

Pitfalls of the LTA 1987 – Tenants’ Rights of First Refusal

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[Landlords of mixed use properties should pay close attention to the traps within Part I of the Landlord and Tenant Act 1987 \(the “Act”\).](#)

Are you a landlord of a mixed use property? Might you become a landlord of a mixed use property in the future? If you answered yes to either of those questions, you may wish to note the following important lessons to be learned from the recent case law...

Artist Court Collective Ltd v Khan [2015] PLSCS 313 concerned a mixed use building in East London. The property was transferred by the freeholder, Mr. Khan, in 2011, to a company in which he retained the beneficial interest under a trust, for a sum of £225,000. Mr. Khan failed to notify his tenants of the transfer in breach of the Act. Upon becoming aware of their rights under the Act, the tenants served a purchase notice on the company requiring the property be transferred to them for the same price. In an attempt to placate the tenants, Mr. Khan transferred the property back to himself, again, without informing the tenants, but this time, for nil consideration. The tenants served another purchase notice on discovering the further disposal and asked for the property to be transferred to them for nil consideration. It was held by the court that both transfers qualified as “relevant disposals” under the Act and thereby triggered the tenants’ rights of first refusal. The disposals were not exempt disposals, by virtue of the trust Mr. Khan had created. He was required to transfer the property to the tenants for nil consideration.

The notice procedure and criminal liability

The main lesson from this case is one of strict interpretation. A landlord of a building to which the Act applies must comply with a strict notice procedure when making a relevant disposal, such as the sale of the freehold. Formal notices must be served on the qualifying tenants, offering them the opportunity to take up the disposal on the same terms as have been agreed with the prospective purchaser.

Failure to follow the notice procedure, can result in criminal liability (although, to the author’s knowledge, there have not yet been any reported cases of convictions) and any disposals made in breach of the Act being unwound – when the qualifying tenants are told of, or, discover a disposal made in breach of the Act, they can force a purchaser to transfer the property to them at the same price, and on the same terms, as the original disposal. This discovery can be made many years down the line, as was the case in *Green v Westleigh Properties Limited* [2008] EWHC 1474 (QB). Here, tenants were able to undo a transaction from 1992, paying just £500 for the freehold of a building with two residential flats. The risk for a purchaser is therefore not only losing the asset, but also any increase in the value of the property achieved between the date of the original disposal to the purchaser, and the date of the forced disposal to the qualifying tenants.

How can a purchaser mitigate some of the risk of a seller failing to follow the correct procedure?

The Act does allow a purchaser to serve notices on the qualifying tenants, as well as the seller – a two pronged approach. This can give a purchaser comfort that the notice procedure has been followed correctly with respect to the prospective purchase. However, this won't cover a failure by any previous owners of the freehold to comply with the Act. Where there is any uncertainty, thorough enquiries and contractual protection should be sought from the seller.

Relevant disposals include the grant of commercial leases and common parts

A relevant disposal not only includes sales of the freehold reversion, but also disposals of parts of the building. This covers the grant of commercial leases and leases of internal and external common parts. Even the grant of a lease of airspace above a roof has been caught (*Dartmouth Court Blackheath Ltd v Berisworth Ltd* [2008] EWHC 350 (Ch)). In this case, a landlord was denied an opportunity to develop upwards by tenants, who forced an assignment of the lease to prevent the development being carried out. Again, this indicates that tenants aware of their rights under the Act, can, and will, exercise them, causing problems for landlords, even in the day to day letting and management of the building.

How can landlords protect themselves?

A common structure is to put in place an intermediate lease of more than seven years with a group company above the residential leases. The entering into of this lease will not be deemed to be a relevant disposal under the Act, where the landlord and the group company have been associated for at least two years. Once this lease is in place, the intermediate landlord becomes the qualifying landlord in relation to the residential tenants, for the purposes of the Act. This will allow the freeholder to make disposals without having to offer the disposals to the residential tenants. It will still have to offer the disposals to its group company, as a qualifying tenant, but not a third party organisation.

Structuring of this nature will depend on the individual facts and circumstances of the relevant property and so specialist legal advice should always be sought before proceeding to implementation.

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