PROPOSED AMENDMENTS TO LANDLORD AND TENANT (COVENANTS) ACT 1995

1. BACKGROUND

1.1 Prior to 1996, the original tenant under a lease remained liable, unless there was an express release, for performance of the lease covenants for the duration of the lease term by virtue of privity of contract. In practice landlords also required that an assignee accept liability for the whole remainder of the term.

1.2 This position was changed by the Landlord and Tenant (Covenants) Act 1995 (“the Act”), which provides for tenants and guarantors of “new leases” (broadly, leases granted on or after 1 January 1996) to be released from liability on a lawful assignment of the lease. Section 25 of the Act contains anti-avoidance provisions. It states that an agreement is void to the extent that it would (apart from that section) “exclude, modify or otherwise frustrate” the operation of the Act (including the provisions for the automatic release of tenants and guarantors).

1.3 Continuing post-assignment liability was not completely abolished by the Act. There is an exception in section 16 of the Act for authorised guarantee agreements (AGAs), under which the outgoing tenant guarantees the assignee’s liability under the tenant covenants in the lease until the next lawful assignment.

2. THE ISSUES

2.1 Uncertainties over the interpretation of the above provisions of the Act led to the cases of Good Harvest Partnership LLP v Centaur Services Ltd and K/S Victoria Street v House of Fraser (Stores Management) Ltd. The Court of Appeal’s decision in K/S Victoria has itself given rise to a number of issues on assignments of leases and guarantors.

2.2 One of the harshest commercial results of the decision in K/S Victoria Street is the inability for a guarantor of an outgoing tenant (T1) to stand as guarantor of the assignee (T2), whether the guarantee is required by the landlord or is “freely offered”. This is particularly problematic in the case of intra-group assignments. A clause in a lease, agreement for lease, licence to assign or other document which requires that guarantee is therefore void. The decision also suggests that an assignment of the lease to the guarantor (G1) of T1 may be void.

2.3 As a result of K/S Victoria Street, landlords are reluctant to agree to intra-group assignments, particularly where the parent company guarantee will be lost, and tenants are finding it more difficult to obtain landlord's consent to corporate restructuring. A landlord is normally happy to consent to a tenant's restructuring providing it does not lose the guarantee. In this regard, the Act, as applied in the cases, does not assist the commercial realities of such transactions. It has also called into question the effect of provisions in alienation clauses in leases specifically designed to preserve covenant strength on intra-group assignments. The potential loss of investment value caused by this has led to insurance having to be put in place in relation to at least one high profile building.

2.4 The decision in K/S Victoria Street also has implications for transactions involving partnerships (and other joint ownership situations), being the need in a partnership situation for non-tenant partners (or a third party such as a bank) to be able to give repeat guarantees when the lease is assigned within the partnership such as on the retirement of a tenant partner (i.e. partners ABCD assign to partners ABCE on the retirement of D, where partners F and G (or X Bank PLC) continue to be guarantors).
2.5 Based on the current drafting of section 28(4) of the Act, it appears that where T1 comprises two or more persons, one or more of them may take an assignment (e.g. where partners ABCD assign to ABCE on the retirement of D). This is because T1 is treated as being ABCD collectively, not A, B, C and D individually. However, the point should be more clearly made on the face of the Act. Moreover, section 28(4) as drafted gives rise to uncertainty as to whether where G1 comprises more than one person, one or more (but not all) of those persons would be prevented from doing what G1 is prohibited from doing (e.g. guaranteeing T2 or taking an assignment from T1).

3. **The Proposal**

3.1 The Law Reform Committee of the Property Litigation Association is looking to put forward a proposed amendment to the Act to address the issues outlined above, particularly those concerning intra-group assignments. Draft amendments to sections 24 and 28 of the Act intended to deal with these issues have been prepared by the Committee and are set out below.

3.2 The amendments proposed by the Committee seek:

- To clarify that G1 may guarantee T1’s covenants in the AGA by way of a sub-guarantee (which was confirmed, albeit obiter, in the Court of appeal decision of *K/S Victoria Street*);

- To enable G1 to stand again as guarantor of T2, provided that it is certified by G1, T1 and T2 in the instrument containing the guarantee (which will usually be the licence to assign) that:

  (a) T1 and T2 are group companies (including LLPs); or

  (b) T1 and T2 are all partners in the same firm; or

  (c) either T1 or T2 comprises partners in a firm and the other is a company (or LLP) in which that firm has a controlling interest;

It will be noted that the proposal is only for certification to be given and not that one of the conditions actually needs to be met. This is to avoid potential difficulties in carrying out due diligence upon acquiring a property subject to a lease with a guarantee. It may be all but impossible for the buyer in that scenario to confirm that one of the conditions was actually met when the lease was assigned. As proposed, however, the buyer should be able to take sufficient comfort if provided with an appropriate certification by the seller.

- To clarify that G1 may take an assignment of a lease from T1;

- To clarify that where T1 or G1 comprise two or more persons, one or more (but not all) of them may act in a way which, had they acted jointly, would be void under the Act. For example (i) in the case of joint tenants, an assignment of the lease from partners ABCD to ABCE (as in the example above) would be allowed, and (ii) in the case of joint guarantors, guarantors GHI would be permitted to guarantee T2 even though FGH had guaranteed T1 (in cases where the proposed intra-group exception above would not apply).

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1 By reason of the proposed introduction of a new defined term of "guarantor" in section 28, it is also proposed that existing references to "a person ("the guarantor")" in sections 17 and 18 are changed to "a guarantor".
24 Effects of release from liability under, or loss of benefit of, covenant.

(1) Any release of a person from a covenant by virtue of this Act does not affect any liability of his arising from a breach of the covenant occurring before the release.

(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 there is a guarantor in relation to 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, the guarantor is released from the covenant mentioned in paragraph (b) to the same extent as the tenant is released from that tenant covenant.

(2A) Where a guarantor is released from a covenant of the tenancy imposing any liability or penalty in the event of a failure by the tenant to comply with a tenant covenant by virtue of subsection (2), nothing in this Act (and in particular section 25) shall preclude him from—

(a) entering into or being bound by a covenant imposing any liability or penalty in the event of a failure by the said tenant to comply with his covenants under any authorised guarantee agreement entered into by that tenant under section 16, or

(b) entering into a covenant imposing any liability or penalty in the event of a failure by an assignee of the tenancy to comply with a tenant covenant where in the instrument containing the said covenant the guarantor and the assignor and the assignee of the tenancy each certify that:

(i) the assignor and the assignee are group companies of each other; or

(ii) the assignor and the assignee comprise individuals who are all partners in the same firm, or

(iii) either the assignor or the assignee comprise individuals who are all partners in the same firm and the other is a company in which that firm has a controlling interest, or

(c) taking an assignment of the tenancy.

(2B) References in this section to individuals who are partners in a firm mean individuals acting in that capacity.

(3) Where a person bound by a landlord or tenant covenant of a tenancy—

(a) assigns the whole or part of his interest in the premises demised by the tenancy, but
(b) is not released by virtue of this Act from the covenant (with the result that subsection (1) does not apply),

the assignment does not affect any liability of his arising from a breach of the covenant occurring before the assignment.

(4) Where by virtue of this Act a person ceases to be entitled to the benefit of a covenant, this does not affect any rights of his arising from a breach of the covenant occurring before he ceases to be so entitled.

28 Interpretation.

(1) In this Act (unless the context otherwise requires)—

“assignment” includes equitable assignment and in addition (subject to section 11) assignment in breach of a covenant of a tenancy or by operation of law;

“authorised guarantee agreement” means an agreement which is an authorised guarantee agreement for the purposes of section 16;

“collateral agreement”, in relation to a tenancy, means any agreement collateral to the tenancy, whether made before or after its creation;

“company” includes any body corporate;

“consent” includes licence;

“covenant” includes term, condition and obligation, and references to a covenant (or any description of covenant) of a tenancy include a covenant (or a covenant of that description) contained in a collateral agreement;

“guarantor” in relation to a tenancy, means any person who is bound by a covenant imposing any liability or penalty in the event of a failure by another person to comply with a covenant of that tenancy;

“landlord” and “tenant”, in relation to a tenancy, mean the person for the time being entitled to the reversion expectant on the term of the tenancy and the person so entitled to that term respectively;

“landlord covenant”, in relation to a tenancy, means a covenant falling to be complied with by the landlord of premises demised by the tenancy;

“new tenancy” means a tenancy which is a new tenancy for the purposes of section 1;

“partner” means a partner for the purposes of the Partnership Act 1890;

“reversion” means the interest expectant on the termination of a tenancy;

“tenancy” means any lease or other tenancy and includes—

(a) a sub-tenancy, and

(b) an agreement for a tenancy,

but does not include a mortgage term;
“tenant covenant”, in relation to a tenancy, means a covenant falling to be complied with by the tenant of premises demised by the tenancy.

(2) For the purposes of any reference in this Act to a covenant falling to be complied with in relation to a particular part of the premises demised by a tenancy, a covenant falls to be so complied with if—

(a) it in terms applies to that part of the premises, or

(b) in its practical application it can be attributed to that part of the premises (whether or not it can also be so attributed to other individual parts of those premises).

(2A) For the purposes of this Act, a body corporate shall be taken to be a group company of another body corporate if and only if one is a subsidiary of the other or both are subsidiaries of a third body corporate or the same person has a controlling interest in both and—

(a) "controlling interest" has the meaning given by section 46(2) of the Landlord and Tenant Act 1954 (as amended),

(b) "subsidiary" has the meaning given by section 1159 of the Companies Act 2006, and

(c) in the case of a limited liability partnership which is a subsidiary of a company or another limited liability partnership, section 1159 of the Companies Act 2006 shall be amended so that:

(i) references in sections 1159(1)(a) and (c) to voting rights are to the members' rights to vote on all or substantially all matters which are decided by a vote of the members of the limited liability partnership; and

(ii) the reference in section 1159(1)(b) to the right to appoint or remove a majority of its board of directors is to the right to appoint or remove members holding a majority of the voting rights.

(3) Subsection (2) does not apply in relation to covenants to pay money; and, for the purposes of any reference in this Act to a covenant falling to be complied with in relation to a particular part of the premises demised by a tenancy, a covenant of a tenancy which is a covenant to pay money falls to be so complied with if—

(a) the covenant in terms applies to that part; or

(b) the amount of the payment is determinable specifically by reference—

(i) to that part, or

(ii) to anything falling to be done by or for a person as tenant or occupier of that part (if it is a tenant covenant), or

(iii) to anything falling to be done by or for a person as landlord of that part (if it is a landlord covenant).

(4) Where—
(a) the landlord, or
(b) the tenant, or
(c) the guarantor

in relation to a tenancy comprises two or more persons jointly constitute either the landlord or the tenant in relation to a tenancy, any reference in this Act to the landlord or the tenant or the guarantor is a reference to both or all of the persons who jointly constitute the landlord or the tenant or the guarantor, as the case may be, as if they were a single entity rather than a reference to each of those persons individually (and accordingly nothing in section 13 applies in relation to the rights and liabilities of such persons between themselves, and nothing in this Act shall preclude one or more (but not all) of those persons from entering into or being bound by a covenant which by virtue of this Act they would be precluded from entering into or being bound by jointly).

(5) References in this Act to the assignment by a landlord of the reversion in the whole or part of the premises demised by a tenancy are to the assignment by him of the whole of his interest (as owner of the reversion) in the whole or part of those premises.

(6) For the purposes of this Act—

(a) any assignment (however effected) consisting in the transfer of the whole of the landlord's interest (as owner of the reversion) in any premises demised by a tenancy shall be treated as an assignment by the landlord of the reversion in those premises even if it is not effected by him; and

(b) any assignment (however effected) consisting in the transfer of the whole of the tenant's interest in any premises demised by a tenancy shall be treated as an assignment by the tenant of those premises even if it is not effected by him.