Assigning a lease to a guarantor

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Jeremy Ferris looks at the question of assigning a lease to a guarantor under the lease

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I act for the landlord of an office premises in central London. A large corporation with several group companies occupies the premises as tenant, and their obligations are guaranteed by one of the group companies. The tenant company is in some financial difficulty and it has made a formal application to my client to assign the lease to that group company. My client is minded to consent to the assignment but has asked for advice.

It has been more than 20 years since the Landlord and Tenants Covenants Act 1995 (the Act) came into force, on 1 January 1996. For any lease that has been granted since that date, the Act has applied so that a tenant, and any guarantor of that tenant's interest, will be automatically released from liability as soon as the lease is assigned. The liability for both will then pass to the assignee.

The 'anti-avoidance' provisions are set out at section 25 of the Act. Essentially, that section renders void any agreement seeking to modify or frustrate the operation of the Act.

Over the last two decades, both the House of Lords and the Court of Appeal have grappled with the balance between the commercial needs and practice of tenant companies and the provisions of the Act ? in particular, the provisions concerning anti-avoidance.

Until recently, there has been some uncertainty as to the effect of the oft-adopted practice of assignment of a lease to a guarantor under the lease. That guarantor is often a group company and assignment has historically been used as a commercially beneficial and convenient mechanism to spread risk and liability between organisations in a larger group.

The recent case of EMI Group Ltd v O&H Q1 Ltd [2016] EWHC 529 (Ch) has given clarification regarding the legality of such arrangements. Briefly, the facts were that HMV Retail occupied a shop in Worcester under a lease created after 1 January 1996; the lease was therefore a 'new' lease, to which the Act applied. EMI guaranteed HMV?s liabilities, and when HMV went into administration in 2013, an application was made to the landlord to assign the lease to EMI. The landlord granted consent and the licence to assign was completed in November 2014, providing for EMI to honour HMV's covenants in the usual way.

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A few months after completion of the assignment, EMI sought a declaration from the court that, although the assignment itself was valid, the tenant's covenants in the lease could not be enforced against EMI. The landlord counterclaimed by seeking a declaration that either the lease was vested in EMI and the covenants in the lease were enforceable, or the assignment itself was void so that the lease remained vested in HMV, with EMI still bound as original guarantor.

In reaching its decision, the High Court made clear that the whole purpose of the Act was to prevent the resumption of liabilities on either a tenant or a guarantor. The court therefore held that in spite of the agreement between the parties, HMV could not validly assign its lease to EMI. Any agreement that sought to implement such an arrangement was void. The original lease thus remained vested in HMV, with EMI remaining as guarantor under the terms of its guarantee.

The court was therefore prepared to take an holistic approach as to the terms of the Act. It was quite prepared to enforce the anti-avoidance provision that otherwise would have diluted the whole purpose of the Act.

Implications

Although providing valuable clarification, the decision has not been universally welcomed, particularly by businesses that have been in the habit of assigning leases between group companies. The presiding judge, however, commented that in spite of that, "the fact that such a conclusion is unattractively limiting and commercially unrealistic is neither here nor there".

Alarm bells have therefore been set ringing. Landlords must be aware that there is a risk that any existing lease that has been assigned is potentially unenforceable. That is so even in cases where the assignment was given voluntarily or was an intra-group assignment.

Considering all of this in relation to the current case and the application to assign, it will almost certainly be reasonable for your client to refuse consent; and as ever, the reasons for the refusal for consent should be given in writing.

As to alternatives, your client might for example call on the guarantor to take a new lease of the premises. That would not fall foul of the Act because it is not an assignment. There would however be stamp duty land tax to pay, and therefore perhaps a natural reluctance to proceed in that way.

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Further information

- The Property Litigation Association has sent a proposal to the government regarding a change in the relevant law.
- This feature was taken from the RICS *Property journal* (September/October 2016).