

PRUDENTIAL ASSURANCE-V-AYRES (3 April 2007)

-GUARANTORS ESCAPE LIABILITY.

The Message: Guarantors can sometimes enjoy a lucky escape from their liabilities by benefiting from agreements they are not even a party to.

The Case: The High Court has held that the Guarantors of a Lease have no liability for substantial rent arrears as a result of the wording used in a separate agreement between the Landlord and the Tenant (Prudential Assurance Company Limited –v- Ayres and Grew (3/4/2007)).

The Prudential is the leasehold owner of Hasilwood House in Bishopsgate, London. In 1997, it granted an Underlease until 2006 of 2 floors in the building to the Defendants. In 2001, the Underlease was transferred to Altheimer & Gray ("A & G"), an American law firm. By that time, the rent was almost £400,000 per annum and the obligations of A & G under the Underlease were guaranteed by the Defendants.

In 2003, A & G went into insolvency in the USA and Prudential then sought to hold the Defendants liable for all sums due under the Underlease. By the time of the trial, the amount outstanding exceeded £1.5 million. Presumably, Prudential has been unable to make any recovery from the assets of A & G.

The Defendants claimed they had no liability because of the terms of a Supplemental Deed dated 21 June 2001 that Prudential had entered into with A & G. Under this Deed, Prudential agreed that, rather than pursuing the partners of A & G personally for any sums due under the Underlease, it would only seek recovery from the partnership assets. The Deed then went on to provide as follows:-

"Consequently any recovery by the Landlord against the Tenant *or any previous tenant* under the Lease for any default shall be limited to assets of the Partnership".

The Defendants argued that the inclusion of the words "or any previous tenant" meant that they also benefited from the agreed limitation as they were the only previous tenant and that, as a result, they could not be held liable for any liability that exceeded the available assets of A & G.

Prudential argued that it made no commercial sense whatsoever for the Defendants to have no greater liability than the tenant's partnership assets as the Defendants could then not be held liable for any sums that were irrecoverable from A & G. They argued that the reference in the Deed to the previous tenant should be ignored entirely as its inclusion was inconsistent with other parts of the Deed.

The Judge held that he could not ignore the actual wording that had been used. In fact, he held that it made good commercial sense to also release the Defendants as, otherwise, Prudential could recover all arrears by the back door by simply claiming against the Defendants who, in turn, could then seek an indemnity from the individual partners of A & G.

The Judge said it was not for the Court to explore the motives as to why Prudential may have agreed to limit its right of recoverability against both A & G and the Defendants. He said, however, it may have been because the thought of a large American law firm becoming insolvent was so unlikely. He said that the giving of the plain meaning to the words used did not result in a

construction so absurd that a different construction had to be sought. He held that the Guarantee would not be rendered entirely worthless as, where there were sufficient partnership assets to meet the rent, it would allow Prudential to pursue the Defendants first for the rent rather than having to possibly pursue A & G in the USA.

In a final attempt to hold the Defendants liable, Prudential argued the Defendants were not entitled to benefit from the Supplemental Deed as they were not a party to it. However, the Judge held that the Contracts (Rights of Third Parties) Act 1989 applied as the Deed conferred a benefit on any previous tenant and the Defendants could, accordingly, enforce the terms of the Deed.