CLIFFORD CHANCE LLP'S RESPONSE TO THE BEIS CALL FOR EVIDENCE PAPER "A REGISTER OF BENEFICAL OWNERS OF OVERSEAS COMPANIES AND OTHER LEGAL ENTITIES" (APRIL 2017)

As per our response to the April 2016 consultation, we recognise the importance of addressing corruption and combating illicit financial flows and support in principle the Government's aims to tackle corruption more efficiently; however, we believe that the new regime needs to strike a balance between the need to improve transparency and minimise the burden on legitimate commercial activity so as not to put off legitimate investors and have a chilling effect on the property market.

We have endeavoured to answers the questions as fully as possible; however, a number of the questions raise some very complex and/or technical issues, which we have not be able to consider in as much detail as we would have liked as the paper was issued just before the Easter holidays. We would therefore very much like to meet with the Transparency and Trust Team to discuss our comments in more detail.

Please note that our answers/comments to the questions are given in light of our legal expertise and market knowledge of the commercial property market of England and Wales only.

Question 1: Do you agree that all legal forms that can hold properties should be in the scope of the new register's requirements? If not, what legal forms should we consider an exemption for and why?

We do not agree that all legal forms that can hold properties should be in the scope of the new register's requirements as the current UK PSC regime does not cover all UK legal forms (i.e. it only covers Company Act companies and LLPs). The government's stated intention has always been that the new regime should be equivalent to the UK PSC regime. We appreciate that the UK PSC regime will shortly be updated to accord with the European Fourth Money Laundering Directive and, as a result, additional legal forms will be caught by the UK PSC regime. The new regulations in this regard have not yet been published.

We note that one of the two reasons given in the paper why the new register should focus on all legal forms and not just companies limited by shares is that "*it is often not clear from land registry records what type of entity holds a title, which would make it difficult to ensure compliance with a register that only included some of those entities" (*para 26, page 16). We believe that there is a possible method of identifying if a non-UK entity is equivalent to a UK company limited by shares, see details below.

Notwithstanding the suggestion below, we do accept that limiting the register to equivalent companies limited by shares may encourage the use of other types of vehicles in order to avoid complying with the new regime.

Possible method of identifying if a non-UK entity is equivalent to a UK company limited by shares: when a non-UK legal entity applies to be registered as a legal owner of a registered property, the Land Registry requires a form 7 certificate from a qualified lawyer in the relevant jurisdiction certifying that the entity has, in particular, separate legal personality. See LR Practice 8 Guide for a sample certificate. The form 7 certificate could be adapted to include a new certificate on whether or not the non-UK entity is equivalent to a UK Company limited by shares.

We appreciate that our suggested change of procedure will not assist with regard to non-UK entities already registered at the Land Registry as a registered proprietor. As mentioned below in our response to Questions 10, 27 and 28, we have serious concerns regarding the retrospective

nature of this new regime. If the new regime is to apply to existing registered proprietors, a requirement to produce this new form 7 certificate could be imposed at the same time as the requirement to register beneficial ownership. Failure to supply this new form 7 certificate could trigger automatic registration by the Land Registry of the proposed note highlighting that the non-UK entity may not sell, lease or charge its registered property unless it has complied with the new regime (the "PSC note") (para 47, page 22).

With regard to the question *"what legal forms should we consider an exemption for and why?"*, we are unable to comment at this time. In order to do so, we will need to obtain guidance from colleagues, who are qualified in various other jurisdictions, as to which legal forms they consider should be exempt and why.

Question 2: Is the suggested definition of leasehold appropriate?

Question 3: Will setting the leasehold definition at leases over 21 years create any unintended consequences?

In answer to Questions 2 and 3, we support the proposal at para 30, page 17 that the government aims "*only to capture leaseholds that are analogous to freeholds (for example where a premium has been paid...*)"; however, it is our view that proposed definition will not achieve this aim as leases granted for more than 21 years are not analogous with freeholds.

We accept that for retail leases and leases of parts of buildings the term of such leases are generally in the region of 10-15 years. For leases of whole buildings, factories, distribution centres and project leases (e.g. power stations), the term is often for more than 21 years. None of these leases would be considered equivalent to freeholds.

It should be noted that the proposed definition catches all leases over 21 years and does not distinguish the actual term remaining, e.g. a lease originally granted for 50 years, which now only has say 5 years left to run.

In addition, there are relatively simple mechanisms which can be used to circumvent the proposed 21 years limitation, for example:-

- A landlord could grant a tenant a lease for 21 years less one day at a premium which contained a tenant right to renew for a further period of 21 years less one day on the same terms as the first lease (i.e. with a right to a new lease again).

- A landlord could grant a tenant a lease for 21 years less one day at a premium and at the same time grant to the same tenant a reversionary lease for a period of 21 years less one day at a premium starting immediately after the expiry of the first lease.

For the above reasons, we would suggest that the leasehold definition should not focus on the duration of the lease but rather on whether the tenant pays the landlord a substantial premium. Such a premium must be stated in the Land Registry prescribed lease clause (clause LR7) and disclosed in the stamp duty land tax form, SDLT1. One of the benefits of focusing on the payment of a substantial premium, is that the grant of most statutory residential lease extensions/ new leases under e.g. the Leasehold Reform, Housing & Urban Development Act 1993 will fall outside of the new regime.

Question 4: Do you agree that the definition of beneficial owner for the new overseas register should be aligned to the definition of PSC in the PSC regime?

Question 5: Do you agree that entities that are not similar to UK companies limited by shares should use these adaptations to identify their beneficial owners?

Question 6: Do these adaptations provide sufficient flexibility in the beneficial owner conditions to apply to most legal entities? If not, what additional adaptations should there be?

In answer to Questions 4, 5 and 6, we agree, in principle, that the definition of beneficial owner for the new register should be aligned to the definition in the UK PSC regime. We also agree that entities that are not similar to UK companies limited by shares should use these adaptations to identify their beneficial owners. As to whether these adaptations will provide sufficient flexibility, we are unable to comment at this time. In order to do so, we will need to obtain guidance from colleagues, who are qualified in various other jurisdictions, as to how these adaptations will work in practice in respect of the most common forms of non-UK entities used to acquire UK property.

We note that the UK PSC regime provides that:-

(a) a corporation sole,

(b) a government or government department of a country or territory or a part of a country or territory,

(c) an international organisation whose members include two or more countries or territories (or their governments),

(d) a local authority or local government body in the United Kingdom or elsewhere

are to be treated as individuals even if they are legal persons under the laws by which they are governed (Section 790C(12)). As a number of Sovereign Wealth Funds and other similar bodies have substantial property investments in the UK, we would suggest that the new regime provides expressly that such sovereign entities are also treated as individuals. Ideally, the UK PSC regime would also be amended to put this issue beyond doubt.

Question 7: What methods of raising awareness would be most effective?

If the new regime is to apply to existing non-UK entity registered proprietors, the Land Registry, as a minimum, should serve a notice on such entities at their Land Registry address for service with guidance as to how to comply with the new regime and the consequences of any failure to do so. Notice and guidance should also be served on any registered mortgagees of these properties at their Land Registry address for service.

For new owners and the market generally, the Land Registry, Companies House and the Department for Business, Energy & Industrial Strategy should undertake a comprehensive awareness campaign with the assistance of the legal, accounting, insolvency practitioners and property professional bodies and associations e.g. the Law Society, the RICS, the British Property Federation, BBA, CML, Insolvency Lawyers Association, R3, the City of London Law Society, IAEW, Accounting Europe, LMA and CREFC Europe.

Question 8: Do you have any information that is relevant to our assessment of the cost and benefits of the policy to businesses, society and the economy?

We do not have any empirical evidence; however, we suspect based on experience that a number of HNW individuals and/or prominent families may take into account their lack of anonymity and the open nature of the non-UK PSC register as a factor in their decision on whether to invest in UK property.

Question 9: What, if any, impact do you think that the proposed policy will have on the UK property market (residential and commercial)? Please describe the impacts and provide evidence.

In light of our response to Questions 10, 27 and 28, it is our view that the new regime may:-

- restrict UK parties' ability to sell their property to non-UK entities. Third parties (e.g. tenants and off–plan buyers) and counter-parties (e.g. option and pre-emption holders) may insist on change of control provisions being inserted in their legal documentation in order to control sales by their landlord/counterparty to non-UK entities in order to protect their position should the non-UK entity fail to comply with the new regime. In the UK property market, change of control provisions are rare as they are invariably complex and difficult to agree/draft as well as police;

- for sales, in particular off-plan sales, increase legal and compliance costs as the contracts will require provisions to cover what happens if the seller is or becomes a non-UK entity and at the time of completion has not complied with the new regime;

- for lettings, increase legal and compliance costs as leases and agreements for lease will require provisions to cover what happens if the landlord is or becomes a non-UK entity and at the time of completion (or subsequent renewal) has not complied with the new regime;

- for sales, lettings, joint ventures and lending, increase due diligence costs as the parties will need to check the new register and deal with default scenarios.

Depending on the implementation of the proposed policies, the policies could also have a detrimental impact on the real estate finance market both in terms of the willingness of lenders to advance funds to overseas investors secured on real estate and trading in the secondary debt markets and bond markets (see our answer to question 26).

As a result, we suggest that the new regime may make the UK a less attractive place for investment by non-UK entities if it does not strike the right balance between improving transparency and minimising the burden of compliance by legitimate investors. As the paper acknowledges, the UK property market attracts a lot of inward investment which benefits the economy and supports the construction industry and connected trades. The paper states that between 2004 and 2014, over £180 million worth of property in the UK was investigated as suspected proceeds of corruption (para 10, page 11). Though this is not an insignificant figure, it should be considered in light of the fact that CBRE have calculated that for the UK commercial property market alone investment volumes were just under £50bn in the year 2016 only.

Question 10: Do you agree that the duration of the period given to overseas entities to comply with the new requirements should be one year?

The suggestion at para 45, page 21 that the one year grace period will give non-UK entities, who are registered proprietors, a chance to dispose of their property fails to taken into account that this may not be practical, legal and/or commercial for them to do so. For example:-

- The property may be in the process of construction. In such cases, it is difficult to sell a half-built building.

- The sale of the property may be in breach of a commercial arrangement (e.g. between joint venture partners) or under the terms of an existing financing policy, breakage costs and/or hedging costs prohibitively expensive to cancel.

- The property may be subject to a pre-existing pre-emption agreement, sale agreement or option agreement with a third party, which prohibits or controls the sale of the property.

As discussed in more detail in our response to Questions 27 and 28 below and in light of the above, it is our view that to make the new regime retrospective would be unfairly prejudicial not just to the ultimate owner of the property but also to third parties.

Question 11: Is a system of statutory restrictions and putting notes on the register, backed up by criminal offences, a comprehensive way to ensure compliance?

Yes, we agree that the proposed system of statutory restrictions and notes is a comprehensive way to ensure compliance.

The speed of registrations at Companies House will also be critical for transactions. A lot of new acquisitions in the commercial investment space is transacted through newly incorporated SPVs, which are set up shortly before acquisition. A speedy process (measured in short hours or a single day) is therefore essential to ensure that no delays are caused to the wider transaction.

Question 12: Do you agree that we should prevent any beneficial interest in the property passing to an overseas legal entity that does not have a valid registration number at completion or settlement?

Question 13: Do you agree that the most appropriate way to do this would be to void the transfer document?

Question 14: Is there another way that we could achieve this result?

In response to Questions 12, 13 and 14, the transfer of the beneficial interest in a property can take place, depending on the intention of the parties, at different times in the sale processes (e.g. on exchange, on satisfaction of conditions or on the payment of all or substantially all of the purchase price). The registration of the transfer document is in most cases "irrelevant" as to when beneficial ownership transfers.

In light of the above, we do not agree with the suggestion that the transfer document should be declared void in order to prevent the transfer of the beneficial interest in the property passing on completion to a non-UK entity which has not complied with the new regime. We note that the paper only refer to transfers but assume that this proposal also applies to the grant of new leases caught by this new regime and the transfers of such leases.

As stated in the consultation paper (para 55, page 25), the vast majority of non-UK entities will wish to be registered as the legal owner at the Land Registry as failure to do so will prevent the entity from selling, letting or charging the property. We are therefore of the view that the suggestion to make the transfer document void and/or prevent any passing of beneficial interest is an unnecessary interference with a fundamental principle of land, which may well give rise to unforeseen consequences and adversely impact on third parties. For example, if a non-UK entity completes a purchase and the transfer is treated as void:-

- Where the property is subject to occupational leases, the tenants will be unsure as to who is their landlord and to whom they should pay rent. This may prejudice their position if, for example, they wish to serve a notice to break.

- Where the transfer is of a lease, the non-UK entity will, notwithstanding the transfer being declared void, most likely be in occupation of the property. This will put both the non-UK entity and the seller tenant in breach of the lease entitling the landlord to forfeit.

It is also unclear what should happen to proceeds of sale as these will have been paid to the seller on completion and, in most cases, will have been used by the seller to redeem a mortgage. Are these proceeds to be treated as "proceeds of a crime"? If so, by accepting these monies has the seller and the seller's lender been party to money laundering? We assume the proceeds should not be repaid to the non-UK entity?

Though we acknowledge that contractual provisions can be included in the sale agreement that provide that completion is conditional on the non-UK entity's PSC register being up-to-date, we are concerned that such provisions will not have been included in pre-existing contracts. Example of this could be off-plan agreements or agreement entered into in the period shortly after the introduction of the legislation or in the less sophisticated residential market.

We are of the view that voiding any non-compliant transfer will cause a number of unintended consequences, which will make selling to a non-UK entity risky. The UK property market industry will be affected as a result. The preferable position is for the transaction to be permitted and to the extent the relevant transfer is non-compliant the legislation and criminal sanctions apply.

As to whether there is another way that we could achieve this result, we would suggest a fine or some other penalty perhaps based on a percentage of the income/rents received by the non-UK entity in respect of the property.

Question 16: Do you agree that the information on the new register for overseas entities should be the same as the information required under the PSC regime?

We agree that the information on the new non-UK PSC register should be the same as the information required under the UK PSC regime.

Question 17: Do you agree that entities unable to give information about beneficial owners should be asked to provide information about their managing officers?

We agree that where non-UK entities are unable to give information about beneficial owners they should be asked to provide similar information about their managing officers.

Question 18: Is there any additional information that we should ask for from entities that are unable to give information about their beneficial owners?

We do not believe so.

Question 19: Is a requirement for an update every two years appropriate?

We welcome the proposal that the update requirement is only once every two years. This two year requirement will help limit not only the cost of reporting for non-UK entities but also may limit the potential prejudice to third parties, whose legal arrangements are put in place and completed within this two year time frame.

Question 20: Would a criminal offence be an appropriate way of enforcing the requirement to update information?

We agree that making a failure to update the PSC register a criminal offence would be an appropriate way of enforcing the requirement to update the new register on the basis that the non-UK entity PSC regime should be, as far as reasonably practicable, equivalent to the UK PSC regime.

Question 21: Do our proposals achieve the right balance between ensuring compliance and enabling overseas entities to maintain existing assets?

Subject to our response to Questions 10, 14, 27 and 2, we agree, on the whole, that the proposals achieve the right balance between ensuring compliance and enabling overseas entities to own UK property.

Question 23: Do you think that this provides the correct balance between protecting individuals from harm and ensuring transparency of how properties are owned?

Question 24: Are there additional situations we should consider where protections should be granted?

In response to Question 23 and 24, we think that the proposals strike the correct balance between protecting individuals from harm and ensuring transparency of how properties are owned. We are not aware of any additional situations where protections should be granted.

We suggest that protection should be granted where a property, owned by a non-UK entity, is an individual's residence. At the moment, you cannot carry out a search at the Land Registry against a person's name to ascertain if they own any registered property save in exceptional circumstances (e.g. as part of a police investigation). In contrast, a search against a company may be made by anyone by simply submitting Land Registry Form PN1. It is will therefore be relatively easy to ascertain what property an individual owns in three straightforward steps. First, you search the non-UK entity PSC register for their name to ascertain what non-UK entities they owned. Once you have this information, you can submit a PN1 search against each non-UK entity. The PN1 search will reveal if the non-UK entity is a registered proprietor and, if so, the relevant title number/s. With the title number/s you can order online a copy of each property register, which will list the address of the property etc. As a result, we believe that for privacy, safety and security reasons, particularly, for high net worth individuals, famous people etc, such persons should be entitled to apply for their information to be suppressed in respect of any non-UK entity, which is the registered owner of their private residence/s in the UK. We also suggest that the UK PSC regime is amended to include a similar protection.

Question 26: How can we best ensure that only legitimate lenders are able to repossess and dispose of a property with a restriction against it?

We note that the government is "*keen to ensure that we do not create a loop hole for overseas entities to realise the value of their asset without providing beneficial ownership information to the register*." We agree that it is important that the regime should not be easily circumvented by a beneficial owner which holds a charge against a property using this to repossess and dispose of the property. Therefore, in general, a lender which is related to a sponsor or chargor should not benefit from any exemption to the regime except in certain circumstances.

Whatever restriction is imposed it is very important that it should not prevent a bank, insurance undertaking or financial institution (or wholly owned subsidiary of any such entity) exercising its rights as mortgagee even if they are related to the chargor or sponsor. Any attempt to close the loop hole identified should not be targeted at banks, insurance undertakings or financial institutions or any of their wholly-owned subsidiaries (or a security trustee or security agent acting on their behalf) which are usually regulated entities. To include them in any restriction would be wholly disproportionate in our view.

There will also be circumstances where a lender which is not a bank, insurance undertaking or financial institution and is related to a chargor or sponsor will enter into genuine financing arrangements on third party arm's length terms. These include financings and securitisations (including whole business securitisations) involving loan on loan structures where the property assets are charged by group members to a lender which is also a group member and that lender will, in turn, borrow monies or issue bonds and assign or charge to a bank, insurance undertaking, financial institution or unrelated person or trustee for the bondholders the benefit of the security granted to it by group members. These structures may benefit a bank, insurance undertaking, financial institution or unrelated person or trustee for the bondholders and ought not to be the target of the restriction. These structures can involve the issuance of investment grade rated bonds and any limitation on the ability to repossess and dispose of a property asset because of a restriction against it is likely to have an adverse impact on the rating.

Also, given that many investors owning interests in real estate also have related entities which provide debt finance secured on real estate assets, it is important that these related lenders can, nevertheless, enforce their security (particularly where the loan has been syndicated and the syndicate is made up of both related and non-related lenders). Otherwise this regime would negatively impact genuine security structures and have a negative impact on the syndication market with potential syndicate members reluctant to buy loans (or other instruments) unless they are clear that the rest of the syndicate is not related to the borrower.

We also note that, in many cases, charges granted over properties will be in favour of security agents or security trustees rather than the lenders themselves. Any consideration of whether the lenders are related should look to the lenders themselves and not the security trustee or security agent holding the mortgage on their behalf.

One possible construct is to use the "Sponsor Affiliate" definition which is already in the Loan Market Association standard form real estate finance facility agreements as a means to define which lenders (or other providers of finance) are related to the borrowers.

Adapting this as a basis, the following entities should (notwithstanding the new regime), at all times, be entitled to enforce any charge secured on any property whether or not it predates any non-compliance by the beneficial owners:

(a) any bank, insurance undertaking or financial institution (or a security trustee or security agent acting on their behalf);
(b) any wholly-owned subsidiary of a bank, insurance undertaking or financial institution (or a security trustee agent acting on their behalf); and
(c) any trustee for bondholders as part of a capital market arrangement (of a kind described in paragraph 1 of Schedule 2A to the Insolvency Act 1986) (each a "**Exempt Mortgagee**").

However, the following entities would not be automatically entitled to enforce a mortgage if a beneficial owner had not complied with the regime:

(a) any borrower (each a "**Borrower**") or issuer of securities (each a "**Issuer**") under the relevant financing arrangements secured by the relevant charge;
(b) any guarantor (each a "**Guarantor**") of a Borrowers' or Issuer's obligations under the relevant financing arrangements or related documentation secured by the relevant charge;
(c) any Borrower/Issuer Affiliate; and
(d) any security trustee or security agent (acting on behalf of the entities listed in paragraphs (a) to (c) above),

other than:

(i) where the benefit of the charge granted to a Borrower, Guarantor, Borrower/Issuer Affiliate is granted in favour of or charged or assigned by way of security to (A) any bank, insurance undertaking or financial institution (or a security trustee or security agent acting on their behalf) (B) any trustee for bondholders as part of a capital market arrangement or (C) any other person (or a security trustee or security agent acting on their behalf) which is not a Borrower, Guarantor or Borrower/Issuer Affiliate;
(ii) where the charge is in favour of an Exempt Mortgagee

Related definitions are set out below.

However, we are of the opinion that further detailed consultation is required on this (and any definition of Exempt Mortgagee) to cover the vast number of financing instruments and structures used to finance (and which are secured on) real estate in the UK market. In particular, we are of the view that where any member of the financing syndicate or any noteholder is a genuine third party that notwithstanding the existence of a "Borrower/Issuer Affiliate" within that syndicate or group of noteholders, the security trustee or security agent should be permitted to enforce the charge. Otherwise we remain concerned about the impact on secondary market trading as set out above.

In addition, where an entity is not automatically entitled to enforce its security, there needs to be a regime in which the mortgagee can challenge that restriction on enforcement. Further consideration should be given to common mitigating circumstances which may be taken into account in determining whether such consent would be given.

Where an entity is an Exempt Mortgagee, that exemption should apply to all methods of enforcement. Therefore, if the Exempt Mortgagee enforces its share security (as opposed to enforcing the mortgage and selling the Property) and appropriates the shares (or other ownership interest) of the property owning entity, the Exempt Mortgagee should also be exempt from complying with other aspects of the regime (including providing information about its beneficial ownership) to the extent that the relevant Exempt Mortgagee would otherwise be subject to the regime.

Finally, further consideration needs to be given to charges granted in circumstances other than typical financing arrangements. A good example would be charges granted by an entity in order to secure overage payments and whether any particular category of mortgagee benefiting from these types of arrangements should be exempt from any restrictions on enforcement of the mortgage arising from this regime.

Defined terms:

"**Borrower/Issuer Affiliate**" means each Borrower, Issuer or Guarantor, each of their Affiliates, any trust of which any Borrower, Issuer or Guarantor, or any of their Affiliates is a trustee, any partnership of which any Borrower, Issuer or Guarantor, or any of their Affiliates is a partner and any trust, fund or other entity which is managed by, or is under the control of, any Borrower, Issuer or Guarantor, or any of their Affiliates provided that any such trust, fund or other entity which has been established solely for the purpose of making, purchasing or investing in loans or debt securities and which is managed or controlled independently from all other trusts, funds or other entities managed or controlled by any Borrower, Issuer or Guarantor, or any of its Affiliates which have been established for the primary or main purpose of investing in the share capital of companies will not constitute a Borrower/Issuer Affiliate

"**Affiliate**" means, in relation to any person, a Subsidiary of that person or a Holding Company of that person or any other Subsidiary of that Holding Company.

"**Holding Company**" means, in relation to a person, any other person in respect of which it is a Subsidiary.

"**Subsidiary**" means [a subsidiary undertaking within the meaning of section 1162 of the Companies Act 2006]/[a subsidiary within the meaning of section 1159 of the Companies Act 2006]/[an entity of which a person has direct or indirect control or owns directly or indirectly more than 50 per cent. of the voting capital or similar right of ownership and **control** for this purpose means the power to direct the management and the policies of the entity whether through the ownership of voting capital, by contract or otherwise].

Any such exemption should also apply to:

- insolvency practitioners where the insolvent party is a registered proprietor (this may be an English insolvency practitioner but may also include a recognised foreign insolvency practitioners) (e.g. an administrator, liquidator or equivalent);

- LPA receivers or fixed charge receivers appointed by the lender; and

- administrative receivers.

It should be noted that in the main these insolvency appointees become quasi officers of the corporate entities and therefore they need to be exempted in order to enable them to sell or manage the property and realise value for creditors. The question posed above is relevant here for both lenders and the insolvency processes. In addition the new regime needs to cover what lenders and insolvency practitioners should do with surplus funds that otherwise would go to the shareholders (i.e. how this inter-relates with the money laundering legislation).

Question 27: We are interested in views and evidence of other commercial transactions that could be disrupted by the proposed restrictions regime.

There are a number of other commercial transactions that could be disrupted by the new regime. For example, in development transaction, it is not uncommon for a buyer to purchase a development site with deferred/conditional consideration. For example, a price may have been agreed for the site taking into account that it has the benefit of planning permission for 10 units. On the basis that there is potential to increase the number of units, the seller may have insisted that should the buyer successfully obtain planning permission for more than 15 units the buyer will pay an additional sum. The payment of this additional sum (often described as overage) is

secured by the seller taking a mortgage over the site. If the buyer fails to pay the overage, the seller can force the sale of the site by exercising its mortgagee powers of sale or appointing a receiver in order to secure payment. In this scenario, the seller is not a lender and, presumably, would not therefore benefit from the proposed lender exemption.

Please also see are comments to Question 28 regarding joint venture arrangements.

Question 28: Are there additional third party impacts that should also be addressed?

In response to Questions 27 and 28, we note that the government is *"keen to ensure that the new register does not prevent or interfere with any commercial arrangements that an entity may have entered into with a third party*" (para 117, page 42). We are concerned, however, that many such third party commercial arrangements may be prevented or interfered with. For example, we have set out below four relatively common scenarios. In these scenarios, we have considered the implication of the new regime:-

- Scenario A : for an existing commercial tenant with a right to a new lease with a term of more than 21 years;
- Scenario B : for an individual buying an off-plan lease of a flat;
- Scenario C : for a simple JV arrangement without debt; and
- Scenario D : for a simple JV arrangement with debt.

These scenarios are not exhaustive. We have focused on these four scenarios in order to focus on the most common types of transactions in the market.

For each of these scenarios, we have assumed that the new regime provides that third parties may apply to the court to lift the PSC restriction on the basis that it has a prejudicial effect. We have also stated for each scenario what would be the position if the landlord/landowner (as the case may be) was subject to the UK PSC regime. As a general comment we would point out that the proposals are far more severe for non-UK entities than UK companies and arguments around discrimination against such non-UK entities or preferring UK companies may be forthcoming.

In each of these scenarios, it is clear that third party rights will be severely prejudiced if the new regime does not provide for a cheap and speedy mechanism which can be used by such third parties to protect their interest by, for example, allowing affected tenants to register their new leases notwithstanding that their landlord has not complied with the new regime. Even assuming that such a mechanism is put in place, the need to make a court application will incur substantial costs and delays for these third parties.

In addition, as per our response to Question 14, it is unclear what will be the legal implications for the third parties. Should tenants pay their rent into court rather than to their defaulting landlord in order to avoid any suggestion that they may be involved in money laundering or proceeds of crime?

Moreover, if the relevant interest of the non-compliant owner is charged to a lender, will the payment of interest to the lender be deemed to be proceeds of crime?

As previously stated in our response to the 2016 consultation, we do not agree that existing non-UK entities, who are registered proprietors of land, should be required to comply with the new register. It is our view that this would have an unjustifiable negative impact on existing

shareholders and third parties (such as tenants, JV partners, etc.) as they would have limited ability to compel compliance as they will have completed their legal arrangements before any regulations came into force. Going forward, shareholders and third parties may be able to take into account the proposed regime when negotiating contracts so as to try and protect their position in the event that a majority/controlling shareholder or a party with 25% or more in the equity does not comply with the new regime.

If the new regime is to have retrospective effect, we would argue the new regime should provide that the PSC note will not apply to pre-existing third party arrangements so that, for example:-

- a third party buyer, who entered into a sale contract before the imposition of the regime, can register the transfer completed pursuant to the sale agreement;

- a tenant with an option for a lease, granted before the imposition of the regime, can register the lease; and

- a tenant with a pre-emption right to acquire its landlord's title entered into before the imposition of the regime can register the transfer,

notwithstanding in all such cases that the landowner/landlord has not complied with the new regime.

Scenario 1: Tenant option to renewal

Basic facts

(a) L is a non-UK entity and purchased a commercial property shortly before the new regime comes into force. L is registered at the Land Registry ("**LR**") as proprietor.

(b) T is a tenant of the whole property and operates a factory from the site. T's lease was granted for 25 years 23 years ago at a market rent.

(c) The new regime comes into force. A PSC note is place on L's title.

(d) T exercises its right to call for a new lease for another 25 years.

Consequence of the new regime

1. If T accepts the grant of the renewal lease, T will not be able to register this lease at the LR. If T fails to register the new lease, the lease operates only in equity. Whether or not the new lease is granted and/or registered at the LR, T will still be liable to pay rent to L.

2. T's inability to register the new lease will cause problems for T if T wants to assign (i.e. sell) the new lease in the future and/or raise finance for its business as buyer/lenders will expect the new lease to be registered. If the new lease is assigned before it is registered, there are complex issues as to who (between the new tenant and T) is responsible to pay L the rent.

3. T cannot force L to comply with the new regime as a court would not award T an order for specific performance against L but instead damages. Notwithstanding a damages award, T would still not be able to register its lease without applying to the court to disapply the PSC note.

4. If T does not complete the new lease for this reason but continues to pay rent etc, T may be required to pay SDLT on the basis that there has been substantial performance. If T does not pay the SDLT, it will be liable for penalties.

5. T's only option will therefore be to make an application to the court to lift the PSC restriction. This will incur substantial costs for T and will take time.

6. Even if the original lease was granted after the new regime came into force and contained a provision that the landlord must comply with the new regime, such a provision will be of little assistance for the tenant as the registration of the renewal lease will still be caught by the PSC note. As per para 3 above, the tenant will not be able to force the landlord to comply.

Position if L is a UK Company subject to UK PSC regime

L will issue a warning notice to the defaulting shareholder and, if that is not complied with, impose a restriction on its shares provided that the restriction will not have an unfair effect on third parties. L will also place a note of the restriction on the company register. Notwithstanding the share restriction, T will be entitled to register the new lease at the LR.

Scenario 2: Residential off-plan sale agreement

Basic facts

(a) A is a UK company developer and owns a property, which it is developing into 55 residential flats.

(b) B is an individual and enters into an off-plan agreement with A in 2019 to purchase a flat. The agreement provides that the sale will be effected by the grant of a 125 year lease. The flats are due to be completed in December 2020 but this date for completion is not guaranteed. B pays A's lawyers a deposit of 10% of the purchase price on exchange of the sale agreement. It is very common for off-plan sale agreements to provide that deposits are paid to the developer as deposits are often used to help fund the development works.

(c) A sells the site to C, a non-UK entity. In order to be registered at the LR, C completes the new PSC register. A PSC note is placed on C's title.

(d) B has a mortgage offer from a bank for a loan to purchase the flat. It is a term of the loan that B is registered as the proprietor of the flat lease and the mortgage is registered at the LR.

(e) The development of the flats is delayed and in the meantime C fails to update its PSC register.

(f) Eventually C serves notice on B that the sale (the grant of the long lease) is to be completed as the flat has now been built. Under the terms of the sale agreement, the sale must be completed within 10 working days of the notice. B's solicitors carry out a search at Companies House and discover that C has not updated its PSC register.

Consequence of the PSC note

1. The bank will not complete the loan because the mortgage cannot be registered because of the PSC note. Even where B is buying without a bank loan, B would not want to complete the sale and pay over the purchase price as B cannot register the lease.

2. The sale agreement will be silent on the effect of the PSC note as this was not in the contemplation of the parties at the time it was agreed as A is a UK entity. Depending on the terms of the sale agreement, B may have a right to terminate the agreement and recover its deposit from C. B will therefore have to take legal advice, which will be a cost not anticipated by B.

3. Assuming B has a right to terminate the sale agreement and wants to terminate the sale agreement, B will instruct its lawyer to do so and seek to recover the deposit. If C fails to repay the deposit, B will have to instigate court proceedings.

4. If B terminates the sale agreement, B will have incurred/be liable for the following costs even though B will have not acquired the property:-

    - legal costs for investigation title and negotiating the abortive sale agreement plus searches fees;

    - the bank's arrangement fee for the loan;

    - legal costs for advising on terminating the agreement; and

- legal and court costs to recover the deposit and B's abortive fees etc. if C fails to pay the deposit back.

5. It is likely that C will have entered into sale agreements with other buyers at the same time as B's agreement. It is also highly likely that these buyers will refuse to complete their sale agreements and, as a result, C will be in breach of any development funding agreement and may become insolvent as a result. If C becomes insolvent, B will be an unsecured creditor of D and may never recover the deposit, its abortive sale legal costs and enforcement costs etc.

6. If B wants to proceed with the purchase of the flat, B's only option is to make an application to the court to lift the PSC restriction. This will incur substantial costs for B and will take time. Depending on the terms of the sale agreement, C may be entitled to terminate the agreement due to this delay and may even be entitled to forfeit the deposit.

7. If B is in a "conveyancing chain", (i.e. B is selling a property (e.g. a house) at the same time as buying the new flat), B will have to choose whether to go ahead with the sale of the house even though B does not complete on the flat sale. If B fails to complete the house sale agreement, B will be liable to its buyer for their abortive costs and will have to return its buyer's deposit. B will also have to pay its abortive legal costs for the house sale.

Position if C is a UK Company subject to UK PSC regime

C will issue a warning notice to the defaulting shareholders and, if that is not complied with, impose a restriction on their shares provided that the restriction will not have an unfair effect on third parties. C will also place a note of the restriction on the company register. Notwithstanding the share restriction, B will be entitled to register the new lease. C will be entitled to the purchase price for the flat.

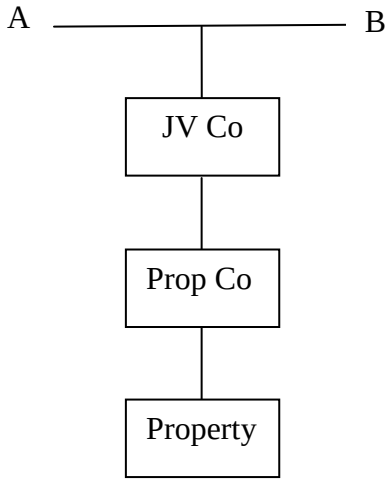
Scenario 3: Existing simple JV scenario without debt

This scenario is based on a very simplistic JV arrangement. Most JV structures are much more complicated. This scenario assumes that the JV is set up before the new regime comes into force and that the regime will have retrospective affect.

Basic facts

(a) A and B entered into a JV arrangement in early 2015 by incorporating a non-UK SPV company (JV Co) and entering into a shareholders' agreement. A and B hold the shares in the JV Co 50/50.

(b) A non-UK company (Prop Co) is incorporated by JV Co. Prop Co purchases in the summer of 2015 an empty property, with a view to refurbishing the property, letting it out and selling it on at a profit. The property is registered in the name of Prop Co. See diagram below.



(c) The new regime comes into force. A PSC note is registered against Prop Co's registered title at the LR. Prop Co cannot comply with the new regime as B's shareholders have refused to provide the necessary information.

Consequence of the PSC note

1. Prop Co cannot now raise finance on the property, let it or sell it. A and B cannot therefore implement the JV business plan. The shareholders' agreement will be silent on the effect of the new regime as this was not in the contemplation of the parties at the time it was agreed (e.g. it will not provide that B's shareholders' failure to provide the PSC information is a termination event). A will therefore not have a right to terminate the agreement unless A can argue that the shareholder's agreement is frustrated. This will incur legal costs and potentially involve court proceedings.

2. Even if A successfully argues that the agreement is frustrated, it will not be able to force the sale of the property unless A applies to the court to lift the PSC restriction. A will not want to force the sale of the property if it is empty, particularly, while it is being refurbished, as this will have a significant negative effect on value. If A wants to continue with the development, A will have to persuade B's shareholder to sell to A their shares. The PSC note will not prevent the sale of these shares.

3. If B's shareholders refuse to sell their shares and A wants to continue with the development, A's only option will be to apply to the court to disapply the PSC restriction to allow Prop Co to grant leases of the property and sell the property once it is finished. This will incur legal costs. It is unlikely that the court will agree to such an order as the refurbishment works, grant of the leases and eventual sale may take several years. A will therefore be in an impossible situation as A cannot force B to comply and it is unlikely the courts will lift the PSC restrictions, save on a case by case basis.

4. Even where A and B were aware of the new regime and provided for it in the JV agreement that failure to comply would trigger a right to buy the defaulting parties shares, such a provision would be of limited value to A, if A does not have the necessary funds to buy out B.

Position if Prop Co is a UK Company subject to UK PSC regime

Prop Co can take no action (i.e. cannot serve a warranty notice etc). It is arguable whether Prop Co can place a note of the share restriction on the company's share register. There is a conflict between the UK PSC Act and the statutory guidance in this regard. Even if there is a share restriction, Prop Co will be entitled to grant leases and sell the property.

Scenario 4: Existing simple JV scenario with debt

Basic facts

As per Scenario 3; however, Prop Co acquires the property and funds the development with a bank loan. The loan is equal to 60% of the purchase price and secured by a mortgage registered at the Land Registry (the "**LR**").

Consequence of the PSC restriction

1. Prop Co will be in breach of the loan agreement. The bank will be entitled to refuse to lend any more money towards the refurbishment works and to enforce its loan, sell the property and recover its break costs as the loan will have been repaid early. All sale costs will be deducted from the proceeds of the sale. On the basis that the bank is not connected with Prop Co, the bank will not be bound by the PSC note as it will benefit from the proposed lender exception.

2. Sales by banks are usually at a discount and may not be at the best time commercially. The bank has no duty or obligation to give Prop Co time to finish the refurbishment works and/or find tenants. The bank is only concerned with recovering the loan, its break cost and sale fees, etc. If the sale price is sufficient to pay the bank these sums, it is irrelevant to the bank that Prop Co will be financially prejudiced by the timing of the sale.

3. If the bank sells, it is not clear as to what is to happen with the balance of the sale proceeds (if any). Will the bank be required to pay the balance into court? Assuming that there are surplus funds and these are paid into court, will A be entitled apply to court to receive its share?

4. If A is successful in arguing that the shareholders' agreement is frustrated as per scenario 3, A will want to recover its costs and losses from B as a result of the early sale. Will A be entitled to be paid these costs from B's share of the sale proceeds, held by the court?

Position if Prop Co is a UK Company subject to UK PSC regime

Prop Co can take no action (i.e. cannot serve a warning notice). It is arguable whether Prop Co can place a note of the share restriction on the company's share register. There is a conflict between the UK PSC Act and the statutory guidance in this regard. Even if there is a share restriction, Prop Co will be entitled to grant leases and sell the property. The imposition of the share restriction may be a breach of Prop Co's loan agreement particularly if the bank has taken security over Prop Co's shares.