UPPER TRIBUNAL (LANDS CHAMBER)

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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LEASEHOLD ENFRANCHISEMENT – HOUSE – preliminary issue – disregard of tenant's improvements – reality principle – house originally divided into five flats – tenant converting back to single house – planning permission for conversions no longer available at valuation date – whether disregard of improvements requires consequential assumption that building cannot lawfully be used as a single house – s.9(1A)(d), Leasehold Reform Act 1967

AN APPLICATION UNDER SECTION 21, LEASEHOLD REFORM ACT 1967

BETWEEN:

FLEUR MARIE ALBERTI

Applicant

and

CADOGAN HOLDINGS LIMITED

Respondent

Re: 10 Cheyne Walk
London SW3

Martin Rodger QC, Deputy Chamber President

9 March 2021

By remote video platform

Stephen Jourdan QC and *James Fieldsend*, instructed by Teacher Stern LLP, for the applicant
Mark Sefton QC, instructed by Cripps Pemberton Greenish, for the respondent

The following cases are referred to in this decision:

Fattal v Keepers and Governors of the Free Grammar School of John Lyon [2004] EWCA Civ 1530; [2005] 1 WLR 803

Fowler v Revenue and Customs Commissioners [2020] UKSC 22; [2020] 1 WLR 2227

Harbinger Capital Partners v Caldwell [2013] EWCA Civ 492

Lewisham Investment Partnership Ltd v Morgan [1997] 2 EGLR 150

Mundy v Trustees of the Sloane Stanley Estate [2018] EWCA Civ 35; [2018] 1 WLR 4751

Shalson v Keepers and Governors of the Free Grammar School of John Lyon [2003] UKHL 32; [2004] 1 AC 802

Shalson v Keepers and Governors of the Free Grammar School of John Lyon (2000) EWLands LRA/7/2000

Sharp v Cadogan (1998) EWLands LRA/33&35/97

Introduction

1. In 1971 the cartoonist and illustrator Gerald Scarfe took a long lease of a house in Chelsea which at that time was divided into five separate flats. Over a number of years he restored 10 Cheyne Walk to a single house by removing internal partitions, taking out redundant bathrooms and kitchens and making other improvements. The local planning authority did not regard the work as involving a material change in the use of the building or otherwise as development for which planning permission would have been required.

2. By 2019 planning policy in Chelsea had come to favour the retention of flats and leaned decisively against the sort of project Mr Scarfe had undertaken in the 1970s. It was undoubtedly lawful for 10 Cheyne Walk to be used as a single house, but if it had still been divided into five flats it is almost certain that planning permission to convert it to a house would not then have been available.

3. On 13 May 2019 Mr Scarfe gave notice to his landlord, Cadogan Holdings Ltd, of his intention to purchase the freehold of the house under the Leasehold Reform Act 1967. Less than two years remained of the lease he had acquired in 1971 and, on any view, the freehold reversion was very valuable. The acquisition of the freehold is now being pursued by Mrs Fleur Alberti, who purchased the remains of the lease from Mr Scarfe in August 2019.

4. Mrs Alberti and Cadogan have been unable to agree the price to be paid for the freehold. After Mrs Alberti applied to the First-tier Tribunal for the determination of that price, her application was transferred to this Tribunal with the consent of both parties. The Tribunal has directed the determination of a preliminary issue concerning the scope of the assumption in section 9(1A)(d) of the 1967 Act that the price payable for the house is to be diminished by the extent to which its value has been increased by improvements carried out by the tenant at his own expense.

5. It is common ground that the works carried out by Mr Scarfe in the 1970s were improvements for the purpose of section 9(1A)(d) and therefore that the price payable for the freehold must be diminished by the extent to which the value of the house was increased on the valuation date by those works. But does that direction require that the house be valued as if on the valuation date it could be used only as five flats and could not lawfully be used as a single house, or does it permit a valuation on the basis that the use of the building as a single house was lawful in planning terms?

6. The answer to this question is likely to have a significant effect on the price payable for the freehold. Mrs Alberti's approach is that, if the improvements are assumed not to have been carried out, the use of the building as a house on or after the valuation date would be development for which planning permission would be required but would not be available. On that basis she suggests that the freehold would only have been of interest to buyers looking to make a profit out of a relatively limited development project involving the refurbishment of five flats, and that its value would have been only £2.6m. Cadogan's case is that the value of the freehold, subject only to the unexpired term of the lease, was more

than £11m on the basis that, in reality, it was lawful to use the house as a house. On Cadogan's basis of valuation Mrs Alberti considers the value of the freehold is £4.25m.

7. The hearing of the preliminary issue was conducted using a remote digital platform. The applicant, Mrs Alberti, was represented by Stephen Jourdan QC and James Fieldsend, while the respondent, Cadogan Holdings Ltd, was represented by Mark Sefton QC. I am grateful to them all for their submissions.

The agreed facts

8. The parties agreed a statement of facts from which I take the following as the basis of my determination of the preliminary issue.

9. On 21 May 1971 Earl Cadogan granted Gerald Scarfe a lease of 10 Cheyne Walk for a term expiring on 28 December 2020. On 26 October 2012 the respondent was registered as proprietor of the freehold title to the building and since then has been the landlord under the lease.

10. The lease includes a covenant by the tenant not to use or permit the building or any part of it to be used otherwise than as a caretaker's flat in the basement, a self-contained flat on each of the ground, first and second floors, a self-contained maisonette on the third and fourth floors, and common parts. That covenant reflected the physical configuration of the Building at the time the lease was granted.

11. Between May 1971 and April 1977, Mr Scarfe made internal alterations to the building at his own expense to convert it to a single house. It is agreed that these internal alterations enabled the building to be used as a single house and that Mr Scarfe and his wife Jane Asher used it in that way. From about 1979 Mr Scarfe also carried on his business as a cartoonist in the building.

12. In 1984, the building was listed Grade II under the Town & Country Planning Act 1971. As a result, it became unlawful for any person to execute any works for the alteration or extension of the building which would affect its character as a building of special architectural or historic interest, unless the works were authorised by a listed building consent.

13. On 2 June 1987, planning permission and listed building consent were granted for the construction of a rear studio extension on what had previously been a flat roof at third floor level. Each of the consents included a condition that the works had to be begun within 5 years.

14. The work permitted by the 1987 consents was then carried out by Mr Scarfe at his own expense. For many years he and two employees used the studio and the other two rooms on the third floor for the purposes of his business as a cartoonist which was conducted through a limited company, Gerald Scarfe Limited. The company paid Mr and Mrs Scarfe an annual amount for the use of the third floor, and paid separately for the electricity it consumed.

15. The local planning authority is the Royal Borough of Kensington and Chelsea ("RBKC"). Until August 2014, RBKC's policy was that residential amalgamation schemes involving the loss of fewer than five units did not amount to a material change of use and did not require planning permission. Therefore, at the time that the improvements were carried out in the 1970s to convert the building back to a single house, planning permission was not required for them.

16. RBKC's planning policies changed in August 2014. It became RBKC's policy to resist the loss of residential units through amalgamations unless the amalgamation would result in the net loss of only one unit and the total floorspace of the new dwelling created would be 170 sq m or less.

17. It is accordingly agreed that, if the internal alterations had not been carried out prior to the valuation date, any purchaser of the freehold on the valuation date would have been advised that an application for planning permission and listed building consent to amalgamate the five flats into a single house would have had no chance of success. The prospects of obtaining planning permission for the third-floor extension are not formally agreed but there was, at least, a good chance of permission being granted.

18. On 13 May 2019, Mr Scarfe served on Cadogan a notice claiming the freehold under the 1967 Act. The following day Cadogan admitted the claim. The date of the notice making the claim is the valuation date for assessing the price payable for the freehold under the Act.

19. On 2 August 2019, Mr Scarfe executed a transfer of the lease to Mrs Alberti together with the benefit of the claim to acquire the freehold, and on 28 August 2019, Mrs Alberti was registered as proprietor of the lease. It is agreed that she is entitled to require Cadogan to transfer the freehold title to the building to her under the 1967 Act at a price determined by the Tribunal under section 9(1C).

20. It is also agreed that both the internal alterations carried out in the 1970s and the works to create the third-floor studio are improvements for the purposes of section 9(1A)(d) of the Act, and that they were carried out by Mr Scarfe, while he was the tenant under the lease, at his own expense.

The basis of valuation

21. The 1967 Act originally applied only to houses up to a specified rateable value, but the Act was amended in 1974 to increase the rateable value limits. In the case of houses where a claim could only be made by virtue of the 1974 amendments, the price payable was governed by section 9(1A) which provided a less generous basis of valuation. The Leasehold Reform, Housing and Urban Development Act 1993 further amended the 1967 Act to remove the rateable value limits altogether. In the case of houses where a claim could only be made by virtue of the 1993 Act amendments, the price payable became governed by section 9(1C).

22. In this case the price for the freehold is to be determined under section 9(1C) of the 1967 Act which incorporates by reference section 9(1A) (other than sub-para (b)). Section 9(1A) directs that the price payable is the amount which, at the "relevant date", which is the date

of serving the notice of claim, the freehold subject to the lease might be expected to realise if sold in the open market by a willing seller, on certain assumptions. The relevant assumption here is in section 9(1A)(d):

> "on the assumption that the price be diminished by the extent to which the value of the house and premises has been increased by any improvement carried out by the tenant or his predecessors in title at their own expense."

Guidance on the application of section 9(1A)(d)

23. The valuation hypothesis, and the assumptions which it requires the valuer to make, are statutory deeming provisions: they direct us to assume a state of affairs different in some identified respect from the state of affairs which exists in reality and to answer a particular question on the basis of those modified facts. At a general level it is therefore helpful to have in mind Lord Briggs JSC's guidance on the application and interpretation of statutory deeming provisions in a recent tax case, *Fowler v Revenue and Customs Commissioners* [2020] UKSC 22, at [27]:

> "(1) The extent of the fiction created by a deeming provision is primarily a matter of construction of the statute in which it appears.
>
> (2) For that purpose the court should ascertain, if it can, the purposes for which and the persons between whom the statutory fiction is to be resorted to, and then apply the deeming provision that far, but not where it would produce effects clearly outside those purposes.
>
> (3) But those purposes may be difficult to ascertain, and Parliament may not find it easy to prescribe with precision the intended limits of the artificial assumption which the deeming provision requires to be made.
>
> (4) A deeming provision should not be applied so far as to produce unjust, absurd or anomalous results, unless the court is compelled to do so by clear language.
>
> (5) But the court should not shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real. As Lord Asquith memorably put it in *East End Dwellings Co Ltd v Finsbury Borough Council* [1952] AC 109, 133:
>
> > "The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs."

24. I was also referred to a number of decisions giving more specific guidance on the meaning and purpose of the direction in section 9(1A)(d) that the price payable should be diminished by the extent to which the value of the house and premises has been increased by any improvement carried out by the tenant. The most important of these were the decision of the House of Lords in *Shalson v Keepers and Governors of the Free Grammar School of John Lyon* [2004] 1 AC 802, and the decision of the Court of Appeal in *Fattal v Keepers and Governors of the Free Grammar School of John Lyon* [2005] 1 WLR 803.

25. *Shalson* concerned a substantial Victorian house which had been divided into flats and later restored to its original configuration as a single undivided house. The issue was whether the works which had had the effect of restoring it to its original form could be regarded as improvements for the purpose of section 9(1A)(d). The Court of Appeal had thought not, but the House of Lords unanimously disagreed.

26. Both Lord Bingham, at [3], and Lord Millett, at [32], explained the purpose of the direction in terms of fairness:

> "To the extent of the increase attributable to those works the price payable for the house is diminished. The fairness of this provision is obvious. It would not be fair if the tenant were obliged to pay an enhanced price to the extent that such enhancement was attributable to works done by him or his predecessors in title (probably voluntarily) at their own expense: the tenant would in effect be paying twice. It would not be fair if the owner received a price inflated as a result of works done by the tenant or his predecessors in title (probably voluntarily) at their own expense: the owner would be reaping an adventitious gain as a result of works which he had had no right to require." (Lord Bingham)

> "It is designed to avoid the tenant having to pay a price which reflects a value in the property for which he has already paid: see *Hague on Leasehold Enfranchisement*, 3rd ed (1999), p 199, para 9-30. If the tenant carries out alterations to the property which enhance its value he thereby increases the value of the landlord's reversionary interest which he afterwards claims to acquire. The subsection prevents his own expenditure resulting in an increase in the price he has to pay. … It would also be unfair when the increase in the value of the property was the result of works which he had carried out at his own expense." (Lord Millett)

27. The operation of the provision was explained by Lord Hoffmann, at [17]-[20]. For a tenant to secure a reduction in the price payable on enfranchisement two conditions must be satisfied. The tenant must first identify improvements which they or their predecessors have carried out at their own expense, and secondly, must satisfy the tribunal that but for those improvements the house and premises would have been worth less. The first condition is concerned with physical works, and the second with the effect of those works on value. Demonstration of the second condition requires a simple comparison:

> "What does it mean to say that the value of the house and premises has been increased by the improvement? In my opinion, it signifies a simple causal relationship: but for the improvement, the house and premises would have been worth less. The comparison is between the value of the house as it stands and what its value would have been if the improvement had not been made.
>
> The hypothetical house envisaged by this comparison is in my opinion one which has all the features of the real house, including its history, save for one: that the improvement in question had not been made."

28. Lord Millett took the same approach, saying at [40] that the "extent to which the value of the house and premises has been increased" by an improvement "is simply the difference between the value of the property with the improvement in question and the value of the property without it."

29. The issue in *Fattal* was whether, in undertaking the comparison of the improved and unimproved house and premises, section 9(1A)(d) required the value of the potential for improvement to be excluded from the valuation of the unimproved house. The Court of Appeal held that it did not. Sir Martin Nourse explained, at [13], that:

> "What assumption (d) requires is a calculation of the amount of the increase in value caused by the improvements. That necessarily involves a valuation of the property as it would have been on the valuation date if it had not been improved. Before the Lands Tribunal both valuers agreed that any potential for improvement would be included in the achieved sale prices of unimproved properties; in other words, that a valuation of an unimproved house and premises would include the value of any such potential. It follows that an increase in value caused by an actual improvement must be calculated as an excess over the unimproved valuation (including the value of the potential for improvement), notwithstanding that the potential is merged in or absorbed by the actual improvement."

The reality principle

30. Cadogan's case is founded on the reality principle. The principle was explained by Lewison LJ in *Harbinger Capital Partners v. Caldwell* [2013] EWCA Civ 492, at [22]-[23], as follows:

> "There are many areas of the law in which an amount is to be ascertained by postulating a hypothetical transaction of one kind or another. …. Sometimes the hypothesis is statutory and sometimes it is contractual. The courts have developed a well-established set of principles that apply to both kinds of case. The most important of these is that things are to be taken as they are in reality on the valuation date, except to the extent that the instrument postulating the hypothetical transaction requires a departure from reality. ….
>
> The following points amplify the reality principle:
>
> i) The hypothesis is only a mechanism for enabling one to arrive at a value of particular property for a particular purpose. It does not entitle the valuer to depart from the real world further than the hypothesis compels: *Hoare v National Trust*, 380 (Schiemann LJ). The various hypotheses must be taken no further than their terms make strictly necessary: *Cornwall Coast County Club v Cardgrange Ltd* [1987] 1 EGLR 146, 152. It is necessary to adhere to reality subject only to giving full effect to the hypothesis: *Hoare v National Trust*, 387 (Peter Gibson LJ).
>
> (ii) Giving effect to the hypothesis may require a legal impediment to the implementation of the hypothesis to be ignored or treated as overridden; but

only to the extent necessary to enable the hypothesis to be effective: *IRC v Crossman* [1937] AC 26; *The Law Land Company Ltd v Consumers' Association Ltd* [1980] 2 EGLR 109; *Walton v IRC* [1996] STC 98.

iii) The world of make-believe should be kept as near as possible to reality: *Trocette Property Co Ltd v GLC* (1972) 28 P& CR 408, 420 (Lawton LJ); *Hoare v National Trust*, 386 (Peter Gibson LJ). Reality must be adhered to so far as possible: *Cornwall Coast County Club v Cardgrange Ltd*, 150 (Scott J). The valuer should depart from reality only when the hypothesis so requires: *Hoare v National Trust*, 388 (Peter Gibson LJ).

iv) Where the hypothesis inevitably entails a particular consequence, the valuer must take that consequence into account: *East End Dwellings Co Ltd v Finsbury BC* [1952] AC 109, 132.

v) But there is a clear distinction between hypotheses expressly directed to be made and assumptions allegedly consequential on the express hypotheses. Where the alleged consequence is not inevitable, but merely possible (or even probable), then the consequence cannot be assumed to have happened: *Cornwall Coast County Club v Cardgrange Ltd*, 149 (Scott J).

31. *Harbinger* concerned the meaning of an assumption (referred to as the "Withdrawal Assumption") which was required to be made when valuing the shares of Northern Rock on its nationalisation in February 2008. The Court of Appeal was divided on the interpretation of the assumption and Lewison LJ was in the minority, but neither of the other members of the Court, Mummery and Beatson LJJ, disagreed with his explanation of the reality principle. Mummery LJ nevertheless emphasised, at [122], that the reality principle only applied where the assumption itself did not:

> "In this case my view is that the reality principle tells us no more about the Withdrawal Assumption than is gathered from its wording, as interpreted in accordance with established principles. The reality principle is only saying that departure from the real world must be no greater than is required by the statutory Withdrawal Assumption. If you are not required by statute to depart from reality, you must stick with reality. But the principle does not determine or limit what the statute commands us to assume contrary to reality. The statute determines that. The reality principle is about what is *not* covered by the statutory assumption."

32. Mr Sefton QC questioned Mummery LJ's characterisation of the reality principle as beginning where the statutory assumption ends, and referred to Lewison LJ's observation in *Mundy v Trustees of the Sloane Stanley Estate* [2018] EWCA Civ 35, at [34], that:

> "The principle of reality is also relevant when interpreting a hypothesis required to be made."

Mr Sefton submitted that the direction in section 9(1A)(d) had to be interpreted against a background which included the reality principle. No doubt that is correct, so far as it goes.

The preliminary issue

33. The preliminary issue is concerned with the interplay between section 9(1A)(d) and the reality principle and was formulated in these terms:

> Does section 9(1A)(d) of the Leasehold Reform Act 1967 require the Tribunal to assume that it was unlawful as a matter of planning control to use 10 Cheyne Walk as a single house on the valuation date?

An alternative way of expressing the same issue, which may bring out the point more clearly, would be to ask whether it is a necessary consequence of section 9(1A)(d) that, in its assumed condition, planning permission and listed building consent would need to be obtained by a purchaser of 10 Cheyne Walk if they wished to carry out work to enable it to be occupied and used as a single house.

34. Mrs Alberti's case is that section 9(1A)(d) requires the Tribunal to assume that Mr Scarfe did not convert the building from five self-contained flats into a single house in the 1970s, or add the studio, and that it remained divided into flats at the valuation date. The valuation of the unimproved building should be undertaken by reference to reality, including the planning and building control legislation and policies which really existed on the valuation date and which would have applied to the building in its assumed unimproved condition. A purchaser of the freehold of the unimproved building would have had to get planning permission and listed building consent to make the improvements which Mr Scarfe made during his tenancy. The advice a prospective purchaser would have received about the prospects of getting such consents is a question of fact, not law, but on the agreed facts the purchaser would have been advised that planning policy would have prevented the conversion of the building back to a single house.

35. Cadogan's case is that section 9(1A)(d) is concerned only with the physical condition of the building and does not require or permit any counter-factual assumption to be made about the use which could lawfully be made of it. On the valuation date it was lawful in terms of planning control for the building to be used as a single house and it should therefore be valued on that basis. It should be assumed that the bathroom and kitchen fittings, and the partitions removed by Mr Scarfe in the 1970s are present, and that the additions he made to the building, including the rear studio extension, are absent. Otherwise all relevant features of the building, including its planning status, should be assumed to be as they are in reality. In particular it should not be assumed that it would be illegal to occupy the building as a single house.

36. In support of Mrs Alberti's case Mr Jourdan QC submitted that the key to the preliminary issue was to be found in paragraph [13] of the Court of Appeal's decision in *Fattal* (see paragraph [29] above). It is a matter of valuation rather than law how the Tribunal identifies the extent to which the value of the building was enhanced by the improvements made by Mr Scarfe. But the best guide to the price which the unimproved freehold would have achieved in the open market on the assumption that those improvements had never been made would be an open market sale on the valuation date of the property next door, divided into 5 flats, and with an expired planning permission for a 3rd floor extension which had been

granted in 1987, but which had never been implemented. If such a sale had taken place, it would provide reliable evidence of the value of the building without the improvements, but with whatever potential existed in May 2019 to carry them out. That had been the approach taken by the tenant's valuer in *Shalson* (as recorded in the Lands Tribunal's decision in *Fattal* at [58]: "he had valued the property, which was a re-conversion of four flats into a single house, and used as comparables only properties that were sold as flats".) The Lands Tribunal (Mr Norman Rose FRICS) held that if, contrary to the Tribunal's primary determination, the tenant was right about the issue of law, there was nothing wrong with his valuation: see *Shalson* (2000) EWLands LRA/7/2000 at [53].

37. In principle, Mr Jourdan argued, all the real world regulatory and economic factors capable of influencing the price which would be paid for the unimproved building in the open market should be taken to have been as they were on the valuation date. If Mr Scarfe had never carried out his improvements the building would have been less valuable on the valuation date. That was partly because the building had been made larger by the rear studio extension, but it was mostly because of changes in external factors, including changes in the supply and demand for houses rather than flats, and the change in RBKC's planning policies. Nothing in the language or policy of section 9(1A)(d) prevented the Tribunal from taking full account of the influence those external factors would have had on the value of the unimproved building, and the reality principle required that it should do so.

38. On behalf of Cadogan Mr Sefton submitted that the building has been used as a house for more than half a century and was being used in that way on the valuation date. It was lawful to use it as a house, and it should be valued on that basis. Section 9(1A)(d) required the valuer to assume a change in the physical state of the building, but it required no assumption about its planning status. It was not necessary to ask why the use of the building as a single house was lawful on the valuation date, that was irrelevant. Just as the existence of planning permission to improve the house was not an improvement, so the right to occupy the building as a single house was not an improvement and it should not be disregarded.

39. Mr Sefton relied on the proposition that improvements are physical things, which had been applied by Neuberger J in *Lewisham Investment Partnership Ltd v Morgan* [1997] 2 EGLR 150, 157K-L (a rent review case), and by Lord Hoffmann and Lord Millett in *Shalson.* It was the basis of the conclusion that while value added by carrying out improvements cannot be taken into account, value attributable to the potential to carry out improvements should be, as the Court of Appeal had decided in *Fattal*. The direction that the price be diminished by the extent to which the value of the house and premises has been increased by any improvement was concerned only with the physical improvement. It did not apply to the right to occupy the building as a single house.

40. Mr Sefton's approach to the application of section 9(1A)(d) was therefore to propose the narrowest application of the statutory hypothesis. The Tribunal needed to identify the value that the house would have had on the valuation date if the physical works done to it by Mr Scarfe were notionally to be un-done. The valuation should therefore be of the building assuming the return of the partitions and fittings removed in the 1970s, and the removal of the extension built in the 1980s, but otherwise with all its characteristics and advantages as they existed on the valuation date. The valuer should not assume the building had never been used as a single house, such that its use for that purpose would now constitute

development for which planning permission would be required. The valuer was not required to speculate about what would now have been the lawful use of the building if the history of the house had been entirely different. The valuer must simply value the building on the basis that, apart from the physical differences that need to be assumed, everything else was the same as in reality, including that it could lawfully be used in whatever way was permissible in reality as a matter of planning control.

41. While Mr Jourdan focussed on the second part of Lord Bingham's explanation in *Shalson* of the purpose of section 9(1A)(d) (the avoidance of an "adventitious gain" for the landlord), Mr Sefton stressed Lord Millett's explanation ("to avoid the tenant having to pay a price which reflects a value in the property for which he has already paid"). But these are opposite sides of the same coin, and no tension exists between them. In particular, Lord Millett was not suggesting any equivalence between what the tenant had paid for the works and the degree to which the value of the house and premises may be taken to have been enhanced. I agree with Mr Jourdan that any such comparison is irrelevant. Mr Sefton contrasted the relatively modest works undertaken 50 years ago to convert the building from flats to single occupation with the difference in value of many millions of pounds which they were now said to justify. The contrast is certainly striking, but the amount by which the price of the house may have to be diminished to eliminate the influence of the tenant's improvements is not limited by the cost of the works. It is simply a matter of valuation, and if, properly applied, the statutory direction results in a very favourable valuation for one side or the other it would not be right to "boggle when it comes to the inevitable corollaries of" the hypothesis which the statute requires.

42. Nor do I consider that a general appeal to fairness assists either party. Mr Sefton suggested that fairness to Mrs Alberti did not require the outcome she sought. The right to use the house as a house was not something which had been paid for by Mr Scarfe or Mrs Alberti, it was the consequence of planning policy in the 1970s. On the contrary, Mr Sefton suggested, it would be unfair to Cadogan for it to be compelled to sell the freehold of a very large house in a prestigious street at a price which assumed the purchaser would have no right to live in it. Mr Jourdan's answer was that there can be nothing unfair in Cadogan receiving the price it would have received for the property if the works had never been done.

43. How the reality principle is to be applied in this case depends on the meaning and effect to be given to the statutory direction to diminish the price payable by the extent to which the value of the house and premises has been increased by any improvement carried out by the tenant or his predecessors. In *Harbinger Capital* Lewison LJ stated the principle to be "that things are to be taken as they are in reality on the valuation date, except to the extent that the instrument postulating the hypothetical transaction requires a departure from reality". As Mummery LJ explained, the reality principle takes over where the statutory assumption ends, because it "is about what is *not* covered by the statutory assumption." The starting point must therefore be section 9(1A)(d) itself.

44. The difference in approach between the parties can be seen most clearly by comparing Mr Sefton's suggestion that the alterations should be assumed notionally to be undone on the valuation date with Mr Jourdan's proposition that it should be assumed Mr Scarfe did not convert the building from five self-contained flats into a single house in the 1970s.

45. There is no doubt about how section 9(1A)(d) is to be applied. Authoritative guidance was provided by Lord Hoffmann in *Shalson*. I appreciate that the issue in *Shalson* was not the same as in this case, but Lord Hoffmann's explanation of what it means to say that the value of a house has been increased by an improvement is of general application. In order to identify the extent to which the value of the house has been increased by an improvement, what is required is a comparison "between the value of the house as it stands and what its value would have been if the improvement had not been made." That was also the approach taken by Sir Martin Nourse in *Fattal* where he said that what is necessarily involved is "a valuation of the property as it would have been on the valuation date if it had not been improved."

46. As far as the works carried out in the 1970s are concerned, the only permitted departure from reality is therefore that it must be assumed that the house was not converted from a building divided into flats by works rendering it capable of single occupation. I reject Mr Sefton's submission that the building must be assumed to be divided into flats on the valuation date alone but that no assumption contrary to reality should be made about its condition at any other time. The exercise is not limited to interfering with reality on the date of valuation alone; the history of the house is to be re-written by treating the improvements as if they had not been made.

47. The authorities surveyed by Lewison LJ in *Harbinger Capital* show how strictly the valuer's imagination must be kept in check. The valuer must not depart from the real world further than the hypothesis "compels" and must take the hypothesis no further than "strictly necessary". But in doing so it is necessary to give "full effect to the hypothesis" and, as Lewison LJ acknowledged, that requires that any "inevitable" consequence of the hypothesis must also be assumed. As Lord Briggs JSC put it, in *Fowler*, "the court should not shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real."

48. In my judgment the inevitable consequence of treating the works as if they had never been done is that any occupation of the house between the date on which the works were carried out and the valuation date must be assumed to have been of the building in its unimproved condition. It follows that the prospective purchaser of the unimproved house on the valuation date would not be advised that, although the building was divided into five flats, it nevertheless had the benefit of an established planning use which would render it lawful, without planning consent, to occupy it as a single house.

49. I accept Mr Jourdan's submission that, in principle, the best proxy for the value of the unimproved house would be a house next door which had been divided into flats on the date the lease was granted and remained in that condition on the valuation date. The planning status of the two properties would be the same and Cadogan should therefore expect to receive the same price on a notional sale of both properties. To credit Cadogan in the assessment of the price of 10 Cheyne Walk with the benefit of a planning status which was a consequence of the occupation of the property as a single house, when that style of occupation was enabled only by the improvements carried out by Gerald Scarfe, would not be to diminish the price by the extent to which the value of the house had been increased by those improvements.

50. Mr Sefton submitted that *Fattal* was binding authority that the planning status of the building should be taken to be as it actually was on the valuation date. I disagree. In *Fattal* the tenant's improvements did not cause the planning permission to be granted; the planning permission was not itself an improvement nor was it an inevitable consequence of the improvements (on the contrary, it pre-dated the improvements). In this case the planning status of the building is not an improvement, but it is a direct consequence of the improvements and would not have been enjoyed without them. That requires that the building must be assumed to have had the same planning status on the valuation date as it would inevitably have had if the improvements had not been carried out.

51. I should add that both counsel relied on other authorities from a number of different statutory and contractual contexts in support of their submissions. For the most part they illustrate the application of the reality to principle to different types of valuation, but I do not think they assist in the determination of the appeal. The decision of the Lands Tribunal (Mr Peter Clark FRICS) in *Sharp v Cadogan* (1998) LRA/33&35/97 to which Mr Jourdan referred was a case under the 1967 Act. It emphasised that the value of improvements must be disregarded at each stage of the assessment of the price, including the capitalisation of the ground rent. That was not a controversial proposition in this case.

52. I therefore determine the preliminary issue in the sense contended for by Mrs Alberti. Section 9(1A)(d) does require the Tribunal to assume that it would have been unlawful as a matter of planning control to use 10 Cheyne Walk as a single house on the valuation date.

Martin Rodger QC

Deputy Chamber President

9 April 2021