Committee's response to Law Commission's consultation on Generating ideas for the Law Commission's 14th Programme of law reform: Commercial Leasehold

Introduction

The Land Law Committee of the City of London Law Society ("the Committee") is responding to the Law Commission's consultation on Generating ideas for the Law Commission's 14th Programme of law reform.

One of the Law Commission's ideas is in relation to Commercial Leasehold, Are there areas of commercial landlord and tenant law which create unnecessary restrictions, inefficiencies or costs? The Law Commission highlights concerns with aspects of the Landlord and Tenant Act 1954 and the Landlord and Tenant (Covenants) Act 1995. Over the years in various contexts representative bodies of real estate practitioners have expressed concerns about both these Acts and this response brings together some of those key points and how they can be addressed.

Although not directly related to the topics mentioned by the Law Commission, the Committee has included at the end of this response sections on problems in practice arising from:

- the "registration gap",
- the doctrine that an underletting for the residue of the headlease term can create an assignment, and
- the impact of the residential right of first refusal on commercial transactions.

The Committee would be grateful if the Law Commission can also consider these issues.

Many of the concerns that the Committee has mentioned are technical, but, potentially, they may have a very real, adverse economic consequence for the parties to commercial real estate documentation. Changes to the legislation can overcome some, if not all, of the uncertainties highlighted here. The Committee hopes that the Law Commission can

consider the points raised and will be delighted to discuss this further with the Law Commission.

The Committee also endorses the Law Commission's suggestion that it may consider the wider question of whether security of tenure for business tenants under Part II of the Landlord and Tenant Act 1954 is still relevant in the current market.

Landlord and Tenant (Covenants) Act 1995 ("1995 Act")

Summary

The Committee considers that the Landlord and Tenant (Covenants) Act 1995 is in need of urgent reform, especially in relation to the problems arising from the way in which the 1995 Act's anti-avoidance provisions have been construed in the case law.

The Act is an impediment to what should be day-to-day transactions such as a guarantor guaranteeing an assignee of a lease or becoming the assignee. This constraint can interfere with intra-group restructuring or transfers between business partners and can be more detrimental to the tenant and its guarantor than the landlord.

Repeat guarantees are invalidated even where the tenant and its guarantor intend that the guarantee is provided or freely offer it. Defeating freedom of contract in those circumstances seems unreasonable. The ambiguity of the 1995 Act and the doubt that subsequent court decisions have cast over the legal effectiveness of guarantees entered into, have a potentially detrimental impact on certain property valuations. This is exacerbated by the fact that very often the strength of the covenant offered lies with the guarantor, since tenants often are special purpose vehicles.

One of the biggest concerns relates to the problems for partnerships caused by the 1995 Act. The guarantor cannot provide a repeat guarantee of assignee partners' lease obligations and there is the uncertainty of whether tenants can assign to themselves (with third parties).

Sub-guarantors

The statutory treatment of an outgoing tenant's guarantor following a lease assignment remains an important point of concern for the property industry. While the decision in *K/S Victoria Street v House of Fraser (Stores Management) Limited* ("House of Fraser") [July 2011] answered some questions and provided greater certainty in how to deal with guarantor's liability following the release of the tenant it guaranteed, a number of questions were left unanswered and new questions were raised.

Much of the uncertainty emanates from ambiguous, possibly defective, drafting in the 1995 Act. The following points, potentially, have significant financial impact on property transactions up and down the country, since they go to the heart of the landlord and tenant relationship – the covenant strength of the tenant and any guarantor.

Uncertainties in this area have caused and will cause major transactions to founder and have a serious adverse impact on the businesses, not only of landlords but also tenants.

In relation to "new tenancies", the 1995 Act provides that if a tenant assigns its lease, it is released, but can be required by a landlord to guarantee its immediate assignee only, under an authorised guarantee agreement (AGA). The uncertainty was whether the tenant's guarantor could be required also to guarantee the assignee. If such a requirement was held not to be permitted, it would be rendered void by the 1995 Act's wide-ranging anti-avoidance provisions in section 25.

In the *House of Fraser* case, the Court of Appeal decided that an existing or contracting guarantor of a tenant cannot validly guarantee the liability of a future assignee (even if the guarantor wishes to do so), because of the anti-avoidance provisions. This decision causes serious problems for landlords seeking to rely on an existing guarantee by an assignor's guarantor of an assignee, but can also cause problems for tenants in, potentially, preventing intra-group assignments.

The Court's other comments are not legally binding precedent, but are regarded as strongly persuasive, because of the judges' seniority. The most important comment is that an existing or contracting guarantor of a tenant can validly be required to guarantee the assignor's liability under the AGA (sometimes known as a "sub" or "parallel" guarantee). That is a key statement for the property industry as the landlord can be more confident that it can continue to look to the financially strong guarantor following the assignment and also makes commercial sense, since the guarantor is often the key element in the tenant's covenant strength. A final important conclusion from the Court is that the guarantor can in any event validly guarantee the liability of an assignee on a further assignment.

The judgment provides some clarity on which types of guarantee are enforceable. The *obiter* approval of the enforceability of sub-guarantees is helpful and it is likely that most practitioners will consider the Court's support for sub-guarantees will enable them to be more comfortable about accepting them, although some commentators have queried the logic behind the Court's views. It may be thought that the distinction between directly guaranteeing an assignee and providing a sub-guarantee is semantic and that, in effect, guaranteeing the outgoing tenant's obligations in the AGA is the same as guaranteeing the assignee.

The reality is that the 1995 Act, while adequately dealing with the position of the outgoing tenant as authorised guarantor, inadequately deals with the outgoing tenant's guarantor, and many of the difficulties highlighted by this and other cases spring from this problem.

Certain of the Court's *obiter* comments have created uncertainty with potentially important implications.

The first issue is whether the original tenant's guarantor can directly guarantee T3 (the second assignee after the original tenant). This is important, particularly, in the context of intra-group arrangements by the tenant and group companies. It is a common

occurrence that, within the tenant's group of companies, there is only one strong financial covenant and the original tenant is a special purpose vehicle with few assets, guaranteed by that strong company.

If the tenant assigns intra-group, following the House of Fraser judgment, the guarantor can sub-guarantee, but what happens if the assignee, subsequently, further assigns to another special purpose vehicle in the group? Can the original guarantor directly guarantee T3? The 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. This interpretation would be very useful in the intra-group situation, where, provided there was no sham, it seems that the landlord can continue to look to the perhaps only strong covenant from assignment to assignment by way of direct guarantee followed by sub-guarantee. It is important that such an arrangement is not "embedded" in the documentation as this would fall foul of the anti-avoidance provision.

However, there is a dissenting view. The judgment did not specifically address a direct guarantee for a new T3 situation and there needs to be a break in the chain of continuing liabilities on the part of the strong covenant. Therefore, this succession of liabilities could be void.

Assignment to guarantors

The next significant issue raised in the *House of Fraser* judgment is whether a tenant can assign to its guarantor, or to the guarantor and itself. The Court's comments suggested that such an assignment does not work, because it would be the equivalent of asking the outgoing tenant's guarantor to directly guarantee the assignee. The comments were *obiter*, but were somewhat disconcerting, because prior to the decision, the general view seemed to be that, provided there was no sham, assignments to guarantors did not fall foul of the anti-avoidance provision. 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 1995 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.

The matter was subsequently considered in *EMI Group Limited v O & H Q1 Limited* in March 2016. The High Court decided that a tenant could not assign a "new tenancy" under the Act to its guarantor. Any agreement which sought to give effect to such an arrangement was void, because it frustrated the purpose of the Act. The consequence was that the assignment did not take effect to vest the lease in the guarantor as an assignee, so the assignor remained the tenant and the guarantor retained its liability as guarantor.

The starting point for the Court's reasoning was the fundamental principle of the Act that on assigning a "new tenancy" (other than an "excluded assignment" as defined by the Act), the assignor is released from its lease liabilities as tenant and a guarantor for the tenant is likewise released. The exception to the release is that the assignor may be

required to enter into an authorised guarantee agreement in respect of its immediate assignee, which AGA may be guaranteed by the guarantor.

The Court considered that the "whole thrust of the Act" was that there should be no re-assumption or renewal of liabilities, whether on the tenant or the guarantor. If a tenant and the tenant's guarantor are each liable for the same or essentially the same liabilities as a result of the tenant's covenants of the tenancy, the guarantor cannot as a result of assignment by the tenant to it of the tenancy re-assume those very same, or essentially the same, liabilities as the tenant when the tenant itself has been released. The consequence of an assignment to the guarantor is that there is no release at all for the guarantor in respect of its liabilities under the tenant covenants and it is this which "frustrates" the operation of the Act.

The Court was in no way disconcerted by the potential commercial impact of its decision. The judge said that the fact that her conclusion is unattractively limiting and commercially unrealistic is neither here nor there.

There are some serious doubts about the correctness of this decision. The preeminent property expert and judge Mr Justice Morgan made some contrary comments in a talk delivered by him to the Property Bar Association prior to the decision. He said that on an assignment, section 24(2) of the Act operates to release the guarantor from its earlier guarantee and section 3(2)(a) operates to impose the burden of the tenant covenants on the former guarantor as assignee. The release under section 24(2) does not frustrate the operation of section 3(2)(a). The imposition of the burden of the covenants under section 3(2)(a) does not frustrate the release under section 24(2). Mr Justice Morgan said that there was no conceivable policy reason not to give effect to this logic. However, the judge in *EMI* referred to, but rejected, those comments.

Whatever one thinks about the decision, it is the law for now and its retrospective effect creates a number of uncertainties over what happens if an assignment is now treated as void as a result of the decision, which will cause concerns for landlords in investment terms.

The uncertainties include:

- What is the impact on registration of the assignment at the Land Registry?
- Or, on any derivative underlease or mortgage of the assigned lease?
- What is the position of the party in occupation who now is no longer the legal tenant under the assigned lease?
- If a tenant cannot assign a "new tenancy" under the Act 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 partnerships and trustees.

It is strange that the Court has decided that the guarantor is unable to become the tenant and use the premises, even if all the parties desired it.

The Committee considers that the Law Commission should determine whether they agree with the approach of the Courts on these issues and whether legislative change is required to overcome the very real commercial uncertainties that have been caused by ambiguities in the legislation. Consideration in particular of the issues of the validity of sub-guarantees and assigning to guarantors will be greatly welcomed.

Section 15

The provisions of section 15 of the Act, which relate to overriding leases, have some very strange consequences, some of which were mentioned, although not resolved by Lightman J, in First Penthouse Limited v Channel Hotels and Properties (UK) Ltd [2004] EWCA Civ 1072. On the face of it, it appears that an intermediate landlord can take an overriding lease of a building from the freeholder, and then find that the freeholder retains the right to forfeit the occupational lease, leaving the intermediate landlord with an empty building and no rental stream – which cannot ever have been the bargain between them.

Contracting out of sections 24 - 28 of the Landlord and Tenant Act 1954 ("1954 Act")

There are a number of concerns arising from changes made to the 1954 Act by the Regulatory Reform (Business Tenancies) (England and Wales) Order 2003. The Committee would be grateful if the Law Commission can consider these concerns and whether changes are required to the 1954 Act to address them. These concerns lead to inconsistent practices among professionals and potential delay, disruption and increased costs for commercial property transactions. The Government has in the past acknowledged concerns with the changes made by the 2003 Order and suggested possible changes to the legislation to deal with the concerns. The Committee considers that it would be sensible for the Law Commission to look at the Government's papers (a DCLG report, a copy of which we understand was previously given to the Law Commission) addressing such concerns and move forward the implementation of changes. The Committee is very happy to assist in providing further information in this regard. Set out below are a number of concerns that the Committee has.

The Committee's primary observation is that the system of warning notices and tenant's declarations under the 1954 Act that was supposed to streamline the contracting out process (as compared to the previous Court order process) has failed. There are legal uncertainties and differences of practice that the Committee highlights in its comments below, which can lead to delays on transactions and the incurring of extra, irrecoverable costs. As a result of the uncertainties in the way that the contracting out process works currently, the statutory declaration route is used in most cases, often signed on the same day that the tenant signs the agreement for lease/lease so that the tenant has no cooling off period. This means that the protection, which the contracting out regime was designed to provide, has been rendered virtually non-existent.

The Committee proposes that the contracting out warning notice and declaration mechanism under the 1954 Act be abolished and replaced by a requirement for a contracted out lease to have a clear warning at the top of the lease as to the statutory rights that the tenant loses. This would greatly reduce the administration and associated costs, yet at the same time warn the tenant that it is giving up statutory rights in entering into the lease. There are many potential traps for professionals and their clients with the current procedures as highlighted below and this simple solution would appear to overcome many of those problems.

If, however, the Law Commission is minded not to recommend such a solution, the Committee would ask the Law Commission to consider the more detailed points on the operation of the 1954 Act set out below.

Problems caused by the "Newham decision"

The decision in London Borough of Newham v Thomas-Van Staden [2008] EWCA Civ 1414 caused some consternation in the property community and the Committee would be grateful if the Law Commission can consider whether legislative change can be made to section 38A(1) of the 1954 Act to resolve the problems caused by the decision.

Section 38A (1) states "The persons who will be the landlord and the tenant in relation to a tenancy to be granted **for a term of years certain** which will be a tenancy to which this Part of this Act applies may agree that the provisions of sections 24 to 28 of this Act shall be excluded in relation to that tenancy."

It is the reference in bold to "for a term of years certain" that causes the problems.

Particularly prior to the "Newham decision", many leases, apparently contracted out of sections 24-28 of the 1954 Act, define the term of the lease to include "any holding over or continuation period" or words to that effect. The reference to a holding over or continuation period is inappropriate for a contracted out lease, because there is no such period for such a lease under the 1954 Act. Draftsmen sometimes included this reference or similar wording either due to inadvertence or because they thought it would do no harm to retain it since it was simply irrelevant.

However, the "Newham decision" confirmed that including such a reference meant that the lease could not be validly contracted out. This was because section 38A(1) required the contracted out tenancy to be for a term of years certain. The Court of Appeal in Newham decided that because the definition of term referred to holding over etc, this meant that the tenancy was not for a term of years certain and, therefore, was not validly contracted out.

The effect of this is that a landlord who may have redevelopment plans for a property and who assumed he could recover possession is now faced with the prospect of having to go through the 1954 Act procedures to seek to recover possession. All because the term definition included some words that many practitioners previously considered merely irrelevant.

The landlord and the tenant had agreed in heads of terms that the lease would be contracted out and the rent was agreed on that basis. Yet a tenant can potentially use the technical error highlighted by the "Newham decision" to gain an unfair advantage over the landlord.

For those reasons, the Committee would ask the Law Commission to consider the removal of for a term of years certain from section 38A(1).

Must the warning notice be served on the tenant direct?

There is sufficient doubt as to whether service on the tenant's solicitor will constitute good service that many law firms' practice over the years has been to serve on the tenant direct with a copy to its solicitor acting on the grant of the lease/agreement to surrender. This is inefficient. It should, however, be noted that especially in the last year many law firms have taken a slightly more pragmatic view on this and will serve on the tenant's solicitor who confirm they are authorised to accept service on their client's behalf.

Simple and statutory declarations

The Central London County Court in Patel v Chiltern Railway Co Ltd [23 May 2007] considered that there is no problem in using a statutory declaration when a simple declaration would have been sufficient. The Court of Appeal has subsequently confirmed the decision and the reasoning of the judge would appear to apply to the warning notice/statutory/simple declarations for agreements to surrender protected tenancies (falling within sections 24-28 of the 1954 Act). It would be good for the 1954 Act to make this clear.

There is a glitch in the drafting of the 2003 Order. Paragraph 7 of Schedule 2 (relating to the form of the simple declaration) requires the tenant to declare that the landlord served the warning notice not less than 14 days before the tenant entered into the lease etc – this is strange as the tenant has not yet entered into the lease and so logically cannot state what period elapsed before it was entered into. The consequence is that it may be unwise to rely on the simple declaration procedure where the declaration was made less than 14 days after the notice was served and as a result the statutory declaration procedure is used in most cases.

There is no current consensus on whether simple declarations and statutory declarations can be electronically signed (some law firms will accept this and others acting for the landlord take the cautionary view and insist on wet ink) so clarity on that would be helpful. The question of virtual swearing of statutory declarations may be out of scope of this Law Commission consultation, but the difficulties of in-person swearing have been encountered during the pandemic and it would be helpful for the Law Commission to consider this further.

Must the exchange of warning notice and declaration be repeated if the tenant's interest is assigned?

Yes, if the change of intended tenant occurs before the agreement for lease or lease (if no agreement for lease) is entered into. No, if the assignment occurs after the lease has been completed. However, the position is unclear, if the assignment occurs between the agreement for lease and grant of the lease. The solution is to prohibit assignment of the benefit of the agreement for lease either absolutely or without the landlord's prior consent. If the latter, the agreement for lease can make non-compliance with the new procedures a "circumstance" in which such consent can be absolutely withheld (for the purposes of section 19(1) (A) of the Landlord and Tenant Act 1927). Again, the position can be clarified by legislative change.

Must the exchange of warning notice and declaration be repeated if the landlord's interest is assigned?

There is a similar lack of clarity as to whether the exchange of warning notice and declaration must be repeated if the landlord's interest is transferred between the agreement for lease and grant of the lease. An example of where difficulties can arise is an agreement for a contracted out lease where a developer wants to include a right for it to novate the agreement with tenant's consent but the tenant cannot be contractually obliged in the agreement to go through the contracting out process in respect of the novated agreement.

How early can the landlord's warning notice be served?

A concern arises about whether the landlord's warning notice needs to be re-served if the form of lease is changed after service of the notice but before the lease is completed (or the agreement for lease is exchanged if earlier). In the past, the Office of the Deputy Prime Minister (ODPM) confirmed that the "spirit of the law" is that the tenant should only be able to validly give up its security of tenure rights if it knows what it is giving up. If the terms of the lease change materially after the tenant signs its declaration, the ODPM suggested that this would cast doubt on the informed nature of the tenant's consent (through the declaration). Therefore, by implication a new notice and declaration would need to be exchanged for the lease to be validly contracted out. The ODPM believed that the “Palacegate” principles (relevant to the former Court Orders for contracting out) still applied. Clarification here would be welcomed.

Does the warning notice need to be re-served and the declaration re-sworn if the form of lease attached to an agreement for lease is varied materially after exchange of the agreement but before completion of the lease?

This is, probably, not a problem if the "variations" are ones the parties were bound to agree in accordance with the terms of the agreement. Otherwise, problems may arise – perhaps the procedures should be re-done before the landlord is bound to agree the variations to the lease or, alternatively, perhaps the changes should not be made until after the lease has been granted and then the lease can be formally varied, but there may be tax consequences. Consideration should be given to whether the process can better take account of transactional realities.

Where the contracted out lease contains an option to renew on a contracted out basis, what needs to be done to ensure that the renewal lease is validly contracted out?

The warning notice and declaration must be exchanged in relation to the renewal lease (as it is intended to be granted) between the parties who are the intended landlord and tenant to the renewal lease before the tenant is contractually obliged to take up the renewal lease. There are at least two ways of achieving this:

- exchange the warning notice and declaration before the lease containing the option to renew is entered into. Therefore, with a contracted out lease containing an option to renew on a contracted out basis, there will need to be 2 sets of warning notices and declarations before the "original" contracted out lease (or agreement for such lease) is entered into. One set in relation to the original contracted out lease/agreement for such lease and one set for the renewal lease. However, this only works if the form of the renewal lease is frozen (or possibly where any changes are immaterial on the “Palacegate” test). Also the tenant may change during the currency of the original lease and, therefore, there will be a need to serve new warning notices on the assignee before it becomes contractually bound to take the renewal lease (to ensure it is validly contracted out). To deal with this, there will need to be an extra "circumstance" in the assignment provisions (for the purposes of section 19(1) (A) of the Landlord and Tenant Act 1927), permitting the landlord to refuse consent to assign unless the warning notice and declaration have been swapped in relation to the renewal lease. Even this would not pick up automatic assignees (by operation of law).
- wait until the tenant has decided to exercise the option before doing the contracting out paperwork. The tenant would need to be obliged in the option mechanism to serve an "advance notice" on the landlord that the tenant is going to exercise the option and it would need to be a precondition to completion of the renewal lease that the new procedures for contracting out have been carried out. The tenant will probably want a landlord's obligation to serve a warning notice within a specified period of receiving the tenant's advance notice. The advance notice will be a separate notice from the one exercising the option that contractually commits the tenant.

This is somewhat convoluted and it would be useful for the Law Commission to consider if this process can be streamlined.

A protected lease contains an offer back clause on tenant's assignment (or subletting) so that the landlord has the right to take the lease back before it passes to a third party. What has to be done to render binding the "agreement to surrender back" to the landlord?

There must be an exchange of the warning notice and declaration before the agreement to surrender becomes contractually binding. However, there is a potential impasse (the “Allnatt” stalemate) with offer back clauses in leases protected by Part II of the 1954 Act that have not specifically been authorised by the warning notice/declaration process. To deal with this, the offer back clause may prescribe that:

- the tenant notifies the landlord of its desire to assign;
- the tenant must obtain the landlord's consent to assign;
- the landlord, if it wishes to take the lease back, can choose to serve a warning notice within a particular time period of the tenant's notice;
- if and when, in response to the warning notice, the tenant signs the declaration (and provides a copy to the landlord), the obligation to surrender will arise but not before;

and the assignment provisions in the lease can prescribe that the landlord can withhold consent to an assignment to a third party unless and until the offer back procedures as above have been fully complied with.

With that arrangement, there may be a typical “Allnatt” stalemate in that if the tenant does not co-operate in signing the declaration, he cannot assign to the third party and yet the landlord cannot enforce the agreement to surrender. Commercially, however, the tenant is likely to sign the declaration to try to achieve its objective of assigning. In practice, many landlords and tenants who have entered into Allnatt-style offer back clauses simply follow the contractually agreed procedures and do not take the 1954 Act compliance point and of course once the surrender itself is completed the compliance issue goes away. However, the Law Commission should consider if there is any statutory solution to the “Allnatt” stalemate, which remains a potential problem in many commercial property transactions with the adverse impact of delay and extra cost.

Agreement to surrender part of premises and warning notice/declaration process

The warning notice/declaration process to authorise agreements to surrender leases protected by Part II of the 1954 Act applies to "the tenancy". Section 38A(2) of the 1954 Act states:

“The persons who are the landlord and the tenant in relation to a tenancy to which this Part of this Act applies may agree that **the tenancy shall be surrendered** on such date or in such circumstances as may be specified in the agreement and on such terms (if any) as may be so specified.”

It has been suggested in the past that the legislation should be made clear that the warning notice/declaration process can also be used for agreements to surrender part only of the tenancy. Some legal advisers (albeit a very small number) take the view that the only safe way to secure a surrender of part is for the tenant to agree to surrender the whole tenancy and then enter into a new lease for those parts of the premises that they will continue to occupy. This approach itself has disadvantages for both landlords and tenants.

It would therefore be helpful to make it clear that the warning notice/declaration process can apply also to agreements to surrender part only of the tenancy/premises.

The contracted out lease contains a put option whereby the landlord can require the tenant to take another contracted out lease. What needs to be done to ensure the new procedures are complied with in relation to the lease the tenant is required to take up?

The warning notice and declaration must be swapped in relation to the new lease (as it is intended to be granted) between the intended landlord and tenant to the new lease before the tenant is contractually obliged to take up that lease. The landlord can simply serve the warning notice before it exercises the put option. The problem for the landlord is it cannot compel the tenant to sign the declaration and if the declaration is not signed, the new lease will be protected. As a result, put options for contracted out new leases (a rare breed, admittedly) are not likely to be worth the paper they are written on.

More significantly, there remains the issue of put options in guarantor clauses in contracted out leases and whether there is a need to go through the new procedures in relation to a landlord requiring a guarantor to take up a new contracted out lease following a tenant's disclaimer. There are two schools of thought here. One is that if there is a guarantor and the guarantee contains such a put option, the landlord should serve a warning notice and the guarantor should sign a declaration before the "original" lease containing the guarantee is entered into. The more pragmatic view is that the new procedures should be carried out if and when the landlord requires the guarantor to take a lease following tenant disclaimer. Although there is a risk that the lease has not been properly contracted out, some landlords may take the view that this risk is less of an issue than the confusion that is caused by having to serve a multiplicity of warning notices on guarantors (which of course may include guarantors under licences to assign, underlet, authorised guarantee agreements etc).

It is worth reiterating that such warning notices and declarations do not relate to the contracted out lease that is about to be entered into, but relate instead to a lease that may never be entered into pursuant to the guarantee clause. Differences of practice among law firms cause confusion in the property industry and delay, disruption and extra costs on transactions. The Law Commission should look to clarify the position, perhaps, along the lines previously suggested by the Government that if the original lease is contracted out, the lease pursuant to the guarantee clause is automatically contracted out without needing to serve the notice on the guarantor and have a declaration for that lease. This would have an important beneficial deregulatory impact.

The "registration gap"

The "registration gap" continues to cause problems in practice, particularly in the light of the delays encountered with the processing of applications by Land Registry. It can take months for a registration to be completed, and in the meantime, the new owner (equitable but not yet legal) cannot serve notices in its own name. There may be numerous notices that need serving in respect of an investment property, for example, rent review trigger notices, notices under the Landlord and Tenant Act 1954, break notices etc.

A good example of this problem was the case of Stodday Land Ltd v Pye [2016] EWHC 2454 (Ch), where the court held that a new landlord cannot validly serve a notice on a tenant until it has become registered as proprietor of the property at Land Registry. This "registration gap" is a conveyancing trap and efforts need to be made to try to eliminate it.

If a buyer has paid for a property, surely it should have the rights of a landowner, even if the registration formalities have not yet been finalised. This could be addressed by stating in a Law of Property Act that a landowner will have the rights it will have when it becomes the registered proprietor as soon as the purchase money has been received by the registered proprietor.

Complications arising from the doctrine that an underletting for the residue of the headlease term can create an assignment

There is the well-known problem that the grant of an underlease for the residue of the term granted by the headlease may create an assignment of the headlease, which is usually not intended by the parties. A very common complication that arises in this area is where a tenant occupies under two consecutive terms and it is proposed that an underlease should be granted that straddles the term date in the first lease. There seems to be no specific authority on the subject, but there is a fear that granting one underlease would take effect as an assignment of the first lease.

For example, T occupies under two leases, one that ends on 31 August 2022 and a second (a reversionary lease) starting on 1 September 2022 and continuing for five years. If T were to grant an underlease ending on 1 October 2023, there is a fear that this would effect an assignment of the first lease. This is an absurd result and legislation should expressly provide that this is not the case. At present the only solution is for T to grant two underleases, the first for one day less than the length of the unexpired residue of the first lease, and the second starting on the date of the reversionary lease. This leaves one day in which the undertenant has no right to occupy the premises, which has to be fudged with a side letter in which T agrees not to take any action – which is arguably legally ineffective in any event. All of this generates unnecessary legal costs for the parties.

Impact of Residential right of first refusal on commercial transactions

The Committee also wishes to raise a concern in relation to the impact on commercial transactions of the Right of First Refusal in section 2 of the Landlord and Tenant Act 1987.

The Committee considers that there should be greater clarity in the legislation that the right of first refusal provisions do not apply to commercial transactions. This is particularly an issue in relation to mixed use properties as highlighted for example in Dartmouth Court Blackheath Ltd v Berisworth Ltd [2008] EWHC 350 (Ch). The legislation needs to be amended to make it clear that the right of first refusal does not apply in mixed commercial/residential premises to the grant of a lease of the commercial parts. Currently, if a landlord grants a lease of a shop on the ground floor of a mansion block, the grant of the shop lease may technically trigger the right of first refusal.

Conclusion

The Committee has highlighted the concerns in this response because they have caused and continue to cause problems on real estate transactions. The Committee

hopes that the Law Commission can consider the points raised and will be delighted to discuss this further with the Law Commission.

Land Law Committee

City of London Law Society