand to make a substantial gain from the ability they will have to release the covenants. This gain was not paid for when the 2010 New Lease was granted. And if this appeal succeeds it will never be paid for. The appellants will have received a windfall. In the section 48 determination the LVT clearly took the view that this was a matter that ought to be dealt with when the enfranchisement claim came to be considered. It was right. In this process the LVT has tackled the issue, and has come to the correct conclusion.

47. Responding to Mr Dutton's argument on marriage value, Ms Gibbons submitted:

(1) Marriage value under paragraph 4(2) of Schedule 6 is only a value arising from the leaseholder's ability to increase the length of the term of his leasehold interest by having a new lease granted to him. This submission is strengthened by the provisions of paragraph 4(2A). Marriage value attributable to the ability to increase the length of the term reduces as the length of the unexpired term increases: hence the insertion of the cut-off point at which no marriage value is payable. Such a provision would not be necessary if marriage value included other benefits from the coalescence of interests – benefits that do not depend on the length of the unexpired term.

(2) The appellants' reliance on the Tribunal's decision in *Maryland Estates Ltd* is misplaced. That case was decided before paragraph 4(2A) came into force. The decision is not binding. And if its rationale is that marriage value includes the value released by the ability of participating tenants' to vary the terms of their leases, the decision is unsound.

(3) The additional sum of £161,750 determined as payable by the LVT in this case does not represent an increase in value "attributable to" the potential ability of the participating tenants, once the superior interests have been acquired, "to have new leases granted to them without payment of any premium and without restriction as to length of term". In truth, it represents a monetary benefit that would accrue in any event, for the owner of the freehold, when restrictions are removed from the existing leases. It is not a species of value belonging within paragraph 4(2), and it is not, therefore, excluded by the provisions of paragraph 4(2A).

48. As to the valuation of the freeholder's interest Ms Gibbons submitted:

(1) The additional sum of £161,750 determined as payable by the LVT has nothing to do with the provisions for marriage value in paragraph 4(2).

(2) As Lord Neuberger had explained in *Cadogan v Sportelli* (at paragraph 112), it was "not possible to include hope value in relation to participating tenants' flats under [paragraph] 3, as it has already been subsumed into the marriage value exercise mandated by [paragraph] 4", for two main reasons: (i) because it was clear "as a matter of commercial sense and justice", and (ii) because "paragraph 2 envisages the purchase price consisting of the aggregate of the sums in sub-paragraphs (a) and (b), and it cannot have been envisaged that the same sum be included under both sub-paragraphs". In this case the sum in dispute cannot be regarded as marriage value within paragraph 4. No question of double counting arises, and the recovery of this value is not contrary to commercial sense, justice or the provisions of paragraph 2 of Schedule 6.

(3) Crucially, there is nothing in the wording of paragraph 3 of Schedule 6 to preclude an assumption, when the freeholder's interest is being valued, that the tenant of the basement flat would be prepared to pay for the removal of the user and alienation restrictions, and that the hypothetical purchaser would be alive to this prospect. Paragraph 3(1) provides that it is to be assumed that no person falling within 3(1A) is "buying or seeking to buy". But when the hypothetical sale of the freehold is being considered there is no statutory assumption that such a person would not seek to free himself from onerous covenants in his lease. The market would not ignore this prospect. The LVT saw that. Paragraph 3(2) allowed it to make "appropriate" assumptions in addition to the specific assumptions set out in paragraph 3(1A)(a) to (d). It was entitled to make the assumption it did. That assumption was not contrary to paragraph 3(1). It was an obvious one to make, and plainly "appropriate for determining the amount which at the valuation date the freeholder's interest in the specified premises might be expected to realise if sold as mentioned in [sub-paragraph (1)]". There was nothing to prevent the LVT from taking account of the consequent enhancement in the value of the freehold reversion, under paragraph 3. To have left that enhancement in value out of the reckoning would have been wrong. Had the LVT done that, its determination of the price payable on enfranchisement would have been flawed.

(4) The LVT was not right, however, to approach this part of the valuation exercise by making an end allowance. The respondent's alternative valuation, produced since the appeal was lodged, takes the right approach. The figures ought not to be controversial. They were all either agreed between the parties or determined by the LVT.

49. Ms Gibbons added some submissions based on the requirement in section 3(1) of the Human Rights Act 1998 that "so far as it is possible to do so, primary legislation and subordinate legislation must be read and given effect in a way which is compatible with the Convention rights". She submitted:

(1) In *James v. United Kingdom* (1986) 8 E.H.R.R 123 it was held that "…the taking of property without payment of an amount reasonably related to its value would normally constitute a disproportionate interference which could not be considered justifiable under Article 1 [of the First Protocol]" (paragraph 54 of the judgment of the European Court of Human Rights). Article 1 does not guarantee a right to full compensation in all circumstances. Legitimate objectives of "public interest" may warrant less than reimbursement of the full market value (ibid.).

(2) In this case the value of the freeholder's interest, excluding hope and marriage value, was found by the LVT to be £611,008. The value to the freeholder of relaxing the restriction as to user was found to be £161,750. That is 21% of the total value of the freehold interest. Article 1 to the First Protocol does not guarantee a right to full compensation. But to permit covenants such as this to be relaxed for no consideration would not be in the "public interest". It would not achieve greater social justice. It would enable property developers and speculators to gain a windfall. A construction of Schedule 6 that prevents a landlord from recovering what he would otherwise receive for lifting a covenant would amount to a deprivation of his property rights without adequate compensation and a breach of Article 1.

(3) Under section 3 of the Human Rights Act, the court's duty is to construe and give effect to the provisions of statute, if it can, in a way that is compatible with Convention rights. The natural and proper construction of paragraph 3 of Schedule 6 permits the assumption made by the LVT when valuing the freeholder's interest. If the Tribunal finds it possible to interpret paragraph 3 in this way, section 3 of the Human Rights Act compels it do so.

Discussion

General approach

50. It is not necessary for us to add to the criticism that has been levelled at the drafting of Schedule 6 of the 1993 Act. Our task in deciding this appeal is to apply the statutory provisions Parliament has chosen to put in place, without resorting to what Lord Hoffmann described in *Cadogan v Sportelli* (at paragraph 25 in his opinion) as "heroic methods of construction". The provisions of Schedule 6 are surely meant to permit a common sense view of the hypothetical transactions in the "no-enfranchisement" world. In principle, the valuer should be striving to apply those provisions to get to a price for the freehold that corresponds to market reality as closely as the statutory assumptions permit. Otherwise, we think, Parliament's purpose in enacting the provisions of Schedule 6 – poor as the drafting may be – is liable not to be met.

51. The parties to this appeal agree that the leasehold covenant restricting the use of the basement flat, while it subsists, holds in prospect for the freehold owner of the building some monetary value. That value is likely to be substantial. The appellants have never sought to deny this. They accept that the respondent has the benefit of the covenants in the 2010 New Lease. They accept that nobody else does. They also accept that, until it is removed, the covenant restricting the use of the basement flat will depress the price that a long leasehold interest in it would be likely to command in the market, well below the level one might otherwise expect. So the respondent, as freehold owner, may reasonably look forward to receiving a premium – either for agreeing to remove that restriction or for its ability to do so. This expectation is intrinsic to the freeholder's interest. The question at the heart of this appeal is whether such value can and should be reflected in the price to be paid for the freehold of the building upon enfranchisement. The LVT plainly thought that it should.

52. We do not think there is any significance – at least for the issues we have to decide – in the dispute between the parties over the status of the covenants in the 1984 Headlease. The appellants say that, by the time the claim for enfranchisement was made, the 1984 Headlease did not constrain the use of the basement flat, and that the only restriction on the use of that flat was in clause 4.8.1 of the 2010 New Lease. The respondent disagrees. It says that the surrender of the 1984 Headlease, in so far as it related to the basement flat, did not relieve the lessee of the obligation in clause 2(10) not to use that flat otherwise than as a caretaker's flat. In our view the appellants are right on this point. But even if they are not, the valuation essentials with which we are concerned are exactly the same. As the respondent accepts, the 2010 New Lease replicated the restrictions in the 1984 Headlease, and those restrictions, unless formally removed in the meantime, will stay in effect until 25 March 2043. As a result of the enfranchisement the benefit of the restriction will pass to the nominee purchaser, and the appellants, as participating tenants, will be able to release it. This much is not in dispute.

53. There are at least two ways in which the value held in prospect by the removal of the covenants in clause 4.8.1 of the 2010 New Lease could be realized by the respondent as freehold owner of the building.

54. This could be achieved either by a variation of the 2010 New Lease to remove the restriction or by the grant of a new lease without that restriction. A value would be crystallized, at the level the parties agreed. Such value could also be secured by a sale of the freehold interest either to the existing leaseholders of the basement flat or to a third party investor. The purchase price could then be expected to reflect the difference, or at least a proportion of the difference, between the value of the basement flat with its use limited to use as a caretaker's flat and its value without that constraint. A sale to the leaseholders would serve to relieve them of the restriction. A sale to a third party investor would enable him to negotiate with the leaseholders for the covenant to be discharged. Either way, the release or potential release of the restriction would attract its real value in the market, whatever that value might be.

55. Does it offend the scheme of the 1993 Act as a whole, or any of its provisions relevant in this case, if the price payable for the freehold of the building embraces that latent value? We think not. To recognize such value would be, we think, entirely consistent with the emphasis given by the House of Lords in *Cadogan v Sportelli* to the concepts of commercial sense and justice – provided always, of course, that the determination of the price to be paid for the freeholder's interest does not exceed the statutory parameters set by the provisions of Schedule 6, that the relevant principles of valuation are properly applied, and that the mischief of double counting (or double recovery) is avoided.

The LVT's decision

56. The LVT expressed its conclusions on this part of its valuation succinctly, in five short paragraphs (which we have quoted in paragraph 16 above). It is clear, however, that the LVT based those conclusions not on the provisions of paragraph 4 of Schedule 6 but solely on the provisions of paragraph 3. In other words, the LVT was purporting to undertake, and only to undertake, a valuation of the freeholder's interest. It did not embark on any consideration of the freeholder's share of marriage value. It made that

clear. In the penultimate paragraph of this part of its decision the LVT referred to the exercise of "valuing the freeholder's interest". And in the final sentence of the last paragraph it said that the additional value it was apportioning to the freeholder's interest had "nothing to do with marriage value". The LVT clearly did not think the provisions of paragraph 4 had any bearing on its assessment of the price to be paid for the freehold.

57. Three points emerge from the LVT's analysis.

58. First, the LVT was clearly conscious of the provisions of paragraph 3(1) as to a hypothetical sale in the open market, in which the nominee purchaser – as well as the other persons specified in sub-paragraph (1A) – was deemed not to be "buying or seeking to buy" any relevant interest in the building.

59. Secondly, the LVT was also aware of the scope it had for making assumptions of its own. It noted that it had the power under paragraph 3(2) to make assumptions beyond those it was compelled to make by paragraph 3(1). Mr Dutton did not submit that the LVT failed to make any of the mandatory assumptions in paragraph 3(1) (a) to (d). His submission, to which we shall come, was that the LVT made a further assumption that was inappropriate and not open to it.

60. Thirdly, that further assumption was, in effect, the one supported by the respondent's valuation witness, Mr Clark, in paragraph 8.18 of his proof of evidence (which we have quoted at paragraph 14 above). In the LVT's judgment it was likely that there would be an agreement "to vary the Headleases to remove the present obligation from the headlessees to the freeholder." It accepted Mr Clark's view that the potential gain attributable to the release of the covenant restricting the use of the basement flat was not something the vendor of the freehold interest would willingly forego. The freeholder would want at least a share of the consequent gain in value. Mr Clark's evidence was that the freeholder would not be prepared to relax the user restriction without securing at least half of that gain in return. There being no counter-proposal from the appellants, the LVT adopted Mr Clark's approach.

Issue (1) – marriage value under paragraph 4 of Schedule 6

61. The appellants have never denied – and paragraph 12.c. of their statement of case concedes – that after enfranchisement, as participating tenants, they will be able to vary the terms of the 2010 New Lease by removing the restriction on the use of the basement flat. They insist that their potential ability to do this falls squarely within the provisions relating to marriage value in paragraph 4 of Schedule 6. The consequent increase in the value of the basement flat would be a benefit, they say, in the nature of marriage value properly understood. It would be an increase of the kind envisaged in paragraph 4(2)(a) of Schedule 6, "attributable to the potential ability of the participating tenants … to have new leases granted to them without payment of any premium and without restriction as to length of term". But for the fact that the 2010 New Lease has more than 80 years of its term unexpired, this, the appellants contend, is a benefit that would have come into the valuation exercise within the second strand of value in paragraph 2(1) of Schedule 6, namely "the freeholder's share of the marriage value as determined in accordance with paragraph 4" (sub-paragraph (b)). But the cut-off in paragraph 4(2A) is the limitation

Parliament has decided to impose on the freeholder's entitlement to marriage value in a claim such as this, and that cut-off applies here.

62. The appellants say there is therefore no means by which Schedule 6 allows the valuation of the purchase price to incorporate the gain promised by the removal of the restrictions on the use of the basement flat.

63. We do not accept that proposition.

64. Paragraph 4 of Schedule 6 is precisely framed. And in our view one should be wary of reading more into that paragraph than the draftsman saw fit to include, lest one distorts the valuation exercise encapsulated in paragraph 2.

65. Paragraph 4 defines marriage value specifically as a form of value "attributable to" the potential ability of the participating tenants, upon enfranchisement, "to have new leases granted to them" without their having to pay any premium and without any restriction on the length of the term. It does not refer to the variation of existing leases. Nor does it refer to the prospect of negotiated agreements for the release or adjustment of restrictions in such leases.

66. Mr Dutton's argument effectively conflates the concept of a new lease coming into existence on a surrender and re-grant with the concept of the terms of an existing lease being varied. But the two concepts are not the same. This is not to say that the idea of "new leases" being granted in the situation envisaged by paragraph 4 signifies only a new lease being granted on the same terms as those of the old. It plainly does not. In the context of disputes as to the quantification of marriage value under paragraph 4, this has been accepted by the Tribunal in *Maryland Estates Ltd* and *Forty-five Holdings Ltd.*

67. We do not think that in either of those two cases, on the facts and in the light of the submissions made to it, the Tribunal went wrong. In both cases it was focusing, as the argument required and as the decisions themselves make plain, on the prospect of new leases being granted on terms different from those of the leases already in place. In *Maryland Estates Ltd*, however, the Tribunal took care to stress (at p.102G-H) that the assumptions required in the assessment of marriage value (under paragraphs 4(3) and 4(4)) did not prevent any other appropriate assumptions being made under paragraph 3(2) in the determination of the market value of the freehold. It was thus recognizing, rightly in our view, that the first two of the parts of the valuation exercise referred to in paragraph 2 – the valuation of the freeholder's interest in the premises, determined in accordance with paragraph 3 (sub-paragraph (a)), and the valuation of the freeholder's share of the marriage value, determined in accordance with paragraph 4 (sub-paragraph (b)) – are necessarily and always distinct, and that the marriage value exercise under paragraph 4 does not displace the need to make appropriate assumptions when valuing the freeholder's interest in accordance with paragraph 3.

68. In this case, as we have said, there is more than one scenario in which the restriction on the use of the basement flat could be lifted. As the respondent has pointed out (in paragraph 10 of its statement of case), lessees will typically pay for the right to do things that their leases forbid. A tenant can deal with his landlord for the relaxation or removal of covenants in his lease that prohibit a particular activity or require a particular use. A restriction may be removed once two or more interests have coalesced, as they will when

a claim for enfranchisement succeeds. But the value locked in that restriction is still a potential benefit for the freeholder upon its release, regardless of any such claim. As the LVT understood, this is not an increase in value arising from the potential ability of the participating tenants, upon their acquisition of the freehold, to have new leases granted to them. It is a value inherent in the freeholder's power as landlord to relieve his tenant of a restriction that he might otherwise enforce. It is not contingent upon a claim for enfranchisement succeeding. It does not depend upon freehold and leasehold interests being merged.

69. In any event we see nothing in the provisions relating to marriage value in paragraph 4 of Schedule 6 to exclude a potential benefit of this kind from the valuation of the freeholder's interest under paragraph 3 if it is truly germane to the value of that interest. As a matter of principle, no legitimate portion of value should be left out of account, and none should come in more than once. As Lord Neuberger stressed in paragraph 112 of his opinion in *Cadogan v Sportelli*, a component of value assessed as marriage value under paragraph 4 – in that case the potential ability of the participating tenants to have new leases granted to them once enfranchisement had occurred – cannot also be included in the assessment of value pertaining to the valuation of the freeholder's interest under paragraph 3. The same sum cannot be included under both paragraphs. If it comes into the valuation under paragraph 4 it cannot feature again under paragraph 3 – and vice versa.

70. With those principles in mind, we must now consider whether in this case the element of value in dispute qualifies for inclusion under paragraph 3.

Issue (2) – valuing the freeholder's interest under paragraph 3 of Schedule 6

71. Paragraph 3 of Schedule 6 is concerned with the valuation of the freeholder's interest, within the somewhat elaborate framework it sets. Paragraph 3(1) deems the nominee purchaser to be neither buying nor selling. It stipulates (in sub-paragraphs (a) to (d)) four assumptions that have to be made. These may be supplemented by further assumptions – assumptions as to "other matters" – adopted by the valuer under paragraph 3(2). Any further assumption must be "appropriate" for determining the amount which at the relevant date the freeholder's interest in the specified premises might be expected to realize if sold in the manner prescribed in paragraph 3(1).

72. To bring into the valuation of the freeholder's interest a sum attributable to his control over the use of the basement flat and his ability to generate additional value for himself by releasing the restriction in clause 4.8.1 of the 2010 New Lease is in no sense inimical to the provisions of paragraph 3. This is not to predicate the value of the freeholder's interest upon a transaction other than the hypothetical sale of the freehold itself and the capital payment resulting from that. It assumes that a notional third party purchaser of the freehold reversion, in the open market, will bid on the basis that the leaseholder of the basement flat is likely to be prepared to pay a capital sum to free himself from the restriction binding its use. In our view this is a perfectly sensible assumption, which the LVT was entitled to make in the light of the facts and circumstances as it knew them to be. Mr Dutton's argument does not question the realism of the assumption – and hardly could. The submission is that it was not permissible. In our view, however, it does not lie outside the range of assumptions

available under paragraph 3. It is clearly appropriate to the assessment of relevant value. And it does not offend the requirement in paragraph 3(1) that the valuer must consider a sale of the freehold interest without the nominee purchaser or any other tenant of the premises "buying or seeking to buy" a relevant interest. The fact that the covenant is contained in a lease held by participating tenants does not shut out the assumption that they or their successors in title would act as any other leaseholder would in the "no-enfranchisement" world. In view of the submissions made to us and the evidence that was before the LVT, we think it realistic and right to assume that the hypothetical purchaser would bid for the freehold with a high degree of optimism as to the prospects of his securing, sooner rather than later, a capital sum from the leaseholder of the basement flat in return for the release of the restriction on its use.

73. We do not think Mr Dutton's argument finds any support in the decision of the House of Lords in *Cadogan v Sportelli*. The majority in that case did not hold that, in principle, "hope value" lay beyond the bounds drawn for the valuation of the freeholder's interest in paragraph 3. The relevant discussion, which culminated in the conclusion expressed in paragraph 115 of Lord Neuberger's opinion, related to the acquisition of long leasehold interests in the specified premises, respectively by participating and non-participating tenants. It distinguished between the hope value that may arise when non-participating tenants are assumed to be seeking new leases of their flats in the open market – which was held to be properly an element of value within paragraph 3 – and hope value relating to new leases being sought by participating tenants – which, it was held, is subsumed into the marriage value exercise provided for in paragraph 4. That, however, is not the issue with which we are concerned in this appeal.

74. In our view, the concept of tenants, including participating tenants, not being "in the market" – the expression employed by Mr Dutton in his submissions – does not extend to their seeking, or being likely to seek, a release from the restriction on the use of the basement flat. The desire of the leasehold owners of the basement flat to acquire "additional rights or benefits" of that kind (paragraph 13.e. of the appellant's statement of case) is not tantamount to their "buying or seeking to buy" a relevant interest, freehold or leasehold, for the purposes of paragraph 3. The decision in *Cadogan v Sportelli* does not sustain the contrary view.

75. Finally – and leaving aside for the moment what we need to say about the method of valuation adopted – we reject Mr Dutton's submission that the LVT's approach cannot be reconciled with the decision of the Court of Appeal, in a different statutory context, in *Van Dal Footwear*. In our view there is no force in that suggestion. One needs to concentrate here on the essential purpose of Schedule 6 to the 1993 Act, which is the assessment of a purchase price. This requires the valuer to imagine a hypothetical sale. He has to predict what the parties to that transaction would be likely to do. When selling its interest a freehold owner will generally seek to secure what value it can. In this case it seems reasonable to think – indeed, it is clear – that the value of the freeholder's interest is enhanced by the promise of gain for the purchaser when the user restrictions are lifted. We have explained the assumption that will reflect this reality in the valuation of the freeholder's interest (in paragraph 72 above). The fact that arrangements for the release of the covenants are yet to be made does not render this assumption unreal, or impermissible under paragraph 3. To make such assumptions is part of the valuer's task. The provisions for calculating marriage value under paragraph 4 are also concerned with

likely future events. They look to predicted increases in value through new leases yet to be granted, on terms that the parties would have to agree.

76. For all those reasons we are unable to accept Mr Dutton's submissions on paragraph 3.

Human rights

77. Having concluded as we have on the principal issues in this appeal, we do not need to address Ms Gibbons' submissions on section 3 of the Human Rights Act 1998 and Article 1 to the First Protocol to the Convention. It is enough to say – though possibly an understatement – that we can see some difficulty for such an argument. Observations made by Lord Walker in *Cadogan v Sportelli* (at paragraphs 47 and 48 in his opinion) explain why. Those remarks were obiter, because, as Lord Walker said (at paragraph 47), the majority of their Lordships had upheld the appeal on the point relating to Schedule 6 of the 1993 Act on ordinary principles of statutory construction, without the need for section 3 of the Human Rights Act to be invoked. But Lord Walker went on to say (at paragraph 48) that the submissions made on the basis of section 3, so far as they related to other provisions of the 1993 Act, and section 9 of the Leasehold Reform Act 1967, met an "insuperable obstacle" in the decision of the European Court of Human Rights in *James v United Kingdom*. As Lord Walker emphasized (ibid.), it is "for Parliament as the national legislature to decide on policies to remedy social injustice, with a wide margin of appreciation", and "Parliament's conclusions on social policy will be accepted by the Strasbourg court unless manifestly unreasonable".

78. The conclusion to which we have come avoids the "windfall" to the appellants that the respondent regards as repugnant to the statutory scheme. This conclusion does not, in our view, rest on any strained construction of the relevant provisions of Schedule 6 to the 1993 Act. It also has the merit, we believe, of achieving a realistic and fair outcome, consistent with commercial sense and justice. But if we are wrong about that, we do not think the submissions made by Ms Gibbons on the Human Rights Convention could be seen as any more cogent than those that Lord Walker found unpersuasive in *Cadogan v Sportelli*.

Valuation

79. Both parties agree that if the element of value contentious in this appeal formed part of the value of the freeholder's interest under paragraph 3, as the LVT decided it did, the approach taken by the LVT when calculating that value was flawed.

80. At the hearing before us the respondent sought to rely on its fresh valuation, reflecting its concession that an end allowance was inappropriate. This valuation was appended to its statement of case. But the appellants were not able to agree with the respondent's approach, nor were they prepared to discuss it in the course of this appeal. Given that the appeal is by way of review, rather than rehearing, we do not criticize the appellants for that.

81. In the circumstances we shall not attempt to substitute our own decision for that of the LVT. We think the right thing to do is to remit the matter to the LVT for it to reconsider the valuation of the freehold interest on the evidence and submissions before it, and in the light of the conclusions we have set out.

Conclusion

82. For the reasons we have given, the appeal is allowed solely on the ground that the LVT erred in its calculation of the value of the freehold interest to reflect its decision that the transfer should not restrict the use of the basement flat to use as a caretaker's flat. The appellants' claim will therefore be remitted to the LVT for redetermination of the price to be paid for the freehold of the building. The LVT will no doubt invite the parties to submit revised valuations and expert reports, and not rely simply on the evidence at the previous hearing.

Dated 26 June 2013

Sir Keith Lindblom, President

N.J. Rose F.R.I.C.S.