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CHAMBERS

CONSENT TO CARRY OUT ALTERATIONS CONSENT TO ASSIGN AND SUB LET

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CONSENT TO CARRY OUT ALTERATIONS CONSENT TO ASSIGN AND SUB LET

Introduction

This is an exploration into when a landlord is entitled to refuse consent to alter or improve a property and also when the landlord is entitled to refuse consent to sub let or assign. They are both problems that are of central importance to anyone acting for either a landlord or tenant.

The issue of whether the landlord is prepared to grant consent in such matters can often lead to a dispute and so it is beneficial to have a sound grasp as to the basic principles involved when advising and especially in determining whether it is advisable to commence a claim in court.

ALTERATIONS

It is possible for a landlord to impose an absolute covenant, for example prohibiting all alterations under any circumstances. It is also possible to find qualified covenants where for example alterations are prohibited unless the landlord consents to them.

I want to focus upon the very common covenant where the landlord's consent to alteration is not to be unreasonably withheld. By virtue of section 19(2) of the Landlord and Tenant Act 1927 such a proviso is to be read into all covenants against making improvements.

Section 19(2) Landlord and Tenant Act 1927

Section 19(2) prohibits the landlord, in the case of improvements, from unreasonably withholding consent but it does permit the landlord to require as a condition of granting a licence or consent the payment of a reasonable sum in respect of the diminution in the value of the premises or any neighbouring premises belonging to the landlord.

This section does not apply where the covenant amounts to an absolute bar on improvements. It only applies where it is in the form of – "tenant shall not make improvements without the landlord's licence or consent".

An alteration or addition to premises is an "improvement" within the meaning of the subsection when such alteration or addition is an improvement to the demised premises from the point of view of the tenant. Examples of improvements from the point of view of the tenant have been:

- installing a new shop front and altering a staircase;
- converting roof space into habitable accommodation; and
- merging demised premises into a larger composite building.

Reasonableness

The courts have spent considerable time looking at the question of reasonableness in refusing consent to carry out alterations. In this paper I focus on some of the cases of the past few years in order to identify the way the courts have treated this issue.

Iqbal

This question was revisited by the Court of Appeal in the case of *Iqbal v Thraker* [2004] EWCA Civ 592, [2004] 36 EG 122. The landlord owned a property in Folkestone and the tenant purchased a long lease and wanted to convert the ground floor unit into an Indian restaurant. The landlord was developing the upper part of the property into what it described as ten luxury flats.

The tenant's architect wrote to the landlord requesting consent for the conversion into an Indian restaurant. The architect also informed the landlord that planning permission and building regulation approval had been obtained. The landlord opposed the conversion.

The lease contained the clause:

"Not to make any structural alterations or additions to the demised premises either internally or externally without the approval in writing of the landlord (such approval not to be unreasonably withheld) to the plans and specifications".

The tenants applied for approval of the structural alterations and additions as shown on their plans. They proposed to install a new narrow window and a new door. Internal partitioning and a brick pier were to be removed.

The landlord took a hostile approach and was particularly concerned about the structure of the building and the effect it would have on the residential units. The tenants sought a declaration from the court that consent had been unreasonably withheld. The Recorder in the County Court held that consent had been unreasonably withheld.

The landlord appealed to the Court of Appeal. Peter Gibson LJ applied with some amendment the guidelines that had been set out in the case of

International Drilling Fluids Ltd v Louisville Investments (Uxbridge) Ltd [1986] Ch 513. In fact he set out 8 guidelines:

- 1 The purpose of the covenant is to protect the landlord from the tenant carrying out alterations and additions that could damage the landlord's property interests;
- 2 A landlord cannot refuse consent on grounds that are unrelated to property interests;
- 3 It is for the tenant to show that the landlord has unreasonably withheld consent. The tenant has to make sufficiently clear what its proposals are in order to let the landlord make an informed decision;
- 4 It is not necessary for the landlord to prove that the conclusions that led it to refuse consent were justified if they were conclusions that might have been reached by a reasonable landlord in the particular circumstances;
- 5 The reasonableness of the landlord's refusal will depend on all the particular circumstances. The court gave an example that it might be unreasonable to refuse consent if the proposed use was a permitted use and the intention of the tenant in acquiring the premises to use them for that purpose was known to the freeholder when the freeholder acquired the freehold;
- 6 There might be cases where it would be disproportionate for a landlord to refuse consent, having regard to the effects upon it, and the tenant;
- 7 Consent cannot be refused on the basis of pecuniary loss alone. The proper course in this situation is for the landlord to ask for a compensatory payment; and

8 In each case it will be a question of fact, dependent on the particular circumstances of the case.

The Court of Appeal allowed the appeal, holding that the landlords were entitled to withhold consent on the ground that the tenants' proposals either would or could give rise to structural problems. The withholding of consent could not be deemed unreasonable on the basis that a conditional consent could have been granted to address structural problems. It was unreasonable for the landlord to refuse consent on the ground that they objected to the use of the premises as an Indian restaurant as the lease had been sold with a Class A3 use. But it was clear to the Court that where a tenant is proposing to carry out structural works the landlord is entitled to know the tenant's suggested solution to any structural problem.

The court wants to see clarity in plans and proposals. It is therefore important that tenants have a good team of architects and engineers on board before putting forward such plans to the landlord. It is only then that a landlord will be in a fully informed position to make any decision with regard to consent and should consent be refused, it places the tenant in a far stronger position when it comes to arguing the question of reasonableness before a court.

Iqbal was followed in a Central London County Court case, *Shapiro v Mayhew* in November 2004. The parties jointly owned the freehold of the building with each party owning the lease of one floor in the two storey house. The Claimant sought permission to carry out repairs and convert the roof and the Defendant refused on the ground that the Claimant had not considered the impact this would have on the structure of the building. Further grounds for refusal were the lack of clarity in the plans and the Defendant was not satisfied about the proposed time scale and the question of disturbance.

The judge held that no reasonable landlord supplied with the information that had been provided could properly refuse consent. The lessee had provided sketches of the proposed works and had indicated building regulation approval had been obtained. The landlord had not sought any advice before refusing consent

Another recent case concerning a loft conversion was *Dulwich Estate v Baptiste* [2007] EWHC Ch 410. The landlord refused permission for the works to take place on the basis that the proposed side dormer window did not comply with relevant guidelines. The arbitrator found that the refusal was unreasonable and concluded that on balance the landlord would not be significantly disadvantaged if the proposal was allowed but that the tenant would be disadvantaged by a refusal.

The judge held that the impact of the refusal on the applicant was only a relevant factor if there was such disproportion between the benefit to the landlord and detriment to the tenant that it was unreasonable to withhold consent. As there was no evidence that there was actual necessity for the loft conversion and it could still be built without the window the landlord was entitled to refuse consent.

Sargeant

The principles as set out in *Iqbal* were applied by Lewison J in *Sargeant v Macepark (Whittlebury) Ltd* [2004] EWHC 1333. This case was essentially a dispute about competing businesses and this spilled over into the landlord and tenant context.

Mr and Mrs Sargeant owned a golf course, clubhouse, bars and restaurant close to Silverstone motor racing circuit. They also planned to build a hotel at the site. They leased out part of their land to the defendant on the basis that

it was to develop a hotel there, which it did. The lease contained a covenant that the defendant should not make alterations without the landlords' consent, such consent not to be unreasonably withheld or delayed.

In 2003 the defendant applied for consent to construct an extension to the hotel. The claimants said they would give consent, but only on certain conditions. The defendant took the view this stance was unreasonable and started the works without consent. The claimants then sought an interim injunction which was eventually dealt with by consent until the trial of the preliminary issues as to whether consent had been unreasonably withheld.

The claimants had granted a licence for the works to be carried out but it was subject to a number of conditions. They wanted a provision to be added to a clause in the lease whereby the use of the public rooms in the extension would be limited to "functions and activities which are directly related or connected to management training conferences held at the premises".

This was really a dispute about competition as the claimants held golf days, corporate hospitality events, lunches, dinners and weddings at their golf and country club. The defendant was a market leader in the field of management training. The parties did not get on well and there had been a number of disputes between them. The claimants complained that the defendant was using the hotel "for functions, weddings and private dining". When the defendant applied for planning permission to build an extension with ten syndicate rooms and a conference hall capable of accommodating 700 people, this raised serious concerns with the claimants.

Lewison J referred to Peter Gibson LJ's eight principles in *Iqbal* and he considered that the seventh principle was new and that this mirrored the statutory framework of section 19(2) of the Landlord and Tenant Act 1927. He

went on to examine whether it is reasonable for a landlord to refuse consent to the making of alterations on the ground that the alterations would damage its trading interests.

Peter Gibson LJ considered that the answer to the above was no and that it would only be reasonable if damage to trading interests were to affect property interests that trading interests would become a potentially relevant consideration. Lewison J disagreed and said that a refusal of consent based upon fear of competition has been upheld as reasonable in relation to covenants against alienation and change of use. He cited *Sportoffer Ltd v Erewash BC* [1999] 3 EGLR 136 where Lloyd J held that landlords were entitled to refuse consent to change premises from a squash club to a leisure centre as this would compete with the landlord's own leisure centre.

Lewison J considered that there is no rule of law preventing a landlord from relying, under any circumstances, on perceived damage to his trading interests in adjoining or neighbouring property as a ground for refusing consent to an assignment or change of use. He could not see why this principle should be any different in the case of alterations.

He accepted that the landlord had a right to be concerned about the threat posed by the tenant. In this case, the defendant was likely to compete with the landlord for wedding business and the holding of other functions. The judge went on to examine whether the concerns justified the condition. The fear would not have justified an outright refusal of consent as the landlord had the benefit of increased rent and it would be a disproportionate step. The condition sought to restrict the defendant to the provision of "management training conferences". This he thought was too restrictive and it would prevent the tenant from holding, for example product launches, exhibitions and award ceremonies. He considered that it would have been reasonable had it been restricted to "management training and conference use".

Practical concerns

When advising in such cases the concept of trading interests is potentially of vital significance. It is certainly arguable that these interests can be a legitimate ground for refusing consent. In reality trading interests and property interests merge and the courts take a pragmatic look at what is reasonable or not.

What is clear is that both landlords and tenants should be well aware of the eight point checklist in *Iqbal* and should be prepared either to present coherent plans or be able to comment on them.

When advising landlords they should bear in mind very carefully the sum requested as a reasonable payment in respect of the damage to or diminution in the value of the premises. Where a sum is demanded the onus is on the tenant to prove that in demanding the sum the landlord has unreasonably withheld consent.

In the event that the landlord will not grant consent then the tenant is faced with a choice. It can either proceed with the works without consent or can seek a declaration in court that the landlord has unreasonably withheld consent.

CONSENT TO ASSIGN OR SUB LET

Introduction

At common law a tenant has the right, unless restrained by his lease or agreement from so doing, to sub let the demised premises or part of them. Of course, most leases have some form of prohibition against sub letting or assignment and it is possible to have an absolute covenant against alienation. It may be qualified for example that the landlord's consent is to be required.

The focus in this seminar is on the qualified form where it states "consent not to be unreasonably withheld". If a lease contains a covenant by the tenant not to assign without the landlord's consent, and also a covenant by the landlord not to withhold his consent unreasonably, the two covenants must be construed together.

Section 19(1) Landlord and Tenant Act 1927

Section 19(1) of the Landlord and Tenant Act 1927 applies to such covenants and they are deemed to be subject to:

A proviso to the effect that such licence or consent is not to be unreasonably withheld but this proviso does not preclude the right of the landlord to require payment of a reasonable sum in respect of any legal or other expenses incurred in connection with such licence or consent.

This section only applies where the covenant is not to assign without licence or consent. It does not apply to the absolute covenant against assignment. It is for the court to determine whether the landlord's refusal is reasonable or

not. Therefore parties cannot by the terms of the lease determine the standard that is to be applied to such a test.

Section 19(1) does not give the tenant a right to damages for an arbitrary or unreasonable refusal of consent. It allows the tenant to assign without consent or to apply to the court for a declaration. Essentially this is the same position as with alterations.

As with the case of alterations a claim for a declaration can be commenced either by Part 7 and particulars of claim, or if the facts are not in dispute by Part 8.

Landlord and Tenant Act 1988

There is in addition a statutory duty under the Landlord and Tenant Act 1988 whereby landlords when asked for consent have either to give consent or be prepared to justify the refusal of consent. The Act does not have any bearing on the common law reasonableness test or on absolute covenants against assignment.

The section applies where the tenancy includes a covenant on the part of the tenant not to enter into one or more of the following:

- *Assignments;*
- *Underletting;*
- *Charging; or*
- *Parting with the possession of;*

The premises comprised in the tenancy or any part of the premises without the consent of the landlord...but the covenant is subject to the qualification that the consent is not to be unreasonably withheld.

Where there is served on the person who may grant consent to a proposed transaction a written application for consent then the person (usually the landlord) is under a statutory obligation within a reasonable time to:

- Give consent, except in a case where it is reasonable not to give consent;
- To serve on the tenant written notice of his decision whether or not to give consent specifying in addition-
- If the consent is subject to conditions, the conditions;
- If the consent is withheld the reasons for withholding it.

Unlike the common law position, the burden to prove reasonableness shifts to the landlord. It is for the landlord to show that:

- He gave consent within a reasonable period of time;
- If he gave consent subject to conditions that the conditions were reasonable;
- If he did not give consent that the refusal was reasonable.

Reasons

A large body of case law has developed on the question of reasonableness and also the interaction between the common law and the statutory provisions. Since the 1988 Act the landlord has a duty to state his reasons and reach a decision within a reasonable period of time. In assessing what is a reasonable period of time it will sometimes be measured in weeks rather than days but even in complicated cases it should be measured in weeks rather than months. *Go West v Spigarolo* [2003] 2 WLR 986 CA.

The ascertainment of the landlord's actual reasons is a subjective inquiry into his actual state of mind, but the procedure by which he made up his mind is not relevant to the inquiry – see *Tollbench v Plymouth City Council* [1988] 1 EGLR.

As the landlord has a statutory duty to the tenant to state his reasons for refusal, the landlord is confined to reasons given in his written statement, and is unable to supplement them even if those reasons were given orally to the tenant –see *Footwear Corporation v Amplight Properties* [1999] 1 WLR 551.

Reasonableness

As in the case of alterations the Court of Appeal has set out general guidance as to the approach towards determining reasonableness. This was set out in *International Drilling Fluids v Louisville Investments (Uxbridge)* [1986] Ch 513.

The propositions are as follows:

- (1) The purpose of a covenant against assignment without the consent of the landlord, such consent not to be unreasonably withheld, is to protect the landlord from having his premises used or occupied in an undesirable way, or by an undesirable tenant or assignee;
- (2) A landlord is not entitled to refuse his consent to an assignment on grounds which have nothing whatever to do with the relationship of landlord and tenant in regard to the subject matter of the lease;
- (3) The onus of proving that consent has been unreasonably withheld is on the tenant;
- (4) It is not necessary for the landlord to prove the conclusions which led him to refuse consent were justified, if they were conclusions which might be reached by a reasonable man in the circumstances;

- (5) It may be reasonable for the landlord to refuse his consent to an assignment on the ground of the purpose to which the proposed assignee intends to use the premises, even though that purpose is not forbidden by the lease;
- (6) While a landlord need usually only consider his own interests, there may be cases where there is such a disproportion between the benefit to the landlord and the detriment to the tenant if the landlord withholds his consent to an assignment, that it is unreasonable for the landlord to refuse consent;
- (7) Subject to the propositions set out above, it is, in each case, a question of fact, depending on all the circumstances, whether the landlord's consent has been unreasonably withheld;
- (8) It will normally be reasonable for a landlord to refuse consent or impose a condition if this is necessary to prevent his contractual rights under the lease from being prejudiced by the proposed assignment or sublease; and
- (9) It will not normally be reasonable for a landlord to seek to impose a condition which is designed to increase or enhance the rights that he enjoys under the lease.

It is important to see how the courts have adopted the test of reasonableness over the past few years and a number of cases shed light on this.

Allied Dunbar

In *Allied Dunbar Assurance plc v Homebase Ltd* [2002] 27 EG 144, the Court of Appeal dealt with a case where the lease contained a covenant by the tenant not to underlet the premises without first obtaining the consent of the landlord, such consent not to be unreasonably withheld. The covenant was subject to a proviso that it was intended to control the terms of any intended underletting. It provided that the rent of any underlease should not be "less than the full market

rent reasonably obtainable" and that the underlease should contain covenants in the same terms as the lease.

In February 2000 the tenant entered into an agreement to sublet the premises at a rent less than that reserved under its own lease and on terms as to repairing obligations less onerous than under the lease. A draft underlease was prepared that would comply with the terms of the lease and in a collateral deed the tenant would indemnify the assignee for the difference between the rents in the underlease and that expressed to be payable under the lease.

The landlord refused consent and the assignee withdrew from the transaction. The tenant counterclaimed that the landlord was in breach of its duty under the Landlord and Tenant Act 1988. At trial the judge held that the landlord was entitled to refuse consent. The tenant appealed and this was dismissed by the Court of Appeal. The combined effect of the proposed underlease and the collateral deed was as if the relevant provisions had been included in the underlease. When the collateral deed was read into it, the terms of the proviso were not satisfied. The landlord was therefore entitled to act in the manner it had done.

Clinton Cards

In *Clinton Cards (Essex) Ltd v Sun Alliance & London Assurance Co Ltd* [2002] EHC 1576 (Ch), the tenant held a lease for a term of 25 years. The lease prevented the tenant from underletting (i) at a fine or premium, (ii) at a rent less than the rack rental value; (iii) at less than the defined basic rent unless the landlord was in agreement, such agreement not to be unreasonably withheld if the proposed rent were the full rack rental value; and (iv) without the prior consent of the landlord which was not to be unreasonably withheld. The lease also contained a covenant restricting use to that of a greeting cards shop unless

the landlord agreed to a change, again such consent not to be unreasonably withheld.

In March 1999 the tenant sought the landlord's consent to an underletting at a rent of £95,000 pa subject to upwards only rent reviews and with a use for the sale of mobile telephones. Under a separate deed and one which was personal to the parties the tenant would be abating the rent to £75,000 pa and offering a six month rent free period. Shortly afterwards the tenant informed the landlord that there would be no separate deed of abatement and that that there would be a sub lease at a rent of £75,000 pa.

The landlord refused consent on the basis that the rent would be below the current passing rent and the basic rent and the proposed rent free period would be contrary to the lease as it prohibited an underletting at a fine.

The proposed under lessee found alternative premises and a claim for damages for breach of statutory duty was commenced.

The court dismissed the claim on the basis that the covenant not to underlet at a fine or premium, or at a rent less than the rack rent value was not a covenant falling within section 1(1) of the 1988 Act. It was however unreasonable for the landlord to refuse consent on the basis of the rent of £75,000 as this was the most advantageous rack rent available on the open market.

The claim was dismissed as the Claimant was unable to show causation of loss.

Crestfort

The approach of the court in *Allied Dunbar* was adopted in the case of *Crestfort Ltd & ors v Tesco Stores Ltd & anr* [2005] EWHC 805 (Ch). The landlord sought an injunction ordering the surrender of an underlease by the underlessee to the

lessee. The lessee Tesco counterclaimed for declarations that the landlord had unreasonably withheld consent to the underlease.

Tesco was required to insure in the name of the landlord and itself and, although it insured against physical damage, it deliberately omitted to make it a joint policy and persistently delayed disclosure of the fact. The landlord refused to allow the sub letting until the insurance position had been settled but Tesco sub let without complying.

The issue at trial was whether Tesco was entitled to require the landlord to consider its application for consent to grant of the underlease and not to unreasonably withhold consent. Tesco remained at all times under an absolute obligation not to underlet and the landlord was not under any obligation to consider an application to do so. There were limited situations where the absolute bar was qualified to give the tenant the right to request consent.

The underlease was granted subject to covenants that were the same in substance if not form, as those in the lease and in this case the dissimilarity of the repairing covenants in the underlease was of substance. As the underlease did not contain the repairing covenant that was present in the lease it meant that the condition precedent to any obligation on the part of the landlord to consider the application was never satisfied.

NCR Ltd

In the majority of occasions the issue concerning the landlord is one of finances. That was the case in the Court of Appeal case, *NCR Ltd v Riverland Portfolio No 1 Ltd (No 2)* [2005] EWCA Civ 312, [2005] 22 EG 134.

The tenant held a lease from the landlord and the lease contained an absolute prohibition against underletting unless the underlease was granted "at the best

rent obtainable in the open market without the grantor taking a premium or other capital consideration or (if greater) the rent then payable hereunder...”.

The open market rent was £16 psf and rent payable was £19.30 psf. In June 2003 the tenant sought consent to sublet. The draft terms revealed the payment of a reverse premium of £3 million to the sub lessee by the tenant. The landlord refused consent on the basis that the covenant strength of the proposed subtenant was insufficient and that the proposed financial terms of the sub letting were unsatisfactory.

The trial judge held that the landlord had been unreasonable in its refusal of consent. He held that that the covenant strength was irrelevant as the proposed transaction was an underletting and the tenant remained liable under the terms of the lease.

The Court of Appeal allowed the appeal and held that the general legal principles were the same for assignments and underlettings. The Court of Appeal criticised the fact that the trial judge had dismissed expert evidence on behalf of the landlord that there would be a difference in value of the property with and without the proposed lease of more than £500,000. That expert had concluded that upon expiry of the current lease the sub tenant would be entitled to 1954 Act protection and because of the sub tenant's covenant strength, a higher yield rate at that point would be appropriate in valuing the landlord's interest. The landlord was therefore entitled to refuse consent on this ground.

Recent Decisions

Two recent decisions show how far the question of reasonableness can lead to very different outcomes. In *Royal Bank of Scotland Plc v Victoria Street (No 3) Ltd* [2008] EWHC 3052 (Ch) the tenant sought a declaration that the landlord had unreasonably withheld consent to the assignment of a lease. The landlord had

covenanted that it would not unreasonably withhold consent provided the prospective assignee would be a reasonable and responsible tenant.

The landlord refused to consent to the assignment on the basis that it did not have faith in the assignee's strength as a newly incorporated company. Morgan J held that the reasonableness of the decision to refuse consent was a question of fact and that in this case the decision to refuse consent was one a reasonable landlord could have reached. The landlord was entitled to look at the high rent of the property, the inadequate rent deposit and the lack of trading records of the potential assignee.

The landlord was found to have acted unreasonably in *Landlord Protect Ltd v St Anselm Development Co Ltd* [2009] 08 EG 115 (CS). In that case the head landlord acted unreasonably in stipulating, as a condition of consent to assignment of the leasehold, that the proposed assignee would only be released from its guarantee in the event of subsequent assignment of the lease and then only if "reasonable alternative security" was provided. The Court of Appeal considered this approach to be unreasonable and whilst the head landlord was entitled to ask for a guarantee, the particular terms were considered too draconian.

It would appear that there are no defined rules when dealing with sub letting and assignment cases but those advising both tenants and landlords should always have the *International Drilling* considerations in mind. It is also essential to examine why a landlord is taking a particular stance and try to ascertain through the use of surveying and accounting expert evidence whether it is a legitimate position.

Virtual assignment

The most recent issue consent to assign has been over whether a virtual assignment made without the landlord's consent breached a standard

disposition covenant. In *Clarence House Ltd v National Westminster Bank Plc* [2009] EWCA (Civ) 1311, the Court of Appeal concluded that the virtual assignment did not breach the terms of the lease thus overturning the decision at first instance.

With a virtual assignment the economic benefits and burdens of a lease are transferred to a third party without the actual leasehold interest being transferred. Where the assignor intends to remain in occupation this is known as grey leaseholds and where the assignor is not in occupation it is known as white leaseholds. The motivation behind a virtual assignment can include where a large portfolio is being disposed of and there is a time pressure on the deal or where there is concern that the landlord will not grant consent.

In this case the virtual assignment concerned offices in Manchester. The virtual assignment transferred the economic benefits and burdens of the lease and underlease. The virtual assignee, a Gibraltar company had to manage all dealings with the landlord and was entitled to all monies from the subtenant.

In the Court of Appeal, Ward LJ held that the tenant had not parted with possession. The court found that possession is normally synonymous with exclusive occupation and the right to exclude all others from the premises. In this case the virtual assignee had no right to occupy the property. The virtual assignee also only received the rents as agent for the tenant. Thus it appears the virtual assignment continues.

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