CITY OF LONDON LAW SOCIETY LAND LAW COMMITTEE

Minutes of a meeting held on 21 September 2011 at CMS Cameron McKenna, Mitre House, 160 Aldersgate Street, London EC1A 4DD

In attendance	**Nick Brown (Chair)** **Warren Gordon (Secretary)** **William Boss** **Nick Brent** **Jayne Elkins** **Martin Elliott** **Laurie Heller** **John Nevin** **Nicholas Vergette**
Apologies	**James Barnes** **Nic Berry** **Jeremy Brooks** **John Butler** **Alison Gowman** **Simon Hillson** **Nick Jones** **Anthony Judge** **Daniel McKimm** **Jackie Newstead** **Jon Pike** **Mark Rees-Jones** **Jeanette Shellard** **Peter Taylor** **Mark Wheelhouse** **Martin Wright**

1. WELCOMES

John Nevin from Slaughter and May was welcomed as a new member of the Committee.

2. MINUTES

The Minutes for the Committee meeting of 13 July 2011 were approved. Elizabeth Cooke of the Law Commission will be approached to see if she will talk, at the next Committee meeting, about the Law Commission's report on easements and covenants.

3. IMPLICATIONS OF THE "HOUSE OF FRASER" DECISION

The meeting was reminded of the key part of the Court of Appeal decision in the "House of Fraser" case that, in respect of "new tenancies" under the Landlord and Tenant (Covenants) Act 1995 ("Act"), an outgoing tenant's guarantor is not permitted to directly guarantee an assignee. That guarantee falls foul of the anti-avoidance provisions in section 25 of the Act. This confirmed the High Court decision in the "Good Harvest" case.

This is very significant for completed transactions where reliance is being placed on a former tenant's guarantor's guarantee of an assignee. That guarantee is now void which may leave the landlord with no substantial covenant. This has implications not only for landlords, but also buyers and lenders and will continue to be a focus of due diligence.

Importantly, the Court of Appeal also, but only *obiter*, stated that "sub-guarantees" (an outgoing tenant's guarantor guaranteeing the outgoing tenant's obligations in the authorised guarantee agreement (AGA)) are enforceable and do not fall foul of section 25. While some commentators have queried the reasons for the Court's views on sub-guarantees, most welcome those views. In the light of the make-up of the Court (which included Lord Neuberger, Master of the Rolls, and Etherton LJ), it is likely that most practitioners will consider the Court's support for sub-guarantees (admittedly obiter) to enable them to be more comfortable about accepting them.

Those responsible for drafting leases, licences to assign and other relevant documentation will have greater confidence following the *House of Fraser* decision over which drafting falls foul of section 25 and will be able to draft to accord with the Court's conclusions. However, certain of the Court's obiter comments have created some uncertainty with potentially important implications.

Can the original tenant's guarantor directly guarantee T3 (the second assignee after the original tenant)?

This is an important question, particularly, in the context of intra-group arrangements by the tenant and group companies. The situation commonly arises that, within the tenant's group of companies, there is only one strong covenant and the original tenant is an SPV with no or few assets, guaranteed by that strong company. If the tenant assigns intra-group, following *House of Fraser*, the guarantor can sub-guarantee, but what happens if the assignee, subsequently, further assigns to another SPV in the group? Can the original guarantor directly guarantee T3?

Paragraph 53(iv) of the House of Fraser judgment, on its words, would suggest that the original guarantor can directly guarantee T3, even when it had previously sub-guaranteed T1's AGA obligations for T2- "such a guarantor can **in any event** validly guarantee the liability of an assignee on a further assignment". This interpretation appears to be commonly held among practitioners and would be very useful in the intra-group situation, where, provided there was no artifice, it appears that the landlord could continue to look to the perhaps only strong covenant from assignment to assignment by way of direct guarantee for the original tenant, to sub-guarantee for T1's AGA obligations for T2, to direct guarantee for T3, to sub-guarantee for T3's AGA obligations for T4. It is important

that such an arrangement is not "embedded" in the documentation as this would fall foul of section 25.

A dissenting view was expressed at the meeting that the comment at paragraph 53(iv) had to be seen in the context of the rest of the judgment, which did not specifically address a direct guarantee for a new T3 situation (see paragraph 51). It was considered that there needed to be a break in the chain of continuing liabilities on the part of the strong covenant and even though the liability was taken on in what are, arguably, different capacities (from sub-guarantor to direct guarantor), the view was that was not a sufficient enough break. The concern was that this succession of liabilities would be seen as avoidance and fall foul of section 25.

Caution should be exercised in determining on the facts whether the particular guarantee arrangement falls foul of the Act. Landlords also need to be conscious of possible tenant's claims that they are unreasonably withholding consent to an assignment, because of concerns about the efficacy of a proffered guarantee.

Can a tenant assign to its guarantor or to the guarantor and itself?

The Court in paragraph 37 of the House of Fraser judgment stated "It would also appear to mean that the lease could not be assigned to the guarantor, even where both tenant and guarantor wanted it". They also in that paragraph stated "It can therefore be argued that, where the assignor and the guarantor who want the guarantor to guarantee an assignee, or who want the lease to be assigned to the guarantor, such a renewal, or such an assignment, would not frustrate the operation of any provision of the 1995 Act".

The general tenor of the judgment suggests that the Court considered an assignment did not work (because it would be the equivalent of asking the outgoing tenant's guarantor to directly guarantee the assignee), but they did not have to decide the point. However, their obiter comments are disconcerting because prior to the *House of Fraser* decision, the general view appeared to be that, provided there was no artifice, assignments to guarantors did not fall foul of section 25. That was because the guarantor was becoming the tenant, a different capacity from its previous one as direct guarantor for the tenant. The major purpose behind the Act was to protect tenants after they had assigned- however, in this situation, the guarantor was becoming the tenant and with the ability to occupy and use the premises, it should be liable under the tenant's covenants in the lease.

Despite the Court's comments which create some doubt, the Committee considered, without being able to give a definitive view, that assignments by the tenant to the tenant's guarantor or to the tenant and its guarantor should work, provided there was no artificial arrangement.

If such assignments are void, this creates a number of uncertainties including:

- what is the impact on any registration of the assignment at the Land Registry? Or on any derivative underlease or on any mortgage in respect of the assigned lease? The unravelling of the consequences would be very difficult.

- if a tenant cannot assign to its guarantor, can a tenant assign to itself and another party? By the same logic, it appears not, and this could have serious implications for partnership and trustee situations, although the Trustee Act may be helpful in allowing for changes in trustees in a way that does not fall foul of section 25.

- can the tenant's guarantor be required to take a new lease in the event of the tenant's interest in the lease being disclaimed? This was not mentioned in *House of Fraser* and is unlikely to be affected by that decision, because the guarantor is taking a new lease which should be unaffected by liabilities under the tenant's lease.

Generally, the concerns highlighted above may lead to more stringent controls on intra-group assignments and landlords will need to consider the rent review and other valuation impacts of that level of control. While alternative security is potentially available to landlords such as rent deposits or bank guarantees, they may be impractical in the circumstances.

Can the provision of an AGA by the outgoing tenant be specified in the lease as a condition for assignment?

Prior to the *House of Fraser* decision, it was broadly assumed that such a provision was effective. The decision has cast a little doubt over this. The second part of paragraph 50 states-

"Section 16(3) may or may not preclude a landlord relying on a provision in an alienation covenant which purports to entitle it to insist on an AGA as a matter of right on any assignment (we do not need to decide the point and should not do so). However, if it does preclude the landlord having such an absolute right, so that it is ineffective, that would not prevent the landlord insisting on an AGA, if the alienation covenant also contained a provision that consent to an assignment could not be unreasonably withheld (like clause 5.9.6.6 in *Good Harvest* [2010] Ch 426), and it was reasonable to require an AGA."

Since the Court did not decide the point and also the changes made to section 19 of the Landlord and Tenant Act 1927 by the Act appear to countenance such a condition, the Committee saw little reason to depart from the generally accepted approach to the condition.

Can an outgoing tenant's guarantor act as a co-guarantor under the AGA with the outgoing tenant?

This suggestion was mooted in a bracketed paragraph 47 of the House of Fraser judgment. This would appear to be a guarantee not only by the outgoing tenant of its assignee, but also a direct guarantee by the outgoing tenant's guarantor of the assignee. That seems to fly in the face of *Good Harvest* and other comments of the Court of Appeal in *House of Fraser*.

The Court did not decide the point, but did state "there seems to us to be much force in Mr Randall's point [*judge in High Court decision in House of Fraser]* 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"". That comment appears to recognise that, in effect, there is little difference between a sub-guarantee and a direct guarantee of the assignee, but this runs contrary to the decision in the case and, for that reason, carries little weight.

4. FURTHER CONCERNS ABOUT THE NEW SRA CODE OF CONDUCT

Solicitors are still coming to terms with the new conflicts provisions in the Code and when a solicitor can act for both parties on a lease or a sale or a mortgage. There is a clear statement that the solicitor cannot act where there is a conflict or a significant risk of conflict between two or more current clients and limited exceptions where the clients have a substantially common interest or are competing for the same objective.

The indicative behaviours (which "may tend to show" achievement or non-achievement of the outcomes and are, therefore, not definitive) rule out acting for a landlord and tenant, or a seller and buyer, if the transaction is for value. As to mortgages, the indicative behaviour only refers to acting for a lender and borrower in a private residence situation. No mention is made of standard mortgages in a commercial context, for example, where the lender and borrower have a substantially common interest. Firms can, however, create their own indicative behaviours.

The conclusion is that acting for both parties on a lease, sale or mortgage of property will only be permitted in limited circumstances.

The CLLS Land Law Committee's certificate of title is usually provided by the Company's solicitor to a separately legally represented addressee, so the provisions of Chapter 3 of the Code would appear not to apply in most situations where the certificate is used. It appears that the Solicitors Regulation Authority will not be "recognising" the certificate.

While improvements can be made to Chapter 3, further feedback to the SRA should probably await experiences gained by solicitors in working with the new Code.

5. RIGHTS OF LIGHT PROJECT

Laurie Heller, Nicholas Vergette, Jon Pike, Warren Gordon and Bill Gloyn attended the first meeting on 20 July 2011 of the CLLS rights of light sub-group. Jeanette Shellard, Gordon Ingram and Jayne Elkins are also members of the sub-group, but were unable to attend.

It was agreed that:

- a rights of light project is useful because of the issue's topicality and importance for the City of London;
- production of a rights of light deed (of release) will be useful since it is not especially ubiquitous among firms' precedents which may encourage the use of a CLLS version;

- there will be accompanying guidance on the deed and also a checklist of key issues to consider in a right of light situation (but in no way seeking to supplant existing texts on the subject);

- it would be useful for the City Corporation to contribute to the project (particularly in connection with section 237 of the TCPA 1990). The City Corporation will be approached to ascertain interest. Such a contribution should greatly increase the level of interest, generally, in the project. The sub-group will also liaise with the CLLS's Planning and Environmental Law committee to ascertain their interest in this project;

- it would be useful to have input from a rights of light surveyor on the guidance;

- the importance of the insurance angle/implications will be explored;

- the crane oversail licence will not be pursued as it was not considered of significant enough general interest.

The sub-group is next planning to meet in October/November 2011 and, while it has a starting point for the rights of light drafting, it would be very helpful if Committee members could send through any rights of light deeds for consideration.

6. CLLS CERTIFICATE OF TITLE

There was a brief discussion on the certificate. Drafting is making good progress, but the two key areas remaining to be resolved relate to where the Company does not own the property when its solicitor provides the certificate and, secondly, how to deal with a large number of Letting Documents, particularly, where a disclosure follows each standard statement. Some drafting has been suggested in that regard and a further version of the certificate will be circulated incorporating that drafting for the Committee's comments.

7. CLLS LAND LAW COMMITTEE'S INSURANCE PROVISIONS

A sub-group of the Committee will meet on 12 October 2011 to look again at the Committee's insurance provisions, which have not been looked at in a few years and which appear on the Committee's page of the CLLS website.

8. AOB

There have been 24 visits to the Land Law committee page of the CLLS website for the Shopping Centre service charge provisions and 19 visits for the Office building service charge provisions.

Robert Leeder has circulated further information on the CPD hours available for attending Committee meetings.

9. CPD- 1.75 hours (CPD reference CRI/CLLS).

10. Remaining 2011 meeting: 23 November at 12.30pm at CMS Cameron McKenna, Mitre House, 160 Aldersgate Street, London EC1A 4DD. Dates for 2012?