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Condominium - is English Commonhold in Difficulties?

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CONDOMINIUM – IS ENGLISH COMMONHOLD IN DIFFICULTIES?

I. PRELIMINARY COMMENTS

Commonhold, the English version of statutory condominium, is a recent feature, having been brought into existence by section 2(1) of the Commonhold and Leasehold Reform Act 2002, supplemented by the Commonhold Regulations 2004 SI 2004 No 1829, as amended by Commonhold Regualations 2009 No 2363). It confers freehold ownership on unit holders combined with a permanent management structure. This latter is supplied by the commonhold association, of which unit holders are members. Commonhold has not so far taken root, while the long leasehold system, used for apartment schemes from the late nineteenth century, remains active. In Scotland, apartment ownership relies on the tenement system, a long-standing institution which has been reformed by two pieces of legislation, the Tenements (Scotland) Act 2004 and the Title Conditions (Scotland) Act 2003 (Development Management Scheme) Order 2009 SI 2009 No 789 (for a detailed examination of the latter see Xu, 2010: p. 236).

In Ireland, developers rely on the long lease system (Woods, 2003: p. 285). Irish developers normally grant substantial long leases to unit holders, for up to 999 years, which compares favourably with the shorter lease lengths, typically of between 99 to 200 years, on offer in England. The freehold in Irish schemes is in due course transferred by the developer to an owners' management company, while in England the freehold can be retained by him. General satisfaction, as well as familiarity of developers and purchasers of units with the Irish long lease system as a means of developing condominiums, explains why the Law Reform Commission has made no recommendations that Ireland should enact a freehold apartment ownership statutory regime (Consultation Paper, 2006: p. 144), such as is found in many other jurisdictions including England, Germany, and South Africa (not to mention Poland: see generally van der Merwe, Habdas, 2006: p. 165). By contrast to the situation in Ireland, the English long lease system had become discredited, if only due to the modest length of leases of units in apartment schemes. This aspect, coupled with the retention by the developer of the freehold (which can only be overcome by sufficient long lessees buying them out although often at considerable expense) failed to meet the psychological need for home ownership. In Ireland, leases of apartment units are sufficiently long to equate to a freehold interest. An Irish developer will disappear from the picture once the development has been completed (as envisaged by the Multi-Unit Developments Act sections 3–5).

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This contribution reviews some perceived deficiencies of commonhold, and refers, in the process of commenting on them and of suggesting possible changes, to comparable issues in other legal systems, principally: the German *Wohnungseigentumsgesetz* 1951, the South African Sectional Titles Act No 95 of 1986, and the two statutes affecting the Scottish tenement system. The German statute has proved durable and in need of only modest adjustments, notably by a *Novelle* of 2007. The South African statute shares some principles with the English system (van der Merwe, Habdas, 2006: p. 165). Both owe something to the legislative regime in New South Wales. Under the German and South African models, legislation combines individual ownership of a unit or section with a quota share or participation quota conferring joint ownership of the commonly owned parts of the scheme, and a third aspect, compulsory membership of a *sui generis* owners' body corporate which manages the scheme. In England we find freehold ownership of units but no co-ownership of the common parts of the scheme building. Instead, a commonhold association, governed by general company law, owns the exterior, structure and common parts of the scheme building, with, as already noted, all unit holders being compulsory members of the association (2002 Act, s 34 and 2004 Regulations Sched 2 para 7).

II. ASSESSMENT OF THE ENGLISH CORPORATE MODEL

THE BASIC CORPORATE MODEL

The slow take-up rate of commonhold (it is thought that there may be at most 15 registered schemes) contrasts with the popularity of the tenement institution in Scotland, where there are understood to be some 800,000 tenement properties and Germany, where there are over 5 million apartments subject to the 1951 Law (Bärmann, 2008: p. 29).

However, a problem has been identified in the commonhold system which may not encourage its development. The commonhold association is (section 34(1) of the Commonhold Act 2002 Commonhold Regulations 2004 as amended Sched 2 para 6) a company limited by guarantee with members' liability not to exceed £1 in the event of the association being wound up. Some factors might justify the choice of this particular corporate model. It renders it easy to transfer one's company share to a new unit purchaser, which takes place automatically when the unit is transferred (see further Davies, 2008: 8–10). The seller ceases, on registration of the new purchaser, to hold company membership and liability to pay future assessments passes on sale of a unit to the purchaser.

The fact that English law uses this nebulous corporate form with regard to the management function of commonhold schemes reflects received wisdom to the extent that the management of the affairs of a condominium must be in the hands of a permanent body which can only be dissolved in wholly exceptional circumstances. In Germany, the management body or *Wohnungseigentümergemeinschaft* is accordingly taken to be part of an indissoluble "three-fold unity" concept, consisting of unit ownership, compulsory membership of the management body, and the holding of a quota share allotted to each unit holder in the common property and the land supporting the building (see Bärmann, 1989: pp. 1058–1059; Niedenführ, et. al., 2010: p. 30). The existence of a body corporate is required to give stability and permanence to the community, irre-

spective of the identity of any unit holder, as the identities of the latter will change from time to time as units are bought and sold.

A SHIELD AGAINST DIRECT ACTION?

In England, the need for an owner-run permanent management body was acknowledged in the first reform programme (Commonhold, Freehold Flats, 1987: para 8.1). The commonhold association's purpose has consistently been seen as being not to trade for profit but to exercise scheme management functions. The fact that it is not a trading company is emphasised in that, while it is a going concern, the commonhold association cannot distribute profits or assets to its members (Commonhold Regulations 2004 Sched 2 para 72). The UK legislator could have opted for a *sui generis* model for the management body, as in Germany, South Africa and Scotland, and as was first recommended (Commonhold, Freehold Flats, 1987: paras 8.12–8.14) but declined to do so. The better view now seems to be that, because the commonhold association is a company with liability limited by guarantee, this aspect offers a total shield to unit holders from a direct personal action by an unpaid third party service supplier or creditor to recover debts owed to them by the scheme, as where the commonhold association lacks the funds to settle them, save in the course of a winding –up of the association (Crabb, 2004: 215; Clarke, 2004: para 22[4]). It further appears that any claim in the latter case would be made the form of additional sums levied by the liquidator in the winding up process, acting for creditors. At the same time, while the association continues to exist as a "going concern" the registered unit holders are liable to a potentially unlimited extent to pay annual assessments, which the scheme directors are required by law to make, as well as for any additional or emergency assessments levied from time to time (2002 Act s 38(1); Model CCS paras 4.2.1 and 4.2.2). The fact that direct actions against unit holders by unpaid third party creditors, while the commonhold association is solvent, are ruled out by the guarantee principle contrasts to the position in Scotland as noted below. This aspect itself renders the commonhold rule questionable.

This aspect is emphasised by the fact that the 2002 Act departs from earlier recommendations (see Commonhold 1990 para 3.14; Commonhold Draft Bill 1996, Lord Chancellor's Department, clause 38(2) and (3) and Sched 10). These in essence envisaged that, in the case of a solvent association, unit holders would have been subject to "restricted liability" (see Crabb, 2004: 216). This would have allowed a claim by any unpaid creditor directly against unit holders' own funds, up to the percentage share of assessments they were required to pay by the commonhold community statement (the commonhold constitution). These proposals built on an earlier one (Commonhold, Freehold Flats, 1987: para 8.10) that if a judgment obtained by a creditor against a commonhold association was not met out of its funds, it would be possible to enforce this claim against unit holders, each of whom would similarly be liable only for the share of the outstanding sum which corresponded to the proportion of charges such unit holders were required to pay as stated in the commonhold community statement. Under the 1990 proposals, while a direct liability notion was retained, as a safeguard, suggested presumably in the interests of fairness to the diligent, a unit holder's direct liability to a creditor could not be increased on account of any failure to pay assessments and levies by other unit holders. In other words, no unit holder would have been required to cover the payments of any persistent defaulter, so encouraging the directors to take

prompt steps to recover arrears from any defaulters. Under these proposals, commonhold associations would have been treated as *sui generis* bodies corporate, much as elsewhere. This may have been because winding-up procedures should entail the end both of the commonhold management and property structure, an event which should be regarded as rare and exceptional given that property ownership is a permanent concept.

It is not easy to see why the UK government changed its mind. One reason may have been that allowing creditors' direct claims while the management body was a going concern would, it was thought, lead to a difference with the position of long lease schemes managed by leaseholders (see Crabb, 2004: 215). On the other hand, commonhold is supposed to represent a clean break with long lease systems – the two systems are formally railed off from each other (see Smith, 2004: 194–195). In any case, if the position with commonhold management bodies is as suggested, it seems hard to see how the position with lessee managed companies can be any different.

Parliament thus, arguably, erred in this aspect of the Commonhold Act of 2002. Importing ordinary company law into apartment ownership masks the fact that this form of ownership is ordinarily perceived as being special in nature (it is referred to as *Sondereigentum* in the German *Wohnungseigentumsgesetz* 1951 § 1 Abs 2). In addition, by analogy with the position in South Africa (see *LAWSA*, 2000, para 317) the primary function of termination rules should be to protect the security of lenders and unit holders, which supports the idea that schemes should be permanent. Only if extreme events, such as the scheme building being destroyed, or becoming obsolete, take place, should it ordinarily be possible to dissolve a scheme (as under Sectional Titles Act No 95 of 1986 s 48(1)). The winding-up of a commonhold association on financial grounds should arguably also have been treated as an exceptional event, which body ought not to have been capable of being wound up while the commonhold scheme to which it is linked continued (Commonhold, Freehold Flats, 1987: para 8.12). In return for the adoption of a principle of permanence of a *sui generis* management body, unit holders can fairly be expected to face the possibility of effective remedies being brought to bear against them if they default with their financial obligations, and one of these should it, is suggested, formally include creditors' direct actions against any of their number for unpaid scheme debts, subject to suitable safeguards.

Unhappily, the commonhold legislation lacks sufficient incentives to unit holders to pay their assessments regularly and on time, such as a priority lien over a unit to induce defaulting unit holders to clear unpaid assessments on pain of the risk of a forced sale of their unit, or a right, vested in the scheme body corporate, following notice, to seek a fine against a unit holder who is in persistent default with their payments (as under section 42(11) of the Singapore Land Titles (Strata) Act Cap 158, 1999 revision). Hence, the risk of an English scheme winding-up taking place due to a commonhold association running out of funds may be greater than in the other systems here noted. The English rules confer, as seen, a financial shield against direct creditor action for unpaid debts, and one might logically expect that in return for this aspect, the legislation would have adopted firm remedies, such as the two just noted, to avert the risk of winding-up. Matters are not improved by the fact that the shield of unit holders from direct liability evidently applies while the commonhold association is only technically a going concern – as where it is short of funds required to meet its annual expenditure in full but is not facing a winding-up. Such a position fails to strike a fair balance between the interests of unit holders as service users and their creditors. It also plac-

es undue reliance on the diligence of commonhold directors despite their duty under general company law to promote the best interests or success of the association (see further Davies, 2008: 506).

At the same time, the English guarantee principle is thought to offer no shield to unit holders from unlimited personal liability to creditors should the association go into a creditors' winding-up process (Wong, 2006: 33). A liquidator's claim can evidently be made on behalf of unpaid creditors who have provided services to the association against the current unit holders for unpaid assessments and sinking fund levies arising while they are association members (Crabb, 2004: 215–216). One example could be where management fees are owed (Wong, 2006: 34), not to mention a large outstanding bill for unpaid insurance premiums or maintenance. While, in the silence of the legislation, there is probably no right of direct action against unit holders by an individual judgment creditor, it also seems that creditors' claims can be pressed by liquidators on their behalf in the form of additional levies up to the percentage allocation of each owner's share of assessments allocated to their unit by the commonhold community statement (Clarke, 2004: para 22[5]). This latter assumption seems justified. As long as the commonhold association continues to exist, its scheme constitution continues to apply to regulate the maximum percentage share of any additional assessments or claims for reserve fund levies (Model CCS Annex 3 paras 1 and 2).

Although the winding-up of a commonhold association is not likely to be a particularly frequent event, the risk of potentially unlimited liability to creditors in the event of an insolvency of the commonhold association might deter some purchasers of commonhold units, especially if they thought that they would be better off under the rules applying to long lessee managed schemes, however questionable such an assumption might be. While a "rescue" provision (CLRA, 2002, s. 51) envisages the dissolution of an insolvent commonhold association and the creation of a successor association, the making of a succession order can be prevented if the court rules that the making of such an order is inappropriate having regard to the circumstances of the insolvent commonhold association (s. 51(4)). In the absence of authority, this test might be satisfied if the association is significantly out of funds, and in no position to raise further income or capital on any sensible time-scale, as where some of the unit holders are bankrupt (Wong, 2006: 33). It is also likely that, after any rescue order is made, the unit holders, as members of the successor association, would be required to settle any outstanding assessments and debts so as to reimburse scheme creditors out of their own pockets, unless any surplus common parts or land could be sold to raise the necessary cash, a process to which, luckily, the formal prohibition on the distribution to members of assets (2004 Regulations para 72) does not seem to apply, as the making of a rescue order is taken to be part of a winding-up process.

Given the contrast between the position of commonhold unit holders where the association is insolvent and where it a going concern, it is instructive to turn to the position in three other jurisdictions, which rely on a *sui generis* body corporate to provide management services to unit owners, but where the rules appear fairly balanced as between unit holders and scheme creditors. This is primarily because these systems do not contemplate a no-liability rule while the management body is still operating. This aspect has the advantage over commonholds that unit holders in these systems are under an incentive to keep the scheme coffers well supplied with money, so as to ward off any danger of creditors' direct actions, not to mention the ultimate risk of destruc-

tion of the management body and the whole ownership structure with it. These legal regimes, particularly the Scottish and South African, define the nature of the potential financial risks facing unit holders, in a manner which the English commonhold legislation fails to do, perhaps due to the fact that it relies on general company law to regulate the position.

COMPARISONS WITH GERMAN, SCOTTISH AND SOUTH AFRICAN LAW

Following a ruling of the *Bundesgesetzhof* (BGH, NJW 2005: 2061; and also *Wohnungseigentumsgesetz* 1951 § 10 Abs.6 inserted by *WEG-Novelle* 2007) the *Wohnungseigentümergemeinschaft* is regarded a *sui generis* institution (Abramenko, 2006: pp. 409–411; Maroldt, 2005: p. 363). It thus has an independent capacity to contract with third parties, and can incur debts with contractors on behalf of the unit holders. So far there is a resemblance with the position in England, although this position has only been arrived at recently. However, German unit holders of a solvent body corporate are subject to direct liability for unpaid debts arising when they hold their unit to satisfy such debts, but only, as from 30th June 2007[2], up the value of the registered quota share attached to their unit. The limit is justified (Derleder, Fauser, 2007: p. 2) because no one unit holder should be at risk of being overburdened and threatened with potential financial ruin.

The German limited liability rule (which reverses an earlier no liability principle: see Briesemeister, 2007: 226) confers an independent liability, so that a creditor can evidently make a direct claim against one or more current unit holder's personal funds up to the limit imposed by their registered quota share without, it seems, having first to claim against those of the community (Niedenführ et. al., p. 119). If a similar rule were adopted in England, care would have to be taken to avoid the whole of a debt, say an unpaid repairs bill to the roof of the scheme building, being claimed against just one current unit holder, even if they had paid their assessments to date, as there is no more reason why diligent English unit holders should prop up non-compliant ones than is the case with their German counterparts.

German unit holders are also under a duty (see *WEG* 1951 § 21) to ensure the orderly management of the scheme and thus to keep the management body in sufficient funds to comply with its obligations (Niedenführ et.al., pp. 262 and 267). As a result the body corporate can demand advance payment of annual charges, (Wenzel, 2006: p. 2) which would aim to reduce the likelihood of direct claims against individual unit holders, since the whole sum due can then be claimed by the third party from scheme funds, not a limited sum from each unit holder up their quota share. The current rule in England, arising only if the commonhold is insolvent, fails to address the risk that unit holders are under no formal incentive to supply sufficient funds to the association, thanks to the seductive effect of the guarantee limit. If they fail to supply sufficient funds, as where directors fail over some time to set assessments at a sufficiently high level to cover their actual and anticipated expenditure on services, the current unit holders or their successors in title at some stage face potentially crippling levies from a liquidator, acting solely for the creditors, to cover the payment of sums for maintenance and the like owed by a now penniless association. There is nothing to stop such a levy

[2] Thanks to WEG 1951 art. 10 Abs 8 as amended by the WE *Novelle* of 2007.

being made on only some rather than all of the current unit holders even though none of them can be forced to pay more than their allotted percentage of any extra assessments. Perhaps due to a legislative omission, English law recognises no duty on unit holders to supply their scheme with sufficient funds to avoid the management body being out of funds while a going concern, which would seem to be a logical counterpart of the guarantee shield.

English law also fails to address the unresolved issue of whether any unit holder should have to cover the liability of any other unit holder even where the claim on the first-mentioned person falls within their percentage share of assessments. Take a small scheme with four units. One unit holder has failed to pay assessments for some time. They are now bankrupt. To stave off a possible winding-up, the three diligent unit holders could face, in a special assessment by the current directors, having to cover at least some of the share of the bankrupt, as where the total claimed falls mathematically within the percentage share of assessments of these unit holders, and in any case to avert winding up they may opt voluntarily to pay up the excess sums. Incidentally this aspect emphasises the unfortunate absence of any right by the commonhold association to place a charge and ultimately to sell the unit of a defaulting unit holder so as to recoup some of its losses.

The Scottish Development Management Scheme Regulations 2009 No 729 supply an attractive reform model. They make use of a *sui generis* body corporate, called the owners' association (Schedule 1 Part 2, para 2.2) adopting a method originally proposed for English law (Commonhold: Freehold Flats, 1987: para 8.12). If Scottish contractors are unpaid, they have a statutory right of direct recourse against unit owners, but, as in Germany, only up to the proportion of the service charge attributable to each unit holder. Direct recourse is also possible only if due diligence has been used by the creditor to recover the payment from the owners' association, following a court order, although this requirement does not apply if the unpaid creditor proves that the association does not appear to have any assets which could be reasonably recovered against (2009 Regulations, Part 4: paras 12(2) and (3) and 13). A claim can be made direct by a creditor where the owner's association is solvent, in contrast to the position in England. The Scottish rule is narrower than the German, where unpaid creditors can bring a direct claim against any unit holder's personal funds, up to the limit of their quota share, without, it seems, their first having attempted to secure satisfaction from the body corporate or having to provide proof that payment out of its funds is not reasonably likely to be forthcoming. For these reasons the Scottish approach seems preferable as far as English law is concerned, especially for any unit holders with larger quota share or percentage allocations to cover, and because it applies to both solvent and insolvent associations alike, and further in that the Scottish rules set out the circumstances in which a direct claim can be made, with proper safeguards for individual unit holders.

Thanks to the Sectional Titles Act No 95 of 1986, section 47(1), the position in South Africa is similar to that in Scotland as reformed in 2009, reinforcing doubts about the position in England. An unsatisfied judgment creditor of the body corporate has a right of direct recourse to sectional title owners' funds on a *pro rata* basis in proportion to their respective quota shares – and to that end such a creditor will apply to have the owner joined to the action against the body corporate. Direct recourse is thus only possible as part of recovery proceedings for an ascertained debt. However, an important protection for diligent owners lies in the fact that any sectional title holder who has paid their contributions in respect of the same debt prior to the judgment cannot be joined

as a joint judgment debtor in a recovery action by a judgment creditor (thanks to the 1986 Act, section 47(1) proviso). South African law is no more prepared than the other non-English systems noted to penalise diligent owners by having to make up the financial deficiencies of any other owners – any other rule could be seen as manifestly unfair.

ASSESSMENT

The financial risks to commonhold unit holders for management body debts could justify the fact that assessments are required to be set by directors without any formal recourse to an owners' meeting – the directors need only carry out routine consultations with unit holders (Model CCS, paras 4.2.1–4.2.4). The risks to any unit holder's personal funds entailed in the potentially unlimited exposure in the event of insolvency to any unpaid suppliers claims (not just judgment creditors as in South Africa) may induce some directors of commonhold associations to set assessments at a high level. This could lead to complaints of overcharging by some unit holders, such as had been detected under the long lease system (Hawkins, 1986: p. 13). For this reason it is disappointing that a restricted liability principle for solvent associations was not adopted in England.

The UK Parliament could have enacted that individual unit holders in an association which is a going concern could be exposed to an unpaid creditor's direct action for unpaid scheme debts, but only if the claimant, holding a court order, had failed, following due diligence, to recover these from the commonhold association in proceedings, unless they proved that the result of such would be fruitless. An explicit limit on the sum to be recovered against any one unit holder to the proportion of the unpaid sum corresponding to the percentage of the assessments each unit holder could be required to pay could formally set out in legislation, for the sake of clarity. This could be coupled with a further provision that no unit holder could be required, whether the association is solvent or not, to pay any sums to or on account of a third party judgment creditor to make up any financial deficiencies due to the defaults of any other current unit holder, provided the unit holder concerned had duly complied with their financial obligations to date. The fact that there might have to be several defendants to a creditors' direct action should render it an instrument of last, not first resort. This approach seems to strike a fairer balance between the level of risk cast on individual unit holders and the claims of suppliers of services than the current rules achieve. The fact that third party creditors are likely to have more resources than the unit holders (as recognised by the Scottish Law Commission, 1998: para 6.49) also points in favour of a restricted liability rule.

III. FURTHER PROBLEMS WITH COMMONHOLD

PRELIMINARY

Sections 1 and 12 of the Commonhold Act 2002 set out the nature of the ownership conferred on unit holders: they are freehold owners of their units. By section 25 of the 2002 Act and regulation 9 of the 2004 Regulations the commonhold association owns all exterior and structural parts of the building and the common areas of the development.

Developers must prepare a standard-form scheme constitution, called the commonhold community statement. The commonhold association must be constituted as from

registration. The developer applies for registration of the land as commonhold land (as required by the Commonhold Act 2002 section 2). Having checked his application and the attached plans for accuracy, the Land Registry will register the developer with an absolute freehold title (under section 9(1)(a) of the Land Registration Act 2002). The developer will commence sales of units, and on completion of each transfer, the unit purchaser is registered with an absolute freehold title (thanks to section 12 of the Commonhold Act 2002). As from the sale of the first unit, the commonhold association comes into being, thanks to section 7(3)(a) of the Commonhold Act 2002, the object being to ensure that, from the outset, there is a scheme management body for the commonhold concerned. All of this makes good sense but two potential problems arise.

SALES OFF PLAN

So as to encourage developers to make use of commonhold, there is nothing to prevent them from selling units in a building which exists on paper, or "off plan". Sales of this kind carry risks. If a developer, having reserved the right to do so under section 58 of the 2002 Act, fails to complete service provision as described in the plans, as by not providing originally specified garden areas or tennis courts, unit purchasers could end up obtaining units paid for at a potentially high price yet with less extensive facilities when compared to the level envisaged in the plans. In addition, if the developer becomes insolvent, purchasers risk losing the funds they have sunk in their unit purchase, or at least their deposits, if they have not at this stage paid the full purchase price. Thus, the balance of advantage is slanted in favour of developers. The poor take-up rate of commonholds to date suggests that the UK government policy of making life easy for developers has failed to achieve its object.

An idea which could help to protect off-plan commonhold unit purchasers against financial loss is that Irish developers of condominium schemes (which are called "multi-unit developments") must produce to local authorities security bonds to secure against their insolvency, although there is evidence that the sums secured can fall short of those required for complete security (Irish Law Reform Commission, 2006: para 2.32). A similar consumer safeguard might usefully be incorporated into English commonholds. In addition, the commonhold scheme might become more attractive for purchasers of units in developments with more than one building if the law required each planned building to be completed with relevant services in place before any units in it could be sold (as was suggested by Commonhold Freehold Flats, 1987: paras 3.20–3.22). It is regrettable that this useful consumer protection device was not adopted by the UK legislator, seeing there is a rule with a similar aim in South Africa (Alienation of Land Act No 77 of 1981 s 26; see further LAWSA, 2000: para 216). This in essence prevents the receipt by a developer of money for a unit sold off plan before the unit is registrable. The South African rule, by stopping a developer from selling a unit on paper before he has registered it, avoids the risk of loss of a deposit, which an English off-plan unit purchaser has to accept.

MANAGEMENT OF SCHEMES

On the transfer of a unit, the purchaser automatically becomes a member of the commonhold association as from registration as the unit holder (thanks to sections 1(1)

and 34 of the 2002 Act). Similar compulsion in relation to unit holder membership of a scheme body corporate exists in Germany and South Africa (§ 10 of the *WEG* 1951 and section 36(1) of the Sectional Titles Act 1986). This suggests a need to make sure that a permanent management structure is superimposed on the ownership of units. To this extent, at least, the English corporate model has something to commend it. It is also familiar, since it is made use of with regard to lessee-run long lease management bodies. One or two other matters relating to scheme management deserve mention here in re-assessing English law.

QUOTA SHARES

English commonhold adopts a different approach to the mechanics of scheme ownership allocation to those governing the other systems under discussion. German law confers on each unit a quota share which forms an inseparable part of the property or *Sondereigentum* obtained on purchase of a unit (*WEG* §§ 1 Abs 2 and 6). The quota share gives a unit holder co-ownership with other unit holders of the common property (Weitnauer, 2005: p. 39) as well as fixing them with liability for the payment of their proportion of the scheme charges. Special ownership of units and quota-share co-ownership of the common parts also ties all units formally to the land supporting the building, overcoming the effects of the *superficies* rule. Ownership of the common parts of a commonhold scheme is withheld from English unit holders (Regulations 2004, reg 9). This method is unusual, as shown by the fact that it is as much alien to the French as it is to the German system[3]. The French *loi* of 10th July 1965, by articles 1 and 4, confers a quota share on unit or *lot* holders in the scheme common parts so that the unit holders are co-owners owners (*indivision forcée*) of these.

The English method of dealing with the common areas was borrowed from long leaseholds. This aspect reflects tradition, and there appears to be no need to replace it, especially since, thanks to section 205(1)(ix) of the Law of Property Act 1925, any buildings on land form part of the land itself.

However, whether one uses quota share allocation or not, both South Africa and England have provided special rules designed to protect the stability of apartment ownership schemes. In South Africa, at common law, a co-owner of a share in the common property can deal with their share separately from the other co-owners, and can demand partition, breaking up the co-ownership (Silberberg *et. al*., 2006: p. 135). Under the Sectional Titles Act 1986 there are rules requiring that a sectional titles scheme can only be dissolved following the procedure set out in sections 48 and 49. These, in essence, require a unanimous resolution of the body corporate of the sectional titles development or an order of court (see Van der Merwe 16-5 to 16-9). No member of the commonhold association can, similarly, procure the dissolution of the commonhold association and the resultant termination of the commonhold. A voluntary winding-up procedure must be used under CLRA 2002 sections 41–45) which requires at least 80 per cent of association members to vote in favour of an appropriate resolution.

[3] Not to mention South Africa (Sectional Titles Act No 95 of 1986 ss 1 and 32).

EXTENT OF OWNERSHIP

Although commonhold unit holders have no property in the common parts, they control the use and management of these parts through their votes at commonhold association meetings. If there are units of unequal size in a scheme, the developer may, thanks to Model CCS Annex 3, vary the default one vote per unit allocation attached to units so that larger units have more votes than smaller ones, so giving flexibility and also some recognition to the heavier burden of costs falling on larger as opposed to smaller units. There can, however, only be one management association for the whole of a multi-building scheme, with no provision (Baker, Fenn: 2005, p. 17) for sub-associations for each building, even though the needs and character of each building may sometimes differ. This appears to be a further, if relatively minor, *lacuna* in the commonhold system which needs re-consideration.

A useful aspect of commonhold relates to the quality of the ownership of units. They are registered freehold units, and so of indefinite potential duration. A freehold has psychological attractions to unit holders, when compared to long leases, yet developers remain wedded to the long lease system, because they can keep the freehold, which can later be sold at a profit. Long leaseholders are able to buy out the freeholder[4], but must pay him a potentially heavy premium for the freehold interest, whose amount will increase with every year by which the existing leases diminish. It is the freehold aspect of commonhold unit ownership in the English context which had the potential to make this form of property ownership attractive.

IV. OWNERSHIP DELINEATION

COMMON AND OTHER PROPERTY

In relation to commonholds, it was thought important to delineate those areas of the development which fall within the property conferred on the unit holders and those which are within the property of the management company. In this way, the respective liabilities of each to carry out repairs and maintenance could be allotted. Standardisation of documentation has been adopted, so as to combat the variable quality of the drafting of long leases. Standardisation was advocated from the first days of the reform process (Commonhold: Freehold Flats, 1987: para 1.23). The policy should make the transfer of units cheaper than was the case with long leaseholds, where leases of units have to be inspected for special features such as a right in the landlord to enter units and charge unit holders with the cost of repairs carried out on them. Standardisation of scheme documentation is beneficial, if only as a cost-saving measure. A purchaser of a unit in Devon and their counterpart in Cumbria will both be spared detailed and time-consuming inquiries as to differences between the two schemes, save on minor points of detail such as the rate of interest laid down in a "local rule" on assessments in default (Model CCS, Annex 4).

The method adopted to define the respective property in the commonhold association and in unit holders is negative. The legislator refers to what must be excluded from

[4] Under Leasehold Reform, Housing and Urban Development Act 1993 Part I.

the unit, not to that which is to fall within it. The structure and exterior of the building containing the units must thus be excluded from the definition in the commonhold community statement of the units, thanks to regulation 9(1)(a) of the Commonhold Regulations 2004. The expression "structure and exterior" is not defined, so that the English courts might have to make use of the common law. On this basis, the "structure" of the building comprises "those elements of the overall [building] which give it its essential appearance, stability and shape"[5]. Any room for argument about which parts of the property should be structural is reduced by the principle that any element not essential to its construction would not be structural. With regard to the exterior, any part of the building which faces outwards such as the outward face of windows, doors and roof structures would seem to fall within this category, with the inclusion of outward staircases. The uncertainties inherent in the English definitional approach may be contrasted with two approaches in Scotland.

The first approach is minimalist, and applies to schemes within the Tenements (Scotland) Act 2004 (as discussed by Reid, 2007: pp. 147–172). This legislation applies to the extent that any scheme title deeds[6] do not govern the tenement in question. It tidies up anomalies and uncertainties in the existing law. Thus, thanks to section 2(1) of the 2004 Act, the boundary between two adjoining tenements is defined as the median of the structure that separates them. The top floor flat still extends to the roof over the flat, and a bottom floor flat, thanks to section 2(3) and (4) of the Act, includes the *solum* under that flat. Schedule 1 Rule 1 to the 2004 Act also provides a set of management rules for tenement property which, although owned by each tenement owner, is taken for statutory purposes to fall within "scheme property". This definition is made use of in Rules 2 and 3 to set out what parts of the tenement are subject to scheme decisions of the owners with regard to maintenance and repair. As noted (Xu, 2010: pp. 251–254), the 2004 Act separates questions of property ownership and management. In this respect, it operates differently to commonhold, which vests ownership of the parts of the development which the owners' association is liable to maintain in the commonhold association.

By contrast, the recent Development Management Scheme Rules (SI 2009 No 789, notably regulation 20) list the property which is held by the owners' association. "Scheme property" includes all common property of the owners of two or more units, and the ground on which the building is built, not to mention its foundations, external walls and roof. Units include any door, window or skylight. It has proved possible to list the key elements of what is meant by "structure and exterior" and so it is arguable that this method of definition could profitably be made use of in England, so as to reduce the scope of disputes as to the boundary between unit holder's and common property.

PROPERTY WITHIN UNITS

The fact that a commonhold unit holder is conferred a statutory freehold title to their unit on registration is a qualitative improvement on the long lease system. With a view to promoting the process of unit purchases, the physical extent of each commonhold

[5] *Irvine* v *Moran* [1991] 1 EGLR 261, p 262F-H.

[6] Title deeds impose burdens on tenement owners as to maintenance of the tenement building (Robertson, 2010: p. 38).

unit must, under section 11(3)(a) of the 2002 Act, be referred to in a plan. Any property not within the units will be treated as within the common parts and so it will fall within the maintenance, repairing and insurance obligations of the commonhold association. Pipes, cables and other fixed installations serving more than one unit are treated as within the property of the commonhold association (Guidance, 2004: paras 40–46). Provision is made for areas, such as storage areas and garages, which are located outside the main building, to be registered with a separate freehold title. These rules are flexible, and permit such a unit to include the structure and exterior of such units (regulation 9(1)(a) of the 2004 Regulations) whereupon they can be repaired, maintained and insured separately by the unit holders and not the management body.

All in all, although there are some small defects in the English method of demarcating which parts of the property in a commonhold belong to the unit holders and which to the management body, the results of the use of these methods are satisfactory. The method used should be familiar to developers who have experience of the long lease system, where similar demarcation methods are in use. For reasons given earlier, only minor adjustments to these rules appear to be called for, most usefully along the lines of the most recent set of statutory rules in Scotland.

V. LIMITS ON POWERS OF UNIT HOLDERS

In recognition of the fact that condominium owners live in close physical proximity, so that the arrival of an undesirable person into the community may be unwelcome, some condominium legislation places limits on the powers of unit holders to deal as they think fit with their unit, in the common interest. The question arises as to whether any such rules are suitable for export to English law.

SALES OF UNITS

Commonhold was described in clause 1(1) of the Commonhold Draft Bill (1996, Lord Chancellor's Department) as a "new kind of freehold with special statutory attributes". This approach could justify measures limiting the absolute right of unit holders to sell units, such as a legislative rule requiring them to offer a first refusal at the market price to any other member of the scheme, before disposing of the unit elsewhere. However, any limit on the right of disposal would come up against the fact that, as said in *Re Brown*[7], the "instinct of every equity lawyer" is hostile to any restraints on alienation of freehold land. Section 15(2) of the 2002 Act reflects this tradition by negating any term in a commonhold community statement preventing or restricting the transfer of a unit, so ruling out the inclusion in any scheme rules of a right of first refusal. This approach could deprive the members of a small scheme of one method of preserving its character and harmony by precluding access on the part of potentially financially risky or troublemaking individuals. The requirement on any purchaser to pay a market price for the unit would cause no financial loss to the selling unit holder. The potential arrival in a scheme of a troublemaker or person without sufficient funds to pay assessments could also be met by a rule empowering the manager or commonhold di-

[7] [1954] Ch 39 at p 43 (Harman J).

rectors to refuse consent to the sale of a unit to any person, on an important ground, such as their poor financial state, as may be provided for by any German scheme constitution or *Gemeinschaftsordnung* (WEG 1951, § 12). Such a limit, which is currently not present in England, might be useful to smaller communities, where the financial strength and personal qualities of unit holders can affect the value of units (see Riecke, Schmid, 2008: p. 389). This looks like an area where the traditional common law absolute freedom of disposition of a freeholder requires revision in the light of the financially interdependent nature of apartment ownership.

REMEDIES FOR DEFAULT IN PAYMENT OF ASSESSMENTS

If a unit holder defaults in payment of charges or assessments to a significant extent, this can either risk casting an additional financial burden on all other unit holders, or lead to a diminution in the flow of money into the scheme coffers. Assessments may form the primary source of funds for the commonhold association. In England, this thorny issue is addressed as follows. The commonhold directors can bring a personal action to claim arrears against the defaulter, assuming friendly persuasion has failed: they can attempt mediation within an internal disputes procedure. Exceptionally, as such a dispute relates to financial matters, which are recognised as more serious than, say, disputes over keeping a persistently barking dog or too many cats in a unit, the association is not bound to make use of statutory informal dispute resolution procedures (thanks to Model CCS, para 4.11.11) If the unit is being sold, following a notice procedure, the new registered proprietor of the unit can be rendered personally liable, within 14 days of service of a claim notice by the association for unpaid assessments owed by the former unit holder. If the former unit holder requests a certificate from the association, stating the amount of arrears due, it cannot claim more than this sum from the new registered proprietor (Model CCS, paras 4.7.3–4.7.7). To penalise those in arrears, the local rules section of the model commonhold community statement (Annex 4 rule 1) enables a commonhold association to charge interest on unpaid assessments to the current registered unit proprietor, but no provision is made for levying fines or similar penalties on overdue assessments. It is also thought that a charging order could be obtained by a commonhold association on the unit of a defaulting unit holder for unpaid assessments due from them (under Charging Orders Act 1979, s. 1) but as has been pointed out (Crabb, 2002: p. 208) this would not have priority to any prior legal mortage over the unit.

Despite this array of personal remedies, there is no provision for a real remedy against the unit holder's unit, such as exists in France. There, thanks to article 19-1 of the 1965 Law, a lien (or *privilège immobilier*) is imposed so as to recover unpaid assessments in favour of the body corporate, triggered on the sale of the unit, and conferring a preferential claim as against the seller and any lender for the current year and the two previous years, attaching to the sale price. There is also no mechanism, such as under section 15B(3)(a)(i)(aa) of the South African Sectional Titles Act 1986, requiring their land registry to block a unit transfer, pending repayment by the defaulting sectional title owner of certified outstanding levy arrears to the management body. This remedy may, however, be of little use where substantial sums are owed to a mortgage bond holder by the owner in question and they do not have sufficient additional funds after the sale to cover the arrears (van der Merwe, 2007: p. 9-8).

The real remedy remedial *lacuna* in English law is surprising, because recommendations were on to address the problem, as by the conferral of a legal first priority lien on the commonhold body to secure all arrears of unpaid assessments (Commonhold: Freehold Flats, 1987: paras 9.27–9.30), which would have been triggered by default, and not just on a unit sale, so going further than the rule in both France and South Africa. The enforcement of such a lien, perhaps in priority to any mortgage lender, would ultimately have entailed a sale of the unit.

Such a drastic remedy can be justified because the community of apartment owners is seen as permanent. Each unit holder in an indissoluble community depends on the others to pay their dues promptly in the interests of good management of the scheme (see further Riecke, Schmid, 2008: p. 609). Section 31(8) of the Commonhold Act 2002, in outlawing from the commonhold constitution any remedy akin to forfeiture of leases, inaccurately treats statutory liens as equivalent to lease forfeiture, whose effect, if ordered, is to destroy the lease in question. A statutory lien could cover only unpaid arrears of assessments and need not necessarily confer priority over any mortgagee beyond a certain period, say the last six months of unpaid assessments. While any lien would have to be enforced by a sale of the unit, any surplus moneys not owed to the body corporate or to a mortgage lender would, one presumes, belong to the former unit holder, as also appears to be the position in Germany, when a forced disposal and on default of that sale by auction of a unit takes place (*WEG* §§ 18 and 19; see further Weinauer, 2005: pp. 417–427). In any case, the unit holder would not, unless heavily in debt to a mortgage creditor, face losing the whole value of their investment in the unit, as happens where an English long lease is forfeited with relief being refused[8]. The absence of a statutory lien in favour of the commonhold association to secure unpaid assessments is a serious if not lethal flaw in the commonhold legislation, since assessments are the life blood of condominiums, and it is something meriting urgent re-examination in the light of experience elsewhere.

LEASES OF UNITS

A prohibition is imposed, (regulation 11 of the Commonhold Regulations and para 4.7.11 of the Model CCS) on the granting of a lease of the whole or part of commonhold residential unit for a term exceeding seven years. This could be defended in that, in a community of apartment owners, active participation by unit holders in management is desirable (Commonhold: Freehold Flats, 1987: para 1.21). If a unit holder could let their unit for a long term, this policy could be frustrated. The rule, however, suffers from a number of defects whose cumulative effect is to discredit it. A limit on the maximum length of leases of units is not encountered in Germany (see Weinauer, 2005: p. 307 referring to *Veräußerung*) or South Africa, where section 15B(1)(b) of the Sectional Titles Act 1986 simply requires a notarial lease to be registered in the sectional titles register. These aspects suggest that it is unusual formally to restrict the common law power of a commonhold residential unit holder to lease their unit. Without wishing to re-visit the issue in any detail (see further Smith, [2004]: 200–206) the following points may be of interest.

[8] As in *Di Palma v Victoria Square Property Ltd* [1986] Ch 150, where a long lease of a flat was forfeited on account of some £300 in service charge arrears.

It would be of concern to a commonhold association if the rent reserved under a lease of a residential unit were less than that of the market, given that an absentee unit holder's ability to pay assessments can depend on the rent received. Sufficiency of assessment flows can be helped by banning the taking of lump sums or "premiums" on the granting of a lease, preventing most of the rent from being taken at the outset, as has been catered for in regulation 11(1)(a) of the Commonhold Regulations 2004. A right of veto, on reasonable grounds by a scheme manager, on any proposed letting of a unit might enable financially weak potential tenants to be excluded. The letting limit also fails to address cases where a unit holder grants a tenancy for a week or other short period to a person who has no real interest in the community. While no doubt the local rules of any one commonhold can deal with the latter aspect, some general provision might need to be made in the commonhold legislation to ban or restrict such lettings, as such tenants may be more of a problem to the community than a long lessee, who may well have a stake in the well-being of the community. This latter aspect is recognised in France, where, under article 32 of the Law No 84-595 of 12th July 1984, tenants under a lease enabling them to commence acquiring ownership in their unit (*location-accession*) have the right to attend owners' meetings and to vote on maintenance budgets. In order to meet legitimate concerns about too many leases in a commonhold scheme, the English legislator could have borrowed from South Africa, where scheme rules can validly state that only a given proportion of sections can be let any one time (van der Merwe, 2007: p. 10–19).

The fixed limit on the maximum length of leases which can validly be granted over English residential units was inadequately thought out, due to a narrow focus on the issue of lease length, rather than on wider aspects of the relationship between freehold and leasehold in a commonhold. The rule allows residential unit holders to lease their units at any rent, however low, and to a known troublemaker or someone who is not financially reliable, such as a relative of the unit holder, provided the lease does not exceed the prescribed limit and due notice is given to the management body. The rule seems to need some re-casting so as to make commonhold a more attractive form of property investment. After all, experience in South Africa suggests that some owners let their units, having bought them for the purpose of investment (LAWSA, 2000: p. 128). There is no reason to think the position different in England.

The English lease rules could for example be revised to raise the maximum permitted lease length of a residential unit to 21 years certain, giving lessees a substantial stake in the scheme and so inducing responsible behaviour on their part. In addition, leases would have to be granted at a market rent, so that if the rent has to be intercepted by the commonhold association on default in payment of the unit holder's assessments (as envisaged by Model CCS para 4.2.18), there should be a substantial sum to recover. The granting of short term leases (say for less than one year certain) and any licences of residential units should be formally banned.

VI. CONCLUSION

There is no reason why commonhold should not become an established part of the English property landscape, because condominium can be popular. The institution re-

sponds to the aspiration of many for affordable freehold ownership. A number of defects have been noted with the English scheme which it is argued require to be addressed.

A serious problem relates to the financial risks inherent in corporate model chosen for commonhold associations. The maximum £1 limit on unit holder's liability as a shareholder while the association is solvent, if only just, may be deceptive if the association runs out of funds and faces insolvency proceedings at the hands of its unpaid creditors. This nominal limit on liability seems not to, and anyway should not, protect a unit holder from personal liability to contribute to extra assessments for unsatisfied scheme debts levied by the liquidator either if the scheme is being wound up, or as a condition of its being rescued. A general principle of restricted liability to unpaid creditors should be considered, applying while the commonhold is a going concern, as a deterrent to failing to pay assessments in sufficient amounts or at all. Unit holders can be warned when thinking of buying a unit of the risk to their own funds if things go wrong, but with the nature of the risk being legislatively defined and subject to the safeguards mentioned, notably, that of due diligence by claimant creditors if the association.

The hostility of the English legislation to remedies resembling forfeiture has entailed that there are no effective real remedies to hand to a commonhold association to secure the recovery of arrears of assessments, such as a priority lien or a sale blocking mechanism operating against the unit concerned. The contrast with the other systems noted is glaring. The current English hostility to the forced sale of unit on the ground of serious or persistent non-payment of assessments needs to be overcome if the commonhold association is to have a suitably graduated range of remedies at its disposal, ranging from friendly persuasion to a forced unit sale, to secure the flow of money into its coffers. The then UK government failed to appreciate that condominium ownership is special ownership, if only due to the high level of financial interdependence of unit holders. A persistent failure to pay assessments by any unit holder can put the finances of the body corporate at risk, unless the other unit holders are willing to make up any deficits caused by the persistent defaulter, which it is unfair to expect them to do, but that may be the end result of the current position. If the guarantee principle referred to earlier is retained, this re-enforces the need for a battery of effective real remedies to force the hand of persistently defaulting unit holders.

The ban on granting a lease of a residential unit for over seven years is a questionable limit on the freedom of disposition of English unit holders. Short-term tenancies for as little as one week or month can still be granted by any unit holder, unless an individual commonhold community statement plainly rules this out. Tenants holding under this type of tenancy may be disruptive of the peace and quiet of a commonhold and are also likely to be a rapidly fluctuating element in a permanent community, risking tensions within it. There is at present nothing to prevent short-length tenancies being granted by any number of unit holders, so allowing them to transform the nature of a commonhold from a quiet residential freehold-based scheme to a mixed freehold and lease development, which aspect the ban on leases for over seven years of residential units was supposed to preclude. The fourteen-day notification procedure, which is required from the unit holder to the commonhold association from the date a tenancy is granted (Model CCS para 4.7.15) does not apply, possibly thanks to an oversight, to licences, which are an alternative form of agreement for short-term occupation. The ban on granting longer leases may reflect a wish to separate long leases and commonhold (as implied by section 3(1)(b) of the 2002 Act) with insufficient appre-

ciation of the problems which may arise as the result of short-term residential lettings for purposes which may conflict with the long-term character of a residential commonhold scheme, into which unit holders may have bought on the faith of its original character being maintained.

There are many attractive aspects to the commonhold model. Superseding the long lease system is an appealing idea, given the short length of English long leases and the poor management standards often associated with this form of condominium. The manner in which the English legislation approaches the delineation of common and unit holders' property and its rules bringing into existence the scheme management body at an early stage compares well with the other systems under review. The allocation of ownership of the structure and exterior of the scheme building to the commonhold association spares English law technical problems associated with quota share allocation (see van der Merwe, 2007: pp 4.11–4.18). The conferral of registered freehold ownership on unit holders, combined with membership of a management body corporate with separate legal personality to the unit holder, is an essential feature, in the interests of the stability and continuity of commonhold governance. However, the problems which have been unearthed with the institution suggest that further work needs to be done, almost certainly in the form of amending legislation, before commonhold can take its place as a preferred, or attractive means to the long lease system of holding condominiums in England.

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