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Can You Avoid a Void Assignment?

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What are the consequences of the assignment (transfer) of a lease granted after 1 January 1996 to the guarantor of an existing tenant? This question was considered in the recent Chancery Division case of *EMI Group Ltd v O & HQ1 Ltd* [2016] EWHC 529(Ch), where the Court concluded that an assignment of a lease by a tenant to its guarantor is void, notwithstanding the commercial intention of the parties. In this Alert, we consider the issues arising from the EMI case and the key implications of it and some related decisions for guarantors, tenants, landlords and lenders to those parties.

The Background

The Landlord and Tenant (Covenants) Act 1995 ("the Act") provides that for leases granted after 1 January 1996, when a tenant lawfully assigns that lease, both it and its guarantor (if any) will be released from future liabilities to the landlord under the tenant covenants in the lease. Any attempts to agree otherwise will not work, as comprehensive anti-avoidance provisions in Section 25 are intended to ensure that the Act is not directly or indirectly frustrated.

The only way the Act permits a landlord to keep a tenant 'on the hook' after an assignment is for the landlord to impose a condition that the assigning tenant should enter into an authorised guarantee agreement (known as an "AGA"), to guarantee the covenants of the assignee. This guarantee falls away when the assignee is no longer liable for the tenant covenants in the lease, for example, where there is a subsequent assignment (with landlord's consent, if this is required). The Act's impractical and restrictive anti-avoidance provisions prevent parties from entering into what might otherwise appear to be assignments, particularly intra-group assignments, which would suit all parties commercially, and have caused a number of difficult issues, leading to a series of recent cases including the EMI case.

The Facts of the EMI Case

A lease was granted to HMV UK Ltd ("Tenant") with its parent, EMI Group Plc, as the guarantor ("Guarantor"). The Tenant went into administration in 2013, and the Guarantor asked the landlord, O & HQ1 Ltd ("Landlord"), for consent to assign the lease to it. The Landlord agreed and the lease was assigned to the Guarantor who granted an underlease to an associated company. Shortly after the assignment, the Guarantor advised the Landlord that although the assignment was valid, because of its interpretation of the Act, it was not liable to pay rent or to comply with the tenant covenants in the lease. The Landlord disagreed with the Guarantor's change of position and both parties applied to the Court.

The Legal Analysis

The principal question before Amanda Tipples QC, sitting in the High Court, was whether the Act prevented the Tenant from assigning to the Guarantor, and to what extent an arrangement which seeks to give effect to that is void by virtue of the anti-avoidance provisions in Section 25(1) of the Act.

The Court determined that a tenant is prevented from assigning a lease to its guarantor and that such an assignment is void, on the basis of the inter-relationship of the provisions in the Act relating to the release of the guarantor and the outgoing tenant and the assumption of liability by the assignee. The Court's view was that these all occur simultaneously, so there could be no release of the guarantor before it became the assignee; and therefore the anti-

avoidance provisions of the Act operated to invalidate the assignment. As the assignment was a nullity, the lease remains vested in the Tenant and the Guarantor remained liable under its original guarantee.

The Implications

The EMI case and the series of cases that preceded it have significant ramifications for guarantors, tenants, landlords (and indeed lenders to any of them) and we have summarised the key points below:

Guarantors

An existing tenant's guarantor:

- cannot take an assignment from the tenant whose covenants it has guaranteed (*EMI Group Ltd v O & HQ1 Ltd* [2016] EWHC 529(Ch)); and
- cannot guarantee the covenants of an incoming tenant (*Good Harvest Partnership v Centaur Services Limited* [2010] EWHC 33(Ch)); but
- can provide a sub-guarantee to a tenant's guarantee covenants in an AGA (*K/S Victoria Street v House of Fraser (Stores Management) Ltd* [2012] Ch.497); and/or
- can provide a guarantee to a second, or subsequent, assignee once it has been completely released in respect of its original guarantee on the first assignment (*UK Leasing Brighton Ltd v Topland Neptune Ltd* and *Zinc Cobham Ltd v Adda Hotels (an unlimited company)* [2015] EWHC 53(Ch)).

Landlords

A landlord:

- cannot include a requirement in a lease that the tenant's guarantor should guarantee an assignee as a pre-condition to consent to assign or to an intra-group assignment (*Good Harvest Partnership v Centaur Services Limited* [2010] EWHC 33(Ch));
- should now refuse an application to assign to a tenant's guarantor, making clear the reasons for such refusal;
- should review previous assignments carefully to check whether any have fallen foul of the anti-avoidance provisions of the Act and, if so, consider how to remedy the situation, possibly by the tenant that entered into the void assignment assigning to another group company;
- if a 'tenant' is occupying following a void assignment, should also consider whether an implied tenancy may have arisen and what the terms of this are – they may not be the same as the terms of the lease; and
- should, if there are arrears of rent and there has been a void assignment, check carefully whether any former tenants remain liable for the arrears and, if so, consider whether they are a good covenant for recovery.

Tenants

Tenants should consider:

- has there been a void transaction in any chain of assignments? If so, a tenant should either carry on with the 'implied tenancy' and pay the rent, or approach the landlord to see whether terms can be agreed for the grant of a valid tenancy;
- if the lease is subject to a charge, a tenant must inform the lenders and discuss the way forward;
- if any premium was paid to the assignor, the tenant should consider whether this can be recovered for the void assignment;
- former tenants who thought they had been released may still be liable if there has been a void assignment;
- any underleases granted after a void assignment may also be void and such issues will have to be resolved. There is added complexity where third parties are involved; and

- carefully whether any proposed assignments, such as into the joint names of itself and another, might also fall foul of the strict anti-avoidance terms of the Act (there is, however, no existing decision on this point).

Conclusion

The consequences of the EMI case are commercially unattractive and fail to give effect to the commercial intention of the parties; even so, the judge's view in the EMI case was that this was "neither here nor there". This is a classic case of putting the legal cart before the commercial horse and other members of the judiciary are understood to hold different views about the application of the Act.

Legislative reform is urgently required on these issues, and indeed, the Property Litigation Association, supported by industry and professional bodies, considers this to be the only route and the Law Commission has invited comments for further consideration.

Until either the decision is overturned, or the law is amended, all parties, particularly in corporate reorganisations, will need to consider carefully how to achieve the desired commercial result but without falling foul of the Act.