

**Good Harvest, House of Fraser**  
**AGAs and GAGAs**

Gary Blaker

24th November 2011

selborne  
CHAMBERS

[www.selbornechambers.co.uk](http://www.selbornechambers.co.uk)

Tel: 020 7420 9500

Fax: 020 7420 9555

## Introduction

- 1 Two recent cases, one at first instance and one in the Court of Appeal have caused significant concern amongst property professionals. There have been fears of uncertainty, diminishing values of property holdings and landlords discovering that existing guarantees are void. Are we facing the abyss of chaos and uncertainty or are these fears unfounded? Some consider that the Court of Appeal has at least provided some pragmatism to the thorny problem of guarantees post assignment and that this will provide some comfort to a jittery property industry.
- 2 The two cases are *Good Harvest Partnership LLP v Centaur Services Ltd* [2010] EWHC 330 (Ch) and *K/S Victoria Street (a Danish Partnership) v House of Fraser (Stores Management) Limited & ors* [2011] EWCA Civ 904.
- 3 It is necessary to look at the underlying statute and the history of the introduction of the Landlord and Tenant (Covenants) Act 1995 (“the 1995 Act”) in order to understand the decisions in *Good Harvest* and *House of Fraser*.
- 4 In this seminar, I shall take a detailed look at the two decisions and the mischief that *Good Harvest* created. I shall also look at how the Court of Appeal has sought to ameliorate some of the problems caused by the decision, in its recent judgment in *House of Fraser*. I shall also look at how the cases have left current commercial leases and what the practical implications are for property advisors.

## The old law and the 1995 Act

### Pre 1 January 1996

- 5 The 1995 Act was introduced to deal with what was perceived as the unfair situation that existed with leases entered into before 1 January 1996. Before the commencement of the 1995 Act the original tenant remained liable under the doctrine of privity of contract under covenants in the lease for the entirety of the term of the lease. At the same time, the liability of the guarantor of the original tenant co-existed

with that of the original tenant. Thus, both the original tenant and original guarantor were in a pretty unfavourable position.

- 6 An assignee of a lease was only liable under the doctrine of privity of estate for the period the lease was vested in him, albeit often an assignee would covenant directly with the landlord to comply with the terms of the lease for the remainder of the term. When this occurred, any guarantor of such an assignee would also remain liable for the remainder of the term.
- 7 It was of course possible for the parties to a lease to agree that privity of contract should not apply, this was rare. Thus the problems that are currently faced in respect of providing guarantors after an assignment were not faced with leases prior to 1 January 1996. The landlord did not need to make the original tenant or guarantor, guarantee the obligations of the assignee.
- 8 The “old” situation was perceived as unfair and this was highlighted in the recessions of the early 1980s and 90s. In 1988 the Law Commission reported and recommended that contractual obligations in a lease should only govern the relations between the current owners with interests in the property. The Law Commission felt that landlords were being unduly protected and proposed that all covenants in a lease should be treated the same way, whether or not they “touch and concern” the land.
- 9 Lord Nicholls in *Avonridge v Mashru* [2006] 1 EGLR 15 said:

*“One of the principal mischiefs the Act was intended to remedy was that, as the law stood, the original tenant of a lease remained liable for performance of the tenant’s covenants throughout the entire duration of the lease. A tenant might part with his lease and many years later find himself liable for substantial amounts of unpaid rent, perhaps much increased under rent review provisions and for the cost of making good extensive dilapidation...This was considered unfair. This potential liability was not widely understood by tenants and it could lead to hardship...”*

It is important to bear this sentiment in mind when considering the later cases as the whole policy thrust of the 1995 Act was to ensure that liability ends when there is an assignment.

- 10 It would appear that the Law Commission envisaged the release from liability of the original tenant and assignees upon an assignment. It also envisaged that guarantors of these tenants and assignees would also be released upon an assignment.
- 11 In the Parliamentary passage of the 1995 Act lobbying took place by amongst others, the British Property Federation representing landlords and the British Retail Consortium representing tenants. The landlords were concerned to have greater power to refuse consent to assign and they extracted the concession of obtaining a release for the landlord upon assignment and also the ability to compel a tenant into entering into an authorised guarantee agreement/AGA. The problem that existed in the early 1990s also reflected the fact that leases were generally far longer than they are nowadays. Now that standard commercial leases are five or 10 years in length the problems and concerns that faced both landlords and tenants are not so prevalent.

#### Post 1 January 1996

- 12 The 1995 Act came into force on 1 January 1996 and subject to a few exceptions ended privity of contract for leases granted after that date. Section 5 of the 1995 Act provided as follows:

*“(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...”*

Thus once the tenancy is assigned the tenant/assignor's liability ends.

- 13 Section 24 of the 1995 Act provides:

*“(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..."*

This is a very important section as in essence it is suggesting that once the tenant is released from liability upon assignment, so is any other party which was bound by that covenant. Clearly this section was going to be of central importance in both *Good Harvest* and *House of Fraser*.

14 Section 25 of the 1995 Act deals with the anti avoidance position. It is worth setting out part of s25(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"*

15 Section 25(3) permits the exception of an AGA. It provides that:

*"In accordance with section 16(1) nothing in this section applies to any agreement to the extent that it is an authorised guarantee agreement..."*

16 Section 25(4) ensures that the anti avoidance provisions apply whether or not the agreement is contained in the actual lease or whether it was made before the creation of the tenancy.

17 Section 16 of the 1995 Act governs the creation of an AGA. The 1995 Act does not prevent a tenant upon release from its obligations under an assignment from entering into an AGA. This is subject to the exceptions within that section.

## Good Harvest

18 Somewhat surprisingly there were very few cases concerning the 1995 Act. Additionally there was concern within the property industry as to what the position was in respect of a guarantor of an original tenant and whether the guarantor could be made to guarantee the obligations of an assignee. This led to many landlords insisting that a guarantor should enter into a guarantee upon assignment of the lease. The guarantee would either be a direct guarantee along with the tenant or would be a sub guarantee whereby the outgoing tenant provides a guarantee under an AGA and the guarantor's guarantee is referred to as a GAGA.

19 Until *Good Harvest* no court had been asked to decide upon the validity of a guarantor entering into a guarantee along with the tenant upon assignment. The essential problem is where T is a weak covenant and is only accepted as a tenant because the strong parent company G provides a contractual guarantee. T then assigns the lease to T2 and T is required under the lease to give an AGA for T2. The AGA is weak as T is a weak company and the covenant can only have any strength if G can be asked to provide some security.

20 In *Good Harvest* the landlord granted a lease to Chiron and this lease was guaranteed by Centaur. The lease contained provisions which stated:

*"..the Tenant making the application for licence to assign and its guarantor (if any) shall enter into an authorised guarantee agreement..."*

*"...the Tenant to procure that any...security for the Tenant's obligations under this Lease which the Landlord holds immediately before the assignment is continued or renewed in each case on terms as the Landlord may reasonably require in respect of the Tenant's liability under the authorised guarantee agreement..."*

21 Chiron assigned to Total Home Entertainment and provided an AGA. Centaur also entered into an AGA. When Total Home Entertainment failed to pay the rent, the landlord Good Harvest looked to Centaur to make payment. Centaur alleged that the guarantee agreement was void by reason of section 25 of the 1995 Act.

22 Newey J concluded that section 25 of the 1995 Act did indeed render the AGA given by Centaur, void. He held that once the obligations of a tenant have come to an end

pursuant to section 5 of the 1995 Act upon an assignment of the lease, then pursuant to section 24, the obligations of the guarantor of that tenant must also cease at the same time.

- 23 If the guarantor was made to enter into a further guarantee upon assignment this would frustrate the whole purpose of the 1995 Act. It was argued on behalf of the landlord that the guarantor was free to enter into a new obligation. The court did not accept this proposition. There was only one way in which the tenant could give a guarantee and that was through entering an AGA. The judge also considered that had Parliament wanted to provide a system whereby the tenant's guarantor could guarantee the obligations of an assignee, this could have been provided for in the 1995 Act. Instead no such provision exists in the Act.
- 24 The judge went on to consider the more difficult issue relating to the providing of an AGA. He noted that the 1995 Act does not refer to guarantors providing an AGA and he said that "there is no indication in the section that an AGA can include a guarantee from anyone other than the tenant." His view was also strengthened because he considered that if a landlord could rely upon a tenant's guarantor to give a guarantee for anyone other than the first assignee this would drive a "coach and horses" through the legislation.
- 25 Newey J left open the vexed question of sub guarantees. He considered it doubtful whether the 1995 Act permitted a guarantor to sub-guarantee a tenant's obligations under an AGA. Clearly these concerns were paramount for the property industry and practitioners as it would have a detrimental effect for landlords and for property values.
- 26 The case generated an exceptional amount of comment and the Court of Appeal hearing was eagerly anticipated. The case settled a matter of days before the appeal was due to be heard in July 2010 and so the law was left in a state of flux. Some commentators considered that as it was only a first instance decision, it was not going to be persuasive authority. Also the comment on sub-guarantees was obiter.
- 27 It is somewhat unusual for a lease to require an outgoing tenant's guarantor to provide an AGA for the assignee since even prior to *Good Harvest*, this was considered in all likelihood to fall foul of the anti avoidance provisions in the 1995 Act. The more common position is where the lease requires the tenant's guarantor to

guarantee the AGA ie to guarantee the guarantee. The issue that was left open after *Good Harvest* was whether this was still permissible. The outgoing tenant's obligations had ceased following release under the act and any guarantor was also released at the same time. But entering into an AGA was a new and permissible obligation and the 1995 Act provided a framework for this. The 1995 Act however does not appear to release the contractual guarantor from the new and separate obligation to sub-guarantee the AGA.

28 After *Good Harvest* some commentators regarded the difference between a guarantor entering into an AGA or guaranteeing one (a GAGA) as merely semantic. Thus, there was serious concern that if a previously strong company had guaranteed the original tenant to the lease then if it could not provide a guarantee and no other financially sound company could be found, then this could cause serious difficulties for landlords. The particular concern being the investment value of the freehold.

## House of Fraser

### First Instance

- 29 Thankfully the property industry did not have to wait long for another case on the same issue to arise. The case of *KS Victoria Street v House of Fraser (Stores Management) & ors* was heard at first instance before John Randall QC sitting as a deputy judge of the Chancery Division. The case had relatively similar facts to Good Harvest.
- 30 The dispute concerned Beatties Department store in Wolverhampton and it involved a series of intra company assignments and reorganisations. The facts of the case highlight a common situation for both commercial landlords and tenants, where one company within a group, often the parent company is the only company with a strong covenant.
- 31 In House of Fraser there was a sale and lease back dated January 26 2006. The department store was acquired by a previously dormant and asset less company Stores Management Ltd, (“SML”). SML was to lease the property at a rent of £2.25 million per annum. The parent company, House of Fraser plc provided a guarantee as it was a company with strong finances.
- 32 The arrangement had been set up for tax purposes and the plan was to assign the lease to another company with a good covenant. If that could not happen then the assignment would be to the operating company, House of Fraser Stores Ltd (“Stores”). By April 2006 the assignment had not taken place and the ownership of House of Fraser changed. The new owners removed the plc status of the company and changed the internal arrangements of the group. The result was that Stores was still a strong company but the parent company was not. The claimant sought to specifically perform the agreement to assign to the strong company Stores. This was resisted and one of the arguments adopted by House of Fraser was that the obligation to assign the lease with a continuation of the parent guarantee was void as a result of being in breach of sections 24 and 25 of the 1995 Act.

33 The judge at first instance concluded that he should follow *Good Harvest* albeit it appeared that he had some reservations in so doing. He said:

*“There are difficulties with parts, and I emphasise parts, of the reasoning of Mr Justice Newey in Good Harvest, and I find myself in a position of some uncertainty as to whether I would have decided the Good Harvest case in the same way had that task fallen to me. I cannot, however, conscientiously say that I am convinced that his judgment is wrong, and therefore I must follow and apply it.”*

34 He held that a requirement that a guarantor of an outgoing tenant should enter into a new guarantee of the incoming assignee fell foul of the anti avoidance provisions of the 1995 Act. The deputy judge clearly saw that his decision continued the uncertainty and unusually gave permission to appeal to the Court of Appeal.

#### Court of Appeal

35 The Court of Appeal handed down judgment at the end of July 2011. The court was undoubtedly a powerful and strong court, consisting of the Master of the Rolls, and Lord Justices Etherton and Thomas. The ratio of the judgment and the obiter comments are thus exceptionally persuasive and need to be considered very carefully.

36 Rather than simply uphold the decision of John Randall QC and also Mr Justice Newey, the court provided much wider guidance. The court was clearly concerned that the decision would have far reaching implications and that further guidance especially in relation to sub-guarantees was required.

#### The narrow issue

37 On the narrow issue of the appeal and the main issue in *Good Harvest*, the court held that upon assignment of the lease to Stores, the former tenant SML will be released from all further liability by virtue of section 5(1) of the 1995 Act. As from the

date that SML is released then the guarantor (House of Fraser) would also be released as under section 24 (2) of the 1995 Act House of Fraser would be another person who had covenanted the tenant's obligations.

38 The Court of Appeal agreed with Newey J that if a guarantor could guarantee the liability of an assignee in the event of an assignment, that would "frustrate the operation of section 24(2). If this were not the case then a landlord could require a guarantor of the tenant's liabilities to guarantee the liability of each successive assignee. This would allow a "well advised landlord" to place a guarantor in the position it would be in prior to the 1995 Act.

39 The court was keen to rule out the possibility of what was described as a "renewal obligation". Thus, the situation would not be permitted whereby an occupier of a property was part of a group of companies and the landlord insisted upon a subsidiary taking the lease with the parent acting as a guarantor together with renewal obligations. It is worth remembering that the Court of Appeal saw the 1995 Act as having a "comprehensive anti avoidance provision" – see Lord Nicholls in *Avonridge*. This viewpoint appears to have been behind much of the decision of the court.

#### Obiter guidance

What is true for the guarantor of the original tenant must be true for the guarantor under an assignment.

40 The court went on to provide further obiter guidance and looked at a number of different situations. The first is that what is true for the guarantor of the original tenancy must also be true for the guarantor under an assignment. Therefore, if G2 gives a guarantee for T2, G2 cannot be obliged to guarantee T3.

41 The core view of the court can be summarised that:

- (i) If T1 cannot act in a particular way then G cannot also cannot act in that way;  
and
- (ii) Anything that breaches (i) above is void.

42 K/S's counsel had argued that the purpose of section 24(2) was to ensure that the tenant's release under section 5 was effective. This was on the basis that if the guarantor was not released it could seek through subrogation an indemnity from the tenant. This was rejected by the court which examined the Law Commission report and the 1995 Act and concluded that when the tenant's liability ends, the guarantor's liability ends at the same time.

#### What if the parties enter into the agreement willingly?

43 As is often the case the Court of Appeal in a desire to bring in certainty to an issue had to adopt what can be perceived as a somewhat inflexible position. The court therefore felt that it had to reject the submission that the parties to the agreement had entered it willingly and with no intention of evading the provisions of the 1995 Act. The court had sympathy but rejected this as it would bring a subjective test to deciding whether a provision was in breach of the 1995 Act. This in turn would lead to uncertainty and a lack of clarity.

#### What is meant by release?

44 The Court of Appeal questioned Jonathan Seidler QC as to what is meant by "release" under section 5(2) of the 1995 Act. K/S argued that the concept of release should have a very narrow meaning ie once there has been a release the parties can re-assume liability under the lease again. The widest meaning of "release" is that once the tenant and guarantor have been released they can never re-assume liability. The Court of Appeal adopted a middle course whereby once a party is released it cannot re-assume liability for the duration of one entire assignment cycle.

#### Was Good Harvest correct?

45 The Court of Appeal felt it necessary to look at *Good Harvest* and comment upon the decision of Newey J. The court supported the conclusion reached in *Good Harvest*. It held that an agreement which requires a guarantor to provide a further guarantee in the future falls foul of section 25(1) of the 1995 Act.

46 The court went on to look at two different interpretations of section 25(1). The first was the narrow interpretation and was that the section invalidates any agreement which involves a guarantor of the assignor guaranteeing that assignor's assignee. The second wider interpretation is that it only invalidates such an agreement if it was entered into at the insistence of the landlord.

47 The first narrower interpretation would mean that even where it suited the assignor, the assignee and guarantor that the assignee should have the same guarantor as the assignor, they could not offer that guarantor. This is clearly a restriction upon freedom of contract. The court could see that the second wider interpretation was more attractive in terms of commercial sense as it allows section 25 to protect tenants and guarantors but permits them to enter into an agreement should they wish to do so. Once again in a desire to provide certainty, the court rejected the second interpretation and held that it would lead to the need to look at the negotiations leading up to the guarantee, to see if it had been insisted upon by the landlord. This would cause evidential difficulties as the negotiations might have been oral as well as in writing and there might have been nuances in the negotiations that would make it difficult to decide if the landlord was insisting upon a subsequent guarantee.

#### AGAs are the exception to the general rule

48 The court chose the narrow first interpretation but went on to look at one exception to the general rule, namely the use of AGAs under section 16 of the 1995 Act. By section 24(2) of the 1995 Act on assignment a guarantor of the assignor is only required to be released "to the same extent as the tenant". If section 16(2) applies as the assignor can be made to enter into an AGA then it is permissible for the guarantor to sub-guarantee the AGA. The tenant and guarantor are both released to the same extent of their obligations under the lease.

#### G can guarantee a future assignment but not the immediate assignment cycle

49 Apart from the issue of providing an AGA/GAGA, the court also opened up the possibility of there being an assignment, whereupon the tenant and guarantor are released followed by a later, but not subsequent assignment whereby the original guarantor to the lease once again guarantees the assignee (ie G guarantees T3 but

cannot guarantee T2). The Court of Appeal suggested that this course would mean that the original tenant and guarantor are both released in accordance with the 1995 Act. The fact that either the original tenant or the guarantor decide at a later stage (upon a further assignment) to reassume liability cannot be said to “frustrate” their release upon the first assignment.

50 Permission was not sought to appeal the case to the Supreme Court and so *House of Fraser* is likely to remain, for some time, the leading authority on this subject. There has been much commentary as to where this now leaves the property industry and in particular whether it does bring the much needed clarity to the issue of guarantors after an assignment.

## Issues arising

51 There is no doubt that *House of Fraser* brought some much needed clarity to this area which had certainly been left confused since *Good Harvest*. It did however, leave a number of issues open.

## What is and is not permitted?

52 It is clear that an existing guarantor of a tenant cannot validly be required to enter into a guarantee after the assignment of the lease. Any reference to the outgoing tenant's guarantor guaranteeing the assignee will be void. This is regardless of whether the guarantee has been entered willingly.

53 Practitioners should be keen to check their standard leases and ensure that the wording used does not fall foul of section 25 of the 1995 Act.

54 After *Good Harvest* it was unclear what a tenant that wished to carry out a corporate re-organisation and where there was just one strong company in the group, could actually do. It is now clear that the strong company can provide a sub-guarantee under the AGA ie a GAGA. Also the strong company can provide a direct guarantee with T3 but not with T2. It could also sub guarantee T3's AGA obligations in relation to T4. It should be remembered that this was obiter but it would be surprising if another court (save for the Supreme Court) was prepared to depart from this thinking.

55 This should provide some degree of comfort as in effect it means that the guarantor remains liable throughout the remainder of term –whether by way of GAGA or direct guarantee. In a technical sense upon assignment, the guarantor is released and has a break from being a direct guarantor. The guarantor could continue alternating between being a sub-guarantor and a direct guarantor. It just cannot be a direct guarantor for two consecutive tenants.

56 There has been some discussion as to whether the invalidity of an existing guarantor committing himself in advance to guarantee the liability of a “future assignee”

precludes all future assignees or the immediate assignee. The preferred view in my opinion is that it simply invalidates the next immediate assignment and that there has to be a release of a direct guarantee for one full period of assignment.

Can the guarantor give a co-guarantee jointly with the tenant of the immediate assignee?

57 One thorny issue that has been left is whether the guarantor can give a co-guarantee jointly with the tenant of the immediate assignee. In the judgment the Master of the Rolls said:

*“It may well be that the guarantor could simply act as a co-guarantor under the AGA with the assignor, as might have been the position in Good Harvest –rather than being a guarantor of the assignor’s liability, under the AGA. However, that issue is one which we should not determine as it involves going much further than we need on any view, although there seems to us to be much force in Mr Randall’s point that, if the assignor’s guarantor can guarantee the assignor’s liability under an AGA, it is hard to see why that guarantor should not be able “to do something to the same substantial effect, different only in form”.*

58 Quite why the Court of Appeal tantalised us with this paragraph is unclear. It would seem that a co-guarantee would have the effect of the guarantor continuing to be a guarantor after assignment. This was held to be void in *Good Harvest* and it is difficult to see why it would not be held to be void by a court in the future.

If G’s direct guarantee is void would it invalidate the AGA?

59 One tricky scenario is where T1 is guaranteed by G and upon assignment to T2, T1 enters into an AGA. G then gives a direct guarantee for T2 in the AGA, but it is not a GAGA. In that case the direct guarantee would be void but where would it leave the AGA? It is thought that a court would uphold the AGA and would in effect sever the offending provision and thus ignore the guarantee by G.

Is it possible for T to assign to G?

- 60 What would happen if T1 decided to assign to G? In this case, one can imagine a corporate restructure whereby the only strong company was the guarantor. There has been much debate as to whether such a transfer would be permissible. On the one hand the view is that this would be a void assignment. The explanation for this is that under section 5(2) upon assignment the tenant is released from the tenant's covenants. The only exception to this is to enter into an AGA. As the guarantor is released from its guarantee "to the same extent" as the tenant is released from the tenant covenants, it is also released from its obligations. The tenant cannot assign to itself as it is released from its covenants and therefore the guarantor cannot do what the tenant cannot do ie) it cannot be a valid assignee.
- 61 The above argument uses the wider meaning of the concept of "release". Namely that once there has been a release of the tenant's obligations there must be a "fallow Assignment cycle" whereby neither the tenant nor guarantor can take on liabilities.
- 62 The counter argument is that the above is a flawed argument because T1 cannot assign to itself. It therefore does not make any sense. The court made no particular finding on this issue and any comment was obiter. If it is not possible to assign to the guarantor then this could have far reaching effects. It would seem that the court either did not want to consider this or just ignored the issue. It is possible the court did not want to complicate matters even more by discussing a matter, which it felt it could leave alone.
- 63 The counter argument is that at the moment of assignment T1 is released from the tenant covenants and G is released from its obligations. A scintilla later G becomes the tenant and from that time pursuant to section 3(5) of the 1995 Act, the assignee is bound by the tenant's covenants. The anti avoidance provisions of section 25 would not be necessary as it could not invalidate section 3(5).
- 64 What would happen if an assignment is held to be void but it has already been registered? Under section 58 of the Land Registration Act 2002 the legal title would be vested in the guarantor who had become the assignee. It would be necessary to apply for rectification of the register.

65 Clearly this issue remains contentious although I personally prefer the approach that suggests it is possible to assign to a former guarantor. I consider this to be the more pragmatic approach and the other approach would lead to significant difficulties when carrying out a re-structuring.

Is it possible to have a pre condition in a lease requiring T to provide an AGA on any assignment?

66 The judgment also hinted that it might not be permissible to have a pre condition in a lease that requires the tenant to provide an AGA on any assignment. It is difficult to see why this should be problematic as the whole ratio of the case is that entering into an AGA is permissible as is providing a GAGA. This should not prove to be a troublesome issue as such clauses should be valid pursuant to section 19(1)A of the Landlord and Tenant Act 1927.

Is it necessary to have a guarantee at the time of entering the AGA or is it possible to rely upon a guarantee in the lease?

67 The issue here is whether a landlord can rely upon the guarantee in the lease which makes reference to any further AGA that the tenant might enter into.

68 The argument that it makes no difference is that if the tenant enters into a licence to assign containing an AGA, they are agreeing to guarantee the assignee in advance of actually having assigned the lease. Thus, it should make no difference whether the guarantor provides a sub-guarantee in advance in the lease.

69 The counter argument is that there has to a release of the guarantor's obligations upon assignment. There can be no release if the guarantor has already agreed to provide a sub-guarantee. It is also suggested that as an AGA can only be given upon assignment, so the sub-guarantee cannot be given before assignment.

70 I do not accept the latter argument and would favour the view that it is possible to enter into an agreement to provide a GAGA ahead of assignment. AGAs are entered into before the assignment takes place and so it is difficult to see how it would not be possible to provide a sub-guarantee ahead of an assignment.

### Complex schemes

71 There has been discussion as to whether schemes can be devised to take advantage of the “fallow assignment cycle”. It is certainly a high risk to seek to use a complex device, especially one where the first assignment appears to be a “sham” in order to obviate the problem with section 25. Thus a scheme whereby the assignment is followed almost immediately by another assignment is likely to fall foul of the anti avoidance provisions. In any event the court has indicated that sub-guarantees are permissible and so it is probably best to rely upon this. Having a series of assignments may end up causing practitioners difficulties with registration and also may have tax implications for clients.

### Sub-guarantees v Guarantees

72 Ultimately much will depend upon whether landlords are prepared to accept a sub-guarantee rather than a direct guarantee. There has been some discussion as to whether there is in reality any difference between the two. Few differences have been identified. One is where T1 is insolvent and the landlord might have to deal with an insolvency practitioner who refuses to allow T1 to enter into an AGA. Then it is not possible to obtain a sub-guarantee.

73 There is also a possibility that there is a difference in respect of section 17 notices. Default notices are only required to be served on former tenants and their guarantors being a person within section 17(3). In a sub-guarantee the guarantor would come within 17(3) whereas in the case of a direct repeat guarantor it would not as it would be guaranteeing the current tenant (assignee) and thus would not need to be served with a default notice.

74 It has been suggested that perhaps a clause can be drafted which permits intra-group assignment so long as a valid guarantee is provided from amongst a defined

pool of guarantors. Whilst in theory this has some attraction it does pose a problem if some or all of the companies lose their acceptable covenant strength.

## Practical steps

- 75 Landlords will need to examine leases very carefully. In particular where there are weak tenant covenants backed by guarantors who were repeat guarantors or where the leases permit intra group assignments without consent on the basis that the current guarantor will guarantee the assignee. If there is a guarantee in the direct form then a landlord should expect the guarantor to argue that it is void.
- 76 Landlords should also consider revaluing their properties where there are problematic leases such as the ones referred to above. It should not be forgotten that the concern about the value of the reversion in the event of a loss of a guarantor is a perfectly legitimate reason for a landlord to withhold consent.
- 77 Standard leases should contain provisions requiring a tenant's guarantors to give a sub-guarantee of the of the tenant's AGA on assignment (ie a GAGA). Landlords should also not take into account any offer from a tenant's existing guarantor on an application to assign except where that is an offer to be a sub guarantor under an AGA. An AGA can only be asked for if it is objectively justified.
- 78 Landlords may well want to see the "strong" company as a tenant and not just as a guarantor.
- 79 Tenants should also be prepared to be more flexible with landlords. It might be the case that they are required to provide alternative security upon an application for consent to assign. A landlord who has been well advised is not going to accept the current guarantor as a direct guarantor under the next assignment cycle. Also well advised landlords are unlikely to be prepared to permit an intra group assignment without consent, which previously often took place with the existing guarantor guaranteeing the obligations of the assignee. In dealing with intra group assignments landlords are more likely to introduce financial tests and in other applications to assign are more likely to request a rent deposit.
- 80 No doubt tenants will also be looking at current leases to see whether they contain provisions requiring the existing guarantor to give a guarantee upon assignment. If this is present then that provision will be void.

81 It should be remembered that the option to sublet remains and perhaps in many situations this will be the preferred option to deal with the situation where a strong covenant does not exist to provide a direct guarantee. It would also be possible to surrender and re-grant but this might well lead to adverse tax implications.

Gary Blaker

Selborne Chambers

24 November 2011