Neutral Citation Number: [2010] EWHC 330 (Ch)

Case No: HC09C01928

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 23 February 2010

Before :

MR JUSTICE NEWEY

- -

Between :

GOOD HARVEST PARTNERSHIP LLP	**Claimant**
- and -	
CENTAUR SERVICES LIMITED	**Defendant**

- -
- -

Mr Romie Tager QC and Mr Philip Kremen (instructed by **Brecher**) for the **Claimant**
Mr David Holland (instructed by **Osborne Clarke**) for the **Defendant**

Hearing dates: 19 and 20 January 2010

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JUDGMENT

Mr Justice Newey:

1. This case raises the question whether the Landlord and Tenant (Covenants) Act 1995 ("the Covenants Act") precludes a person who has guaranteed a tenant's obligations under a lease from being required to give a further guarantee in respect of an assignee of the lease.

Basic facts

2. The basic facts can be stated quite shortly.

3. By an underlease dated 5 October 2001 ("the Underlease"), David Gladman, Karen Gladman and Jonathan Shepherd, trading together as "Gladman Homes", demised to Chiron CS Limited ("Chiron") for a term of 10 years

from 16 July 2001 the premises comprising Unit G, Lymedale Business Park, Newcastle-under-Lyme, Staffordshire ("the Premises"). The rent was initially £206,387 annually, but subsequently rose to £245,000 per year. The defendant, Centaur Services Limited ("Centaur"), was also a party to the Underlease, as guarantor for Chiron.

4. The Underlease contained, among others, the following provisions:

i) Clause 5.9.3

By clause 5.9.3, the tenant covenanted "Not to assign … the whole of the Premises … without the prior consent of the Landlord such consent not to be unreasonably withheld or delayed."

ii) Clause 5.9.6

Clause 5.9.6 stated that the landlord was entitled to impose any or all of certain conditions on giving any licence for an assignment of the whole premises. Those conditions included these:

a) *Clause 5.9.6.1*

> "upon or before any assignment … the Tenant making the application for licence to assign and its guarantor (if any but not someone who has already given an authorised guarantee agreement) shall enter into an authorised guarantee agreement in a form permitted by Law and agreed between the parties"

b) *Clause 5.9.6.3*

> "prior to any permitted assignment to procure that the assignee enters into direct covenants with the Landlord to perform and observe all the Tenant's covenants and

> all other provisions during the residue of the Term so far as permitted by law"

c) *Clause 5.9.6.5*

> "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 referred to in clause 5.9.6.1"

d) *Clause 5.9.6.6*

> "the prospective assignee to provide a guarantor or guarantors approved by the Landlord (such approval not to be unreasonably withheld or delayed) where having regard to the financial standing of the prospective assignee it is reasonable for the Landlord to require its obligations under this Lease to be guaranteed"

5. Chiron assigned the Underlease to Total Home Entertainment Distribution Limited ("THED") on 1 September 2004. On the same day, Gladman Homes, Chiron and Centaur entered into a document described as an "authorised guarantee agreement" ("the Guarantee Agreement"). This recited that Gladman Homes had agreed to grant Chiron a licence to effect the assignment to THED subject to Chiron and THED entering into a formal licence (as happened) and to Chiron and Centaur entering into the Guarantee Agreement. The Guarantee Agreement proceeded to state, in clause 3.1, that Chiron and Centaur each covenanted with Gladman Homes (and their successors) that THED would pay rent, and otherwise perform the lessee covenants, "from the date of the Assignment [to THED] until the next lawful assignment of the Underlease".

6. On 12 January 2005 the headlease out of which the Underlease was carved was surrendered, and on 24 February 2005 the Claimant, Good Harvest Partnership LLP ("Good Harvest"), became the registered freehold proprietor. Good Harvest thus became THED's direct landlord.

7. The present proceedings, commenced on 9 June 2009, are to recover from Centaur, pursuant to the Guarantee Agreement, rent due under the Underlease on 25 December 2008 and 25 March 2009. The outcome of the claim can be expected to determine Centaur's liability for rent and other liabilities up to the expiry of the term in July 2011.

8. The application now before me was issued on 1 September 2009. By it, Good Harvest seeks summary judgment in its favour.

9. Centaur disputes the application on two grounds. First, it contends that the Guarantee Agreement is void and unenforceable as against it by reason of section 25 of the Covenants Act. Secondly, it argues that there is a triable issue as to whether the Underlease was surrendered or further assigned.

10. I shall take these points in turn.

The Covenants Act point

The Covenants Act

11. As its long title indicates, the Covenants Act makes provision "for persons bound by covenants of a tenancy to be released from such covenants on the assignment of the tenancy". Among other things, the Covenants Act serves to

curtail the extent to which an original tenant can be liable to the landlord after he has assigned the lease.

12. The Covenants Act implements, albeit with significant alterations, recommendations made by the Law Commission in its report *Landlord and Tenant Law: Privity of Contract and Estate* (Law Com. No. 174, 1988). In *Avonridge Property Co Ltd v Mashru* [2005] UKHL 70, Baroness Hale said (in paragraph 39):

> "The mischief at which the Commission's recommendations were aimed was the continuation of a liability long after the parties had parted with their interests in the property to which it related."

13. The Covenants Act represents a major change in the law. Neuberger J observed in *Wallis Fashion Group Ltd v CGU Life Insurance* (2001) P&CR 28, at paragraph 21, that the Act "represents a sea change in the law relating to a tenant's liability after he assigns the lease".

14. In keeping with its purpose, the Covenants Act provides for tenants and others to be released from their obligations when a lease is assigned. The relevant provisions include these:

i) Section 5

> "(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… ."

ii) Section 24

"(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 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 … ."

15. The expression "tenant covenant", which appears in both section 5 and section 24, is defined in section 28(1) as follows:

> "a covenant falling to be complied with by the tenant of premises demised by the tenancy"

A covenant on the part of a tenant to pay rent will thus be a "tenant covenant".

16. Section 25 of the Act is, as Lord Nicholls noted in the *Avonridge* case (at paragraph 14), "a comprehensive anti-avoidance provision". It states as follows:

"(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, or

(b) it provides for–

(i) the termination or surrender of the tenancy, or

(ii) the imposition on the tenant of any penalty, disability or liability,

in the event of the operation of any provision of this Act, or

(c) it provides for any of the matters referred to in paragraph (b)(i) or (ii) and does so (whether expressly or otherwise) in connection with, or in consequence of, the operation of any provision of this Act.

(2) To the extent that an agreement relating to a tenancy constitutes a covenant (whether absolute or qualified) against the assignment, or parting with the possession, of the premises demised by the tenancy or any part of them–

(a) the agreement is not void by virtue of subsection (1) by reason only of the fact that as such the covenant prohibits or restricts any such assignment or parting with possession; but

(b) paragraph (a) does not otherwise affect the operation of that subsection in relation to the agreement (and in particular does not preclude its application to the agreement to the extent that it purports to regulate the giving of, or the making of any application for, consent to any such assignment or parting with possession).

(3) In accordance with section 16(1) nothing in this section applies to any agreement to the extent that it is an authorised guarantee agreement; but (without prejudice to the generality of subsection (1) above) an agreement is void to the extent that it is one falling within section 16(4)(a) or (b).

(4) This section applies to an agreement relating to a tenancy whether or not the agreement is–

(a) contained in the instrument creating the tenancy; or

(b) made before the creation of the tenancy."

17. In *Avonridge*, Lord Nicholls (with whom Lord Hoffmann and Lord Scott expressed agreement) said, in paragraph 18, that section 25 is "to be interpreted generously, so as to ensure that the operation of the 1995 Act is not frustrated, either directly or indirectly".

18. Section 16, to which reference is made in section 25(3), is concerned with "authorised guarantee agreements". It details agreements which tenants can enter into to guarantee the obligations of their assignees up to the point that the lease is assigned again. The section provides as follows:

> "(1) Where on an assignment a tenant is to any extent released from a tenant covenant of a tenancy by virtue of this Act ('the relevant covenant'), nothing in this Act shall preclude him from entering into an authorised guarantee agreement with respect to the performance of that covenant by the assignee.
>
> (2) For the purposes of this section an agreement is an authorised guarantee agreement if–
>
> (a) under it the tenant guarantees the performance of the relevant covenant to any extent by the assignee; and
>
> (b) it is entered into in the circumstances set out in subsection (3); and
>
> (c) its provisions conform with subsections (4) and (5).
>
> (3) Those circumstances are as follows–
>
> (a) by virtue of a covenant against assignment (whether absolute or qualified) the assignment cannot be effected without the consent of the landlord under the tenancy or some other person;
>
> (b) any such consent is given subject to a condition (lawfully imposed) that the tenant is to enter into an agreement guaranteeing the performance of the covenant by the assignee; and
>
> (c) the agreement is entered into by the tenant in pursuance of that condition.
>
> (4) An agreement is not an authorised guarantee agreement to the extent that it purports–
>
> (a) to impose on the tenant any requirement to guarantee in any way the performance of the relevant covenant by any person other than the assignee; or
>
> (b) to impose on the tenant any liability, restriction or other requirement (of whatever nature) in relation to any time after the assignee is released from that covenant by virtue of this Act.

(5) Subject to subsection (4), an authorised guarantee agreement may–

(a) impose on the tenant any liability as sole or principal debtor in respect of any obligation owed by the assignee under the relevant covenant;

(b) impose on the tenant liabilities as guarantor in respect of the assignee's performance of that covenant which are no more onerous than those to which he would be subject in the event of his being liable as sole or principal debtor in respect of any obligation owed by the assignee under that covenant;

(c) require the tenant, in the event of the tenancy assigned by him being disclaimed, to enter into a new tenancy of the premises comprised in the assignment–

(i) whose term expires not later than the term of the tenancy assigned by the tenant, and

(ii) whose tenant covenants are no more onerous than those of that tenancy;

(d) make provision incidental or supplementary to any provision made by virtue of any of paragraphs (a) to (c).

(6) Where a person ('the former tenant') is to any extent released from a covenant of a tenancy by virtue of section 11(2) as from an assignment and the assignor under the assignment with the landlord with respect to the performance of that covenant by the assignee under the assignment–

(a) the landlord may require the former tenant to enter into an agreement under which he guarantees, on terms corresponding to those of that authorised guarantee agreement, the performance of that covenant by the assignee under the assignment; and

(b) if its provisions conform with subsections (4) and (5), any such agreement shall be an authorised guarantee agreement for the purposes of this section; and

(c) in the application of this section in relation to any such agreement–

(i) subsections (2)(b) and (c) and (3) shall be omitted, and

(ii) any reference to the tenant or to the assignee shall be read as a reference to the former tenant or to the assignee under the assignment.

> (7) For the purposes of subsection (1) it is immaterial that–
>
> (a) the tenant has already made an authorised guarantee agreement in respect of a previous assignment by him of the tenancy referred to in that subsection, it having been subsequently revested by him following a disclaimer on behalf of the previous assignee, or
>
> (b) the tenancy referred to in that subsection is a new tenancy entered into by the tenant in pursuance of an authorised guarantee agreement;
>
> and in any such case subsections (2) to (5) shall apply accordingly.
>
> (8) It is hereby declared that the rules of law relating to guarantees (and in particular those relating to the release of sureties) are, subject to its terms, applicable in relation to any authorised guarantee agreement as in relation to any other guarantee agreement."

The parties' submissions in outline

19. Mr David Holland, who appears for Centaur, argued that the Guarantee Agreement is avoided by section 25(1) of the Covenants Act in so far as it seeks to impose liabilities on Centaur. Section 24(2) of the Act is designed to ensure that, where a person has guaranteed a tenant's obligations, his liabilities in respect of the lease come to an end when the lease is assigned. To allow such a guarantor to be required to give a guarantee in respect of an assignee's obligations would, accordingly, "exclude, modify or otherwise frustrate the operation" of a provision of the Act, contrary to section 25(1). The only exception to the general rule that tenants and their guarantors should, alike, be relieved of obligations in relation to the lease on assignment is to be found in section 16, which allows tenants to give guarantees for their assignees, but section 16 makes no provision for guarantors to give further guarantees. Mr Holland further suggested that clause 5.9.6.1 of the Underlease was a "tenant

covenant" within the meaning of the Act, with the result that, by virtue of sections 5 and 24, both tenant and guarantor were released from the provision.

20. On the other hand, Mr Romie Tager QC, who appears with Mr Philip Kremen for Good Harvest, submitted that the Guarantee Agreement did not exclude, modify or otherwise frustrate the operation of the Covenants Act and so was not avoided by section 25. As a result of the Guarantee Agreement, Centaur undertook new obligations from the date of the assignment to THED; Centaur was nonetheless released from its obligations under the Underlease. Had Parliament intended to interfere with the ability of guarantors to give guarantees for assignees, it would have made specific provision in relation to guarantors; the fact that it did not do so indicated that it did not consider guarantors to need protection in this respect. There could be no good reason for barring guarantors from giving guarantees for assignees. Where a tenant gives a guarantee for an assignee, it is open to the original guarantor to provide a sub-guarantee of the tenant's obligations as guarantor; it would be anomalous if the guarantor could not enter into a direct guarantee for the assignee.

21. Both sides agreed that a trial Judge would be in no better position than I am to decide whether section 25 of the Covenants Act is an answer to Good Harvest's claim against Centaur and that I could and should, accordingly, arrive at a final conclusion on the issue notwithstanding that the application before me is for summary judgment.

Conclusion

22. I have concluded that section 25 of the Covenants Act does bar Good Harvest's claim against Centaur. I can summarise my reasons as follows:

i) Section 24 of the Act was meant to ensure that any obligations undertaken by a person as guarantor for a tenant should come to an end on the assignment of the lease. Mr Tager suggested that the guarantor's obligations would in any event have terminated under the general law relating to guarantees when section 5 of the Act released the tenant from liability. However, I do not think it matters for present purposes whether Mr Tager is right about this. The important point is that Parliament intended section 24 to relieve the guarantor of any liability he might otherwise have had in respect of the guarantee he had given;

ii) If the guarantor is required to enter into a further guarantee when the lease is assigned, it seems to me that the guarantee can, as a matter of language, fairly be said to "frustrate the operation of any provision of [the] Act" (to quote from section 25(1)(a)), in that it would, if valid, impose on the guarantor obligations equivalent to those from which section 24 was designed to secure his release. This conclusion is reinforced by the fact that section 25 is, as noted above, "to be interpreted generously";

iii) Mr Tager argued otherwise on the basis that the guarantor would be undertaking *new* obligations, not reviving old ones. A tenant who gave a guarantee for an assignee could, however, similarly be said to be undertaking new obligations, yet it is abundantly clear that Parliament

intended a tenant to be able to give no guarantee other than an AGA. As I see it, a premise underlying section 16, which provides for AGAs, is that a tenant could not otherwise give any guarantee: in other words, that section 16 represents an exception to a general prohibition. If (subject to section 16) the Act precludes tenants from giving guarantees for assignees, it is difficult to see why guarantors should not likewise be barred from giving such guarantees;

iv) Had Parliament intended a tenant's guarantor to be able to guarantee obligations of an assignee, it could have been expected to say so explicitly, particularly since guarantors are mentioned expressly in the Act more than once (see sections 12(1)(b), 17(3) and 18(3)). It has not done so, however;

v) Section 16 addresses the circumstances in which a tenant can give a guarantee for an assignee, but there is no equivalent provision dealing with guarantors. Nor does section 16 itself contain any reference to guarantors. There is no indication in the section that an AGA can include a guarantee from anyone other than the tenant;

vi) Were it the case that a tenant's guarantor could be required to give a guarantee for an assignee of the tenant, there would seem to be nothing to limit the guarantor's exposure to the period before that first assignee himself assigned. Liability under an AGA given by a tenant has to come to an end when the tenant's assignee assigns: see section 16(4). Since, however, section 16 makes no reference to guarantors, there would be no similar restriction on how long such a guarantor's liability

could continue. Yet for a landlord to be able to call on a tenant's guarantor to give a guarantee for assignees other than the first could drive the proverbial "coach and horse" through the legislation. Take a case in which, as must be common, a parent company or a director gives a guarantee for a tenant. If the guarantor could be required to guarantee obligations of assignees other than the particular assignee to whom the tenant assigned, it might mean little that the liability of the tenant itself had to come to an end by the time the assignee assigned on: the parent company or director would remain liable. The effectiveness of the Act could thus be seriously undermined;

vii) I do not think it is by any means clear that the Covenants Act permits a guarantor to sub-guarantee a tenant's obligations under an AGA. Mr Tager suggested that it could be seen from sections 17 and 18 that a guarantor could give such a sub-guarantee. In this connection, Mr Tager drew attention to the fact that section 17(3) envisages a person guaranteeing "the performance by the former tenant of such a covenant as is mentioned in subsection (1)", and he said that section 17(3) would thus relate to a guarantor of a tenant's obligations under an AGA; he made, moreover, a similar point about section 18(3). However, I agree with Mr Holland that sections 17(3) and 18(3) do not obviously refer to guarantees of tenants' obligations under AGAs. So far as section 17(3) is concerned, the words "such a covenant as is mentioned in subsection (1)" appear to relate to "a tenant covenant of the tenancy under which any fixed charge is payable", and section 18(3) speaks of someone guaranteeing the performance "by the former tenant of a tenant

covenant of the tenancy". In each case, therefore, Parliament seems to have in mind a guarantee of the performance by a former tenant of a tenant covenant. Under an AGA, however, a former tenant is not himself under any obligation to perform tenant covenants; his obligation, as section 17(1)(a) recognises, is to guarantee the performance *by his assignee* of tenant covenants. Section 17(3) is thus more obviously applicable to pre-Act tenancies, under which a tenant can remain liable on tenant covenants notwithstanding assignment, than to AGAs given in connection with what the Act terms "new tenancies". In any case, even if a guarantor could sub-guarantee a tenant's obligations under an AGA, it would not necessarily follow that he should be able to give a direct guarantee for an assignee. In short, I do not think it helps to try to answer the question whether a guarantor can give a sub-guarantee;

viii) It is fair to say that, if the Covenants Act serves to bar a guarantor from giving a guarantee for an assignee, that involves a restriction on freedom of contract. However, the Act is plainly designed to impose restrictions on freedom of contract. The question is how far those restrictions go;

ix) It is fair to say, too, that, if the Act is to be construed as Mr Holland suggests, it will be capable of operating in ways that look arbitrary. Mr Tager took, for example, the case of a parent company guaranteeing a subsidiary's obligations under a tenancy. If it proved desirable to transfer the lease to another subsidiary, why, asked Mr Tager, should

the parent company be unable to act as guarantor? However, it appears to me that the Act could sometimes operate in apparently arbitrary (or at least uncommercial) ways even if I accepted Mr Tager's submissions. Suppose, for example, that a company entered into a lease and that the lease was subsequently, as a result of successive group reorganisations, assigned first to one subsidiary and then to another. The Covenants Act would, even on Mr Tager's case, prevent the parent company from giving any guarantee for the second subsidiary however much it wished to and however commercially desirable that was;

x) In the present case, it is apparent that Centaur was required to enter into a further guarantee when the Underlease was assigned to THED. The recitals to the Guarantee Agreement confirm that Gladman Homes made it a condition of the grant of the necessary licence to assign that Centaur should enter into the Guarantee Agreement;

xi) Accordingly, the Guarantee Agreement is invalidated by section 25 of the Act in so far as it purports to impose liability on Centaur.

23. It follows that, in my judgment, Centaur has a complete defence to Good Harvest's claim and that I should dismiss the proceedings.

The surrender/further assignment point

24. Centaur's alternative argument was that I should not accede to Good Harvest's application because there is a triable issue as to whether the Underlease has been surrendered or further assigned.

25. Mr Holland argued that Centaur has, at the least, a more than fanciful prospect of establishing that the Underlease has been surrendered by operation of law or that there has been either an equitable assignment or an assignment by sub-letting of the Underlease. In support of this submission, Mr Holland pointed to evidence to the following effect:

i) In the autumn of 2006 THED's parent company was acquired by the Woolworths Group;

ii) In May 2007 Good Harvest was informed that the THED operation was to cease and merge with Entertainment UK Limited, another wholly-owned subsidiary of Woolworths. In the following months employees of THED were made redundant and the company vacated the Premises;

iii) In August 2007 THED applied to Good Harvest for consent to assign the Underlease to Woolworths plc;

iv) In February 2008 the entire assets and undertaking of the company were sold, for the most part to Entertainment UK Limited;

v) From about the spring of 2008 the Premises were being occupied by Wincanton under some form of service agreement for another Woolworths company called "MCR" or "Multi Channel Retail";

vi) During 2008 several invoices for rent were addressed to "Entertainment Distribution Limited", and that two such invoices, in respect of the rent due on the June and September quarter days, were paid by Entertainment UK Limited rather than THED.

26. On the other hand, there is evidence before me that Good Harvest has never granted consent to any assignment of the Underlease by THED and that neither THED's directors nor the administrators of Woolworths and Entertainment UK Limited have ever suggested that any assignment or subletting has taken place; in this connection, Mr Tager not only referred to evidence from Good Harvest but pointed out that Centaur has adduced evidence as to what one of its directors has been told by a former director of THED, but it is not said that the latter has spoken of the Underlease having been surrendered or assigned by THED. As regards the invoices addressed to "Entertainment Distribution Limited", these are, as Mr Tager noted, the last three words of THED's name ("Total Home Entertainment Distribution Limited"), and the evidence is that the relevant invoices were addressed to THED's registered office. There is evidence, too, that the application for consent to assign the Underlease made in 2007 was withdrawn in August 2008 and that the Premises are currently being marketed on behalf of the Woolworths Group on the footing that they are "available by way of an assignment or sub-lease of an existing FR&I 10 year lease which commenced in July 2001": in other words, on the basis that the Underlease remains in being. Further, Mr Tager made the point that what will have mattered to Good Harvest will have been that the rent was being paid, not which company wrote the cheques.

27. As Mr Holland recognised, there is no direct evidence before me that the Underlease has been the subject of a surrender or further assignment. Nor, as it seems to me, is there any solid basis for inferring that the Underlease might have been surrendered or assigned on. In all the circumstances, I can see no

real prospect of the Court accepting at a trial that the Underlease had been either surrendered or assigned by THED. It follows that, but for my conclusion on the Covenants Act point, I would have granted Good Harvest summary judgment on its claim.

Conclusion

28. In the light of the conclusions I have arrived at on the Covenants Act point, I shall dismiss the proceedings.