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## Fools, pens and a guaranteed mess

**Joss Knight, Barrister**  
**St John's Chambers**

### Common Law Position



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- Common Law: Tenant (T1) remained bound by the covenants of a lease after assignment for the duration of tenancy.
- By extension, a guarantor was also bound -
- Cheverell Estates Ltd v Harris [1998] 1 E.G.L.R 27
- Who'd be a guarantor?
- *"A guarantor is a fool with a pen in his hand."*

## Landlord & Tenant (Covenants) Act 1995



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- Long Title: "To make provision for persons bound by covenants of a tenancy to be released from such covenants on the assignment of the tenancy, and to make other provision with respect to rights and liabilities arising under such covenants."
- *"the mischief at which the [Law] Commission's recommendations were aimed was the continuation of a liability long after the parties had parted with the interests in the property to which it related."*

London Diocesan Fund Ltd v CGU Life Assurance [2005] 81 P & CR 393, para 39

## Landlord & Tenant (Covenants) Act 1995



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### ➤ Tenants – Section 5

#### **Tenant released from covenants on assignment of tenancy**

- (1) This section applies where a tenant assigns premises demised to him under a tenancy.
- (2) If the tenant assigns the whole of the premises demised to him, he—
  - (a) is released from the tenant covenants of the tenancy, and
  - (b) ceases to be entitled to the benefit of the landlord covenants of the tenancy,
 as from the assignment.

## Landlord & Tenant (Covenants) Act 1995



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### Guarantors – Section 24

(2) Where—

(a) by virtue of this Act a tenant is released from a tenant covenant of a tenancy, and

(b) immediately before the release another person is bound by a covenant of the tenancy imposing any liability or penalty in the event of a failure to comply with that tenant covenant

then, as from the release of the tenant, that other person is released from the covenant mentioned in paragraph (b) to the same extent as the tenant is released from that tenant covenant.

## Landlord & Tenant (Covenants) Act 1995



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### Section 25 – Agreement void if restricts operation of the Act

(1) Any agreement relating to a tenancy is void to the extent that—

(a) it would apart from this section have effect to exclude, modify or otherwise frustrate the operation of any provision of this Act

- (4) This section applies to an agreement relating to a tenancy whether or not the agreement is—
  - (a) contained in the instrument creating the tenancy; or
  - (b) made before the creation of the tenancy.

## Landlord & Tenant (Covenants) Act 1995



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- Less foolish? – Tenant and Guarantor friendly.
- Clause in tenancy agreement stating T1 liable for breaches by T2, T3, T4 etc void.
- Guarantor agreement stating G guarantees the liabilities of T1's successors also void.

## K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors [2011] EWCA Civ 904



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- "Management" a subsidiary of House of Fraser Ltd (HoF Ltd).
- Received title to Property from James Beattie Ltd ("Beattie") another subsidiary.
- Sale and Leaseback agreement:
  - Price: £46m.
  - Term of lease: 35 years at £2.25m per year.
  - HoF Ltd acting as guarantor.

**K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors [2011] EWCA Civ 904**



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➤ **Clause 3.5**

- i) Management would assign the lease to an assignee who was a Group Company of HoF of equal or greater covenant strength to Beatties.
- ii) If Management had not chosen by 20 April 2006, the assignee would be House of Fraser Stores Ltd ("Stores"), who agree to take the assignment by 26 April.
- iii) HoF Ltd would enter into a deed of guarantee of the assignee's liabilities as surety as set out in the Schedule.

**K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors [2011] EWCA Civ 904**



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➤ **Defendants' Argument**

- On assignment, by virtue of s.5, T1's obligations under tenancy extinguished.

5(2) If the tenant assigns the whole of the premises demised to him, he—

- (a) is released from the tenant covenants of the tenancy.

Therefore s.24(2)(a) is met.

**K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors [2011] EWCA Civ 904**



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➤ **Defendants' Argument**

- HoF Ltd "another person" for purposes of s.24(2)(b)
- (2) Where—
  - (a) by virtue of this Act a tenant is released from a tenant covenant of a tenancy, and
  - (b) immediately before the release another person is bound by a covenant of the tenancy imposing any liability or penalty in the event of a failure to comply with that tenant covenant.
- Result: Guarantor also released.
- S.25(1) – the Clause 3.5 cannot overrule section 24.

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➤ **Claimant's Argument**

- Doesn't frustrate the Act as that was not the intention of cl.3.5.
- Cl.3.5 a mechanism to help the HoF Group, not to extend the liability of the T1 and G.
- Landlord agreed as a favour.

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- **Decision**
- High Court upheld – S.25 is concerned with the objective effect of the agreement – does it in fact frustrate the operation of a provision of the Act?
- Not about subjective intention.

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- **[23]** “Given the plain purpose of the 1995 Act, and the widely expressed terms of s 25(1)(a) and 25(4), any contractual arrangement contained in the tenancy (or in a prior agreement), which imposes an obligation, on an existing or prospective guarantor of the tenant's liabilities, to guarantee the liabilities of a future assignee should be void. That conclusion is supported by what was said in *Avonridge* [2005] 1 WLR 3956, paras 14 and 18, by Lord Nicholls of Birkenhead. He described s 25 as “a comprehensive anti-avoidance provision”, which was “to be interpreted generously, so as to ensure that the operation of the 1995 Act is not frustrated, either directly or indirectly”.

**K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors [2011] EWCA Civ 904**



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- This applies to an provisions within the tenancy agreement or a prior agreement (s.25(4)).
- Also applies to contractual arrangement in a later agreement such as a licence to assign [Para 24]

**K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors [2011] EWCA Civ 904**



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**[25]** “When it comes to frustrating the effect of s 24(2), cl 3.5(iii) is *a fortiori* the example of a guarantor of the original tenant entering into a renewal obligation. That is because cl 3.5(iii) is not merely an undertaking by a guarantor of the liability of the original tenant, namely Management, to guarantee the liability of a future assignee, namely Stores: it is an undertaking to do so in relation to an assignment which Victoria, the landlord is entitled to insist on taking place.”



**K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors [2011] EWCA Civ 904**



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- **Outcome:**
- Clause 3.5(iii) was therefore invalid. K/S could not enforce it so as to make HoF Ltd guarantor of T2 – (Stores).
- However, 3.5(iii) was severable, so 3.5(ii) remained. K/S could in principle enforce assignment though could not demand a guarantor.

**K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors [2011] EWCA Civ 904**



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- **Lord Neuberger MR on a Roll...**
- Good Harvest Partnership LLP v Centaur Services Ltd [2010] EWHC 330. Newey J
- Is a guarantor barred from guaranteeing obligations of T2 in any circumstances?

**Good Harvest Partnership LLP v Centaur Services Ltd [2010] EWHC 330.**



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- Landlord: Good Harvest
- Tenant: Chiron
- Guarantor: Centaur
- Intended T2: Total
  
- Tenancy Agreement:
  - i) The tenancy can be assigned with L's consent (not to be unreasonably withheld);
  - ii) A guarantor would be provided for T2, to be approved by L (consent not to be unreasonably withheld).

**Good Harvest Partnership LLP v Centaur Services Ltd [2010] EWHC 330.**



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- Tenancy assigned to Total (T2). Chiron (T1) and Centaur acting as guarantors.
  
- Centaur denied liability on basis they could not be guarantors for T2 under any circumstances.
  
- Newey J agreed - s.25(1) "*serves to bar a guarantor from giving a guarantee for an assignee.*"

### Good Harvest Partnership LLP v Centaur Services Ltd [2010] EWHC 330.



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- Goes beyond conclusion in K/S Victoria
- *“an agreement which requires a guarantor to provide a further guarantee in the future falls foul of section 25(1), because it involves a guarantor, at a time that he is, or is agreeing to become, the tenant’s guarantor, committing himself to re-assume his liabilities on a future assignment, when the plain purpose of s.24(2) is to ensure that he is release from his liabilities with affect from the assignment.” K/S Victoria, para 34*

### K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors Part II



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- **Two alternatives:**
- Interpretation 1:
- S.25(1) means any agreement which involves G of T1 guaranteeing T1’s assignee (T2) is invalid.
- Interpretation 2:
- S.25(1) only invalidates an agreement requiring G to guarantee T2 if it was entered into at landlord’s insistence.

## K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors Part II



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### Interpretation 1

- Immediately unattractive. Far from helping tenants and guarantors, it acts as bar to potential solutions for tenants who are struggling to meet their obligations.
- Particular problem where lease held by subsidiary in a Group, or where T1 & T2 have the same bank.
- *"section 4 was 'intended to benefit tenants...that is its purpose. That is how [it is] meant to operate. So, too, section 24(2) is meant to benefit guarantors. It can therefore be argued that, where the assignor and the guarantor want the guarantor to guarantee an assignee...such an assignment would not frustrate the operation of the any provision of the 1995 Act."* [37]

## K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors Part II



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- *" Interpretation 1 would therefore appear to give the 1995 Act an unattractively limiting and commercially unrealistic effect."* [36]
- Does give certainty. No debate as to whether G and T1 were obliged by L to give a guarantee to T2 or whether it was freely offered.

## K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors Part II



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### Interpretation 2

- More attractive. Consistent with s.25 being an anti-avoidance provision and designed to protect G and T1, not restrict their options.
- However, s.25(1) does not allow for subjective flexibility:
  - “An agreement is void, to the extent that – it would apart from this section have effect to exclude, modify or otherwise frustrate the operation of a provision of this Act.”
- Difficult to differentiate between free offer and requirement from the Landlord.

## K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors Part II



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- Court of Appeal went for Interpretation 1. G can never act as a guarantor for T2.
- Clear and simple position, even if it is “unattractively limiting” and “commercially unrealistic.”
- A long way from the original intention?

*“intended to benefit tenants...That is [its] purpose. That is how [it is] meant to operate.”* London Diocesan v Avonridge

## K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors Part II



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### Ameliorating the Impact

*"Cause I guarantee you've never seen a show like this before.  
Gonna show you something you can't ignore..."*

- Lord Neuberger MR believed he could solve the problem using "GAGAs"



## K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors Part II



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### Section 16 1995 Act – Authorised Guarantee Agreements

- Allows the Landlord to require, as a condition of the assignment, that the T1 guarantees T2's obligations.
- Cannot extend beyond the first assignment. – AGA cannot be used so that T1 is liable for the obligations of T3 etc.
- S.24(2)– other party released to same extent as the tenant is released from the tenant covenant.
- GAGA – Agreement to guarantee T1's AGA.

## K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors Part II



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### Summary of K/S Victoria

- Good Harvest was correct – G can never guarantee T2.
- This is unattractive and commercially unrealistic, but nevertheless the law.
- This can be ameliorated by the use of AGA and GAGAs.
- It did not matter whether clause for AGA and GAGA was in the original lease agreement or a stipulation in the context of “authority not unreasonably withheld.”
- If T1 assigns and T1 and G are therefore released in the normal way, there is nothing to stop them guaranteeing on a subsequent assignment.

## K/S Victoria Street v House of Fraser (Stores Management) Ltd & Ors Part II



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### New Hare?

“As Newey J accepted, interpretation (i) would mean that, even where it suited the assignor, the assignee and the guarantor that the assignee should have the same guarantor as the assignor (because, for instance, the assignor and the assignee had the same parent company, or shared a common bank, which was the guarantor), they could not offer that guarantor. **It would also appear to mean that the lease could not be assigned to the guarantor, even where both tenant and guarantor wanted it.**”

UK Leasing Brighton Ltd and others v Topland Neptune Ltd and another [2015] EWHC 53 (Ch)



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- T1 assigned tenancy in breach of the tenancy agreement. - Excluded Agreement so T1 and G not released from their liabilities.
- How to restore the situation?
- Section 25(1) not engaged if tenancy is assigned back to T1 from T2.
- *"On my analysis of the position of T1, when the lease is assigned by T2 to T1, T1 is released from its original obligations by reason of section 11(2)(b) but becomes bound by the tenant covenants under section 3(2)(a). If G is released from its original obligations under its original guarantee but enters into a fresh guarantee in relation to the tenant covenants, then G is released to the same extent as T1 is released. Section 24(2) takes effect in accordance with its terms and is not frustrated for the purposes of section 25."* [32]

UK Leasing Brighton Ltd and others v Topland Neptune Ltd and another [2015] EWHC 53 (Ch)



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- Alternative arrangement? – Assign to G, who can assign the tenancy back to T1.
- What about comments of Lord Neuberger MR?
- "obiter and somewhat tentative."



## EMI Group Ltd v O & H 1 Ltd [2016] EWHC 529 (Ch)



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- Judge Amanda Tipples QC
- HMV UK Ltd took a 25 year lease, guaranteed by EMI.
- HMV changed name to Record Shop 1 Ltd, soon after went into administration.
- Licence granted to assign the lease to EMI (the guarantors). This went through, and EMI granted an underlease to a subsidiary.
- EMI claimed the lease vested in them, but that the tenant covenants were void following dicta in K/S Victoria and therefore unenforceable.
- Landlord disagreed: the assignment does not contravene s.24. Alternatively, if it does the whole lease is void, the tenancy remains with RS1 Ltd and EMI are still guarantors.

## EMI Group Ltd v O & H 1 Ltd [2016] EWHC 529 (Ch)



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### **Can T1 assign tenancy to its guarantor?**

- EMI say no – there is no distinction between liabilities of T and the liabilities of G.
- If G cannot guarantee the assignee's (T2) liabilities, it cannot assume them either.
- Under s.24, G must be released to the same extent as T1, therefore on assignment he must be released, not re-instated as tenant, to do otherwise would be to frustrate the purpose of the Act.

## EMI Group Ltd v O & H 1 Ltd [2016] EWHC 529 (Ch)



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- “Landlord & Tenant (Covenants) Act 1995: 20 years on”- Morgan J.
- s.3(2) – “Where the assignment is by the tenant under the tenancy, then as from the assignment, the assignee -
  - (a) becomes bound by the tenants covenants of the tenancy...”
- Act operates in two different ways s.24 shows how G is released from the earlier guarantee, s.3(2) operates to impose the burden of the tenant covenants on G as assignee.
- This argument was adopted by the Landlord.

## EMI Group Ltd v O & H 1 Ltd [2016] EWHC 529 (Ch)



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- “What this argument misses is that the reason the assignment to G makes G liable on the tenant covenants is that section 3(2)(a) so provides. So the Act operates in two different ways. On the assignment, section 24(2) operates to release G from its earlier guarantee and section 3(2)(a) operates to impose the burden of the tenant covenants on G as assignee. So the Act operates in two consecutive ways.
- “Why should it not operate to the full in both of these ways? The operation on one way does not frustrate the operation of the Act in the other way...There is no conceivable policy reason not to give effect to this logic.”

## EMI Group Ltd v O & H 1 Ltd [2016] EWHC 529 (Ch)



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- Miss Amanda Tipples QC examined the law Commission's report which led to the 1995, which stated:
  - *"Whenever the liability of a tenant would be wholly cancelled under our recommendations, we recommend that liabilities which had been undertaken in parallel and are essentially to the same effect would also be terminated."*
- Agreed with EMI Ltd and Lord Neuberger's obiter – liabilities are essentially the same. G must be released.
- Rejected Morgan J's analysis – 3(2) a tidying up provision, wrong to say there is a sequential release and assumption of liability, it is instantaneous and therefore a retention of liability.

## EMI Group Ltd v O & H 1 Ltd [2016] EWHC 529 (Ch)



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### What is the effect?

EMI's submission – the tenant covenants are void as against G, but the lease subsists and vest in EMI (G).

*"The contractual obligations which touch and concern the land having become imprinted on the estate, the tenancy is capable of existence as a species of property independently of the contract."*

London Corporation v Fell [1994] 1 Act 458 at 465D-E.

Rejected by Amanda Tipples QC as nonsensical.

## EMI Group Ltd v O & H 1 Ltd [2016] EWHC 529 (Ch)



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### What is the effect?

*"To my mind, Mr Seidler's submissions as to what happens to the Lease on an assignment do not make any sense at all...it is not a tenancy as we would ordinarily know it, but an arrangement which is unbalanced as well as "emasculated and unworkable" (per Patten LJ in Tindall Cobham 1 Ltd).*

*"It seems to me that the obvious consequence of s.25(1)(a) in the present circumstances is that the assignment is void....and the consequence of this is that the assignment will not take effect to vest the Lease in the Claimant, as an assignee." [88-89]*

## EMI Group Ltd v O & H 1 Ltd [2016] EWHC 529 (Ch)



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### Impact

- 1) Guarantors cannot guarantee liabilities of assignee:
  - Good for guarantors? Bad for landlords?
  - Particularly bad for Group companies as it restricts their ability to shift a lease around the company.
  
- 2) Guarantors cannot take assignment of lease:
  - Bad for Tenants, particularly bad for Guarantors, who remain liable for the tenant covenants but are unable to take over the lease and derive some benefit. Bad for landlords.

## EMI Group Ltd v O & H 1 Ltd [2016] EWHC 529 (Ch)



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*“the fact such a conclusion is unattractively limiting and commercially unrealistic is neither here nor there.” [86]*

- Reform?

## Conclusions



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### Issues to Consider: T & G

- Group company – which company takes the lease?
- If do want the flexibility, can another member offer a guarantee?
- Do you trust your principal?
- Are there likely to be potential assignees willing to take on the lease?
- Be prepared to AGAs and GAGAs.

## Conclusions



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### **The Court's approach to offending clauses**

"A balanced approach to invalidation which, whilst neutralising the offending parts of the contract, does not leave it emasculated and unworkable."

The court will look at "the structure of the agreement in an objective and common sense way."

Tindall Cobham 1 Ltd v Adda Hotels [2015] 1 P&CR 5