One more instalment in the AGA saga...

The Landlord & Tenant (Covenants) Act 1995 (the "Act") has had a lot of bad press. It is almost universally agreed to be a well-intentioned, but ultimately flawed piece of legislation which has spawned a cottage industry of litigation as parties struggle to understand how the Act applies to real world commercial transactions. Naomi Campbell explains:

The Act deals with a number of issues but, for the purposes of this article, there are some key principles to bear in mind:

- When a tenant (T1) assigns the whole of a lease it is automatically released from future liability under the lease, except where it agrees to guarantee the obligations of the incoming tenant (T2) under an authorised guarantee agreement (AGA);
- If T1 assigns the lease in breach of its obligations (for example, without the consent of the landlord if that is required) then T1 will not be automatically released from liability on assignment – this is known as an 'excluded assignment';
- If T1 had a guarantor (G1) then it is released from liability on assignment to the same extent as T1;
- The Act has a wide anti-avoidance provision which states that any agreement which seeks to "exclude, modify or otherwise frustrate" the operation of any provision of the Act is void (section 25 of the Act).

What's it for?

Prior to the Act, a tenant which assigned its lease would still be liable to the landlord for its assignee's breaches of the lease. This was a particular problem in the recessions of the 1980s and 1990s when tenants who had assigned a lease many years before were pursued by landlords for the current tenant's arrears. This situation was rightly perceived to be unfair and uncommercial, and the Act provided a way to limit the liability of both landlords and tenants on assignment of their respective interests.

What's wrong with the Act?

While the Act sets out broad principles about the circumstances in which parties will be released from their leasehold covenants on assignment, it does not deal with the particulars of some very common commercial transactions, particularly between group companies. As a consequence, the Courts have had to step into the shoes of legislators, and work out how the principles in the Act should apply in the real world. We have summarised below some of the key cases which have troubled the Courts over the last 6 years. These provide a backdrop and explanation to the most recent instalment in this ongoing saga.

What's the latest?

The High Court gave its judgment in *EMI Group Ltd v O & H Q1 Ltd [2016] EWHC 529 (Ch)* earlier this year. The question before the Court had been raised many years previously in the *K/S Victoria Street* case (see case summary below) when Neuberger J (now Lord Neuberger and appointed to the Supreme Court) commented that the operation of the anti-avoidance provisions in the Act appeared to mean that "the lease could not be assigned to the guarantor, even where both tenant and guarantor want it". Lord Neuberger's comment was obiter, because the Court was not being asked to decide this point in *K/S Victoria*, and it had been a much debated question whether his musings were correct or not.

The High Court has now considered the question directly: can a tenant assign a lease to its own guarantor, or does such an arrangement fall foul of the anti-avoidance provisions in the Act. The answer, according to the High Court, is that this arrangement is void under the Act.

The facts in summary were as follows:

- EMI was the guarantor (G1) of HMV (T1);
- HMV went into administration
- HMV sought consent from the landlord to assign the lease to EMI, which the landlord approved and the lease was assigned to EMI i.e. with the intention that EMI became T2.

The question before the Court was: what was the effect of this arrangement? EMI argued that the assignment from HMV should be treated as valid, but the covenants under the lease should not bind EMI. The landlord claimed that the assignment itself was void, with the effect that EMI and HMV as G1 and T1 remained bound by their original obligations.

The Court agreed with the landlord that the assignment from T1 to G1 was void, and that EMI and HMV remained liable for their respective obligations. This decision has created yet another headache for landlords, as it is quite common for a guarantor to be required to take an assignment of a lease from the defaulting tenant. Landlords will need to review their portfolios and consider whether any assignments could be questioned on this basis. Looking forwards, the safest option in these circumstances would of course have been for EMI (as G1) to take a new lease from the landlord, rather than an assignment.

An appeal of this decision is due to be heard by the Court of Appeal in May 2017. Watch this space...

Helen Wheddon
Partner & Head of Real Estate Disputes
+44 (0)1483 406951
helen.wheddon@stevens-bolton.com

Naomi Campbell
Associate
+44 (0)1483 406412
naomi.campbell@stevens-bolton.com

Question	Answer	Court / Case	Rationale
Can G1 be required to guarantee T2's obligations?	No	Court of Appeal *K/S Victoria Street v House of Fraser (Stores Management) Ltd and others [2011] EWCA Civ 904*	G1 must be released from its obligations to the same extent as T1. An obligation that G1 become guarantor for T2 (known as a 'repeat guarantee') seeks to frustrate this principle.
Can G1 guarantee T1's AGA obligations?	Probably	Court of Appeal *K/S Victoria Street v House of Fraser (Stores Management) Ltd and others [2011] EWCA Civ 904*	This is known as a sub-guarantee. Where the outgoing tenant (T1) enters into an AGA guaranteeing the obligations of the incoming tenant (T2), the Court suggested (on an obiter basis) that T1's guarantor may itself guarantee T1's obligations under the AGA, although it cannot guarantee T2's obligations direct.
If a lease contains a restriction on assignment which includes a condition that G1 must guarantee T2's obligations on assignment (i.e. a repeat guarantee), will the whole of the relevant clause be void?	Maybe (depending on the wording of the lease)	Court of Appeal *Tindall Cobham 1 Ltd and others v Adda Hotels (an unlimited company) and others [2014] EWCA Civ 1215*	The Court had to consider the wording of the particular lease. Where a clause in any contract is void for any reason, the Court must decide whether the whole of the relevant provision is void or whether the offending part can be severed from the contract so as to give commercial effect to the rest of the provision. In this case, the leases provided that the tenant could assign to an associated company with the landlord's consent. The landlord could not withhold consent provided that: a) The tenant gave notice to the landlord of the assignment (Proviso A); and b) The tenant procured that its guarantor would guarantee the incoming assignee (Proviso B). The tenant had assigned the leases to group companies without landlord consent. It argued that only Proviso B was void, with the effect that it could secure the landlord's consent by simply giving notice to the landlord. The landlord argued that the assignments had taken place in breach of the covenants of the lease, and were therefore excluded assignments. The Court held that both Proviso A and B were void, as they were interdependent and could not be severed. The effect was that the lease should be read as if it contained only a simple covenant against assignment without the landlord's consent. As the assignments had taken place without landlord's consent, they were excluded assignments under the Act.
If T1 assigns to T2 (without landlord's consent and in breach of the Act), can T2 re-assign to T1 and can G1 give a fresh guarantee of T1's obligations?	Yes	High Court *UK Leasing Brighton Ltd v Topland Neptune Ltd and Zinc Cobham Ltd v Adda Hotels (an unlimited company) [2015] EWHC 53 (Ch)*	T1's assignment to T2 was an excluded assignment, meaning that T1 (and consequently G1) was not released from its liability under the lease on assignment. The parties wished to regularise the situation by assigning the lease back to T1, with G1 giving a fresh guarantee. The Court was asked to decide whether an agreement in these terms would be void under the Act. The Court said that this arrangement would not fall foul of the anti-avoidance mechanism in the Act. The effect of an assignment from T2 back to T1 was therefore: • T1 would be released from its earlier obligations (which had not been automatically released on the previous excluded assignment); • G1 would be similarly released, to the same extent as T1; • T2 would also be released as the outgoing assignor; and • T1 would be bound by the covenants as the incoming assignee; and • G1 could give a fresh guarantee of T1's obligations.
Can a tenant assign the lease to its own guarantor? (subject to Court of Appeal decision)	No	High Court *EMI Group Ltd v O & H Q1 Ltd [2016] EWHC 529 (Ch)*	See main article – such an arrangement is void as it would frustrate the provision of the Act which states that G1 must be released from its obligations to the same extent as T1 on assignment of the lease.

Note: T1 is the original or outgoing tenant. T2 is the assignee, or the incoming tenant. G1 is T1's guarantor, and G2 is T2's guarantor.

www.stevens-bolton.com
Wey House, Farnham Road, Guildford, Surrey, GU1 4YD
Phone: +44 (0)1483 302264