



Good Harvest Bad for landlords, bad for tenants

Almost 15 years after the Landlord & Tenant (Covenants) Act 1995 (**1995 Act**) was enacted, the High Court in *Good Harvest Partnership LLP v Centaur Services Limited [2010]* have finally decided that the 1995 Act prevents a guarantor of a tenant's obligations from being required to give a further direct guarantee in respect of an assignee of the lease.

Facts

- A 10 year underlease was granted to Chiron CS Limited (**Chiron**) in 2001. Chiron's obligations were guaranteed by Centaur Services Limited (**Centaur**).
- The underlease allowed Chiron to assign subject to a proviso that the undertenant and any guarantor entered into an authorised guarantee agreement (**AGA**).
- Chiron assigned the underlease to Total Home Entertainment Distribution Limited (**THED**) in 2004. At the same time an AGA was entered into under which both Chiron and Centaur directly covenanted with the landlord that the assignee (THED) would pay the rent and otherwise perform the tenant covenants.
- THED failed to pay two quarterly instalments of the annual rent of £245,000. The landlord claimed the money due from Centaur.
- Centaur argued that its guarantee of THED was void and unenforceable by reason of section 25 of the 1995 Act.

Decision

Can a tenant's guarantor be obliged to give a direct covenant to the landlord guaranteeing the assignee's obligations?

No. Newey J concluded that Centaur's direct guarantee of the assignee's obligations was rendered void for the following reasons:

- The 1995 Act provides for tenants and guarantors to be released from their obligations when the lease is assigned (sections 5 and 24 of the 1995 Act), subject only to section 16 of the 1995 Act. That section states that **the tenant** may guarantee the assignee's performance; it makes no provision for the tenant's guarantor to guarantee the assignee's performance.
- If a tenant's guarantor could be required to give a guarantee for an assignee of the tenant, its exposure could be unlimited since there is nothing in the Act to limit the guarantor's exposure to the period before that first assignee himself assigns.
- Section 25 of the 1995 Act expressly states that, to the extent that any agreement attempts to exclude, modify or frustrate the operation of the 1995 Act, it will be void. Applying *Avonridge Property Co Ltd v Mashru [2005]*, the section must be interpreted generously to ensure the operation of the 1995 Act is not directly or indirectly frustrated.
- Newey J commented "If the guarantor is required to enter into a further guarantee when the lease is assigned, it seems to me that the guarantee can...be said to frustrate the operation of any provision of the Act...in that it would, if valid impose on the guarantor obligations equivalent to those from which section 24 was designed to secure his release".

Can a tenant's guarantor voluntarily give a guarantee for the assignee?

The position is uncertain. Newey J commented that Parliament intended a tenant to be able to give no guarantee other than an AGA. As the 1995 Act precludes tenants from giving guarantees for assignees, the Judge stated "it is difficult to see why guarantors should not likewise be barred from giving such guarantees; had Parliament intended a tenant's guarantor to be able to guarantee obligations of an assignee, it could have been expected to say so explicitly particularly given that guarantors are mentioned expressly in the Act more than once".

Is a guarantee of the outgoing tenant's obligations under an AGA (a 'sub-guarantee') void?

Again the position is unclear. The Judge expressed doubts over the enforceability of a guarantor's 'sub-guarantee' of an outgoing tenant's AGA obligations (as opposed to a direct guarantee of the assignee's obligations) but did not decide the point. Further case law will be required to put the issue beyond doubt.

If an AGA contains a direct covenant from the tenant's guarantor, does this affect the guarantee given by the outgoing tenant?

No, the decision does not affect guarantees provided by outgoing tenants in an AGA that complies with the provisions of section 16 of the 1995 Act.

Implications

- Landlords can no longer rely on the guarantees given by former tenant's guarantor following an assignment of the lease. Accordingly, if the landlord receives an application for consent to assign, they are likely to ask for a direct guarantee for the potential assignee from a party other than the current tenant's guarantor.
- On the grant of a lease landlords will be more reluctant to grant leases to lesser group companies. They will be seriously considering whether an entity which previously would have acted as a guarantor should take the lease in its own name so that any guarantee of its successor's obligations will work.
- Tenants/assignees will find that landlords look more carefully at the covenant strength of the proposed assignee on its own rather than the combined assignee, tenant and guarantor package.
- Tenants/assignees, may need to offer additional security to satisfy a landlord that the tenant's covenant is not diluted by the loss of the tenant's guarantor on assignment.
- Covenants prohibiting inter-group assignments are likely to return in new leases. As the decision stands, on assignment to another group company, the parent company guarantor will not be permitted to stand again as guarantor for the new group company assignee.
- Until there is a case directly concerned with the guarantor's 'sub-guarantee' of the outgoing tenant's obligations in its AGA, leases should continue to contain such clauses.

What next?

At the time of going to press we are not aware of any appeal but, given the far reaching implications of the decision, an appeal cannot be ruled out.

Tarnya Mason is a Real Estate Professional Support Lawyer at Clyde & Co LLP

Further information

If you would like further information please contact:

Robert Pilcher
robert.pilcher@clydeco.com

Martin Quicke
martin.quicke@clydeco.com

Graeme Taylor
graeme.taylor@clydeco.com

Adam Taylor-Smith
adam.taylor-smith@clydeco.com

David Wyatt
david.wyatt@clydeco.com

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