

Guarantees The *Good Harvest* Decision: Good for Guarantors, Bad for Landlords



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Bad News for Landlords

In the recent case of *Good Harvest Partnership LLP v Centaur Services Limited* the judge made Landlords quake in their boots by deciding that Landlords cannot enforce guarantees given by the guarantors of out-going tenants in respect of the liabilities of assignees. This decision is seen as a set-back for Landlords and should the decision be upheld in the Court of Appeal on 29 June 2010 it will certainly have far-reaching implications.

Background

Before the Landlord and Tenant (Covenants) Act 1995 (“the Act”) came into existence on 1 January 1996, an original tenant (or, by express covenant on an assignment, a subsequent tenant) was obliged to ensure that all subsequent tenants (“assignees”) complied with their covenants. This obligation lasted for the duration of the lease. A former tenant could therefore be sued should a subsequent assignee not comply with their obligations under the lease. This led to a situation where a tenant could be approached by a landlord many years later to pay the debt of a later assignee with which it had no connection.

The Act abolished this onerous provision, instead limiting the tenant’s liability to a guarantee of the performance of the tenant’s covenants under the lease only by the person/company to whom it assigned the lease, which was a much fairer system.

The guarantee by the out-going tenant is contained in an “Authorised Guarantee Agreement” (“AGA”) whereby the tenant guarantees the performance of the assignee’s obligations for so long as the assignee is the tenant.

In addition Landlords could, prior to this case, require that as a condition of their consent to an assignment a tenant’s guarantor should also enter into the AGA. Landlords argued that the basis for this condition is that a guarantor committed to guaranteeing the tenant’s performance of its covenants under the lease. If the tenant, when entering into an AGA, enters into new covenants then the guarantor should also guarantee these new covenants.

Authorised Guarantee Agreements

An AGA is an agreement whereby the tenant guarantees the performance of the tenant’s covenants under the lease by the assignee. Once the assignee lawfully assigns the lease the original tenant’s guarantee falls away. The assignee would subsequently guarantee the next assignee and so on. This procedure prevented the out-going tenant from being liable for subsequent generations of assignees as was the case before the Act was introduced.

However, the Act was silent as to whether the guarantor could be obliged to enter into an AGA (a “parallel guarantee”), thus keeping it on the hook after an assignment.

The situation which arose therefore was one where Landlords routinely required guarantors of the out-going tenants also to provide these parallel guarantees as a condition of consenting to the assignment. Was this lawful? The appeal decision in the Good Harvest case is about to tell us.

The Decision in *Good Harvest v Centaur*

The facts of the case are set out below.

In 2001 Chiron entered into a 10 year lease. Centaur (the Defendant) provided a guarantee of Chiron's obligations in a guarantee covenant in the lease.

When Chiron assigned the lease to Total Home Entertainment Distribution Limited ("THED"), both Chiron and Centaur provided a guarantee of THED's obligations.

Good Harvest later became THED's Landlord and THED eventually defaulted in its rent payments. As such Good Harvest sought to claim the money owed by THED from Centaur under the guarantee.

Centaur maintained in court that the guarantee agreement was invalid as the Act prevented the AGA from being enforced against the guarantor. The reason they put forward was that by keeping the guarantor on the hook, the Landlord was essentially avoiding the purpose of the Act, which was to release the tenant and its guarantor from their obligations upon assignment.

The court agreed. It was held that the guarantee given by Centaur was void and unenforceable in relation to THED (although the guarantee given by the tenant would not be affected) and, if Chiron was unable to pay, Good Harvest was unable to recover the rent from Centaur.

What are the implications of this case?

The implications of this decision are important for Landlords and have been described by commentators as a "straight-jacket" dramatically reducing the options of the Landlord on assignment by a tenant.

Landlords can only now rely on guarantees given in an AGA by a tenant. It is clear that a guarantor's guarantee given under an AGA is not worth the paper it is written on.

To add further insult to injury, Landlords may now find that money previously recovered from guarantors of assignees may well be subject to a claim for repayment in that the money was paid out under a mistake of law (i.e. that the guarantee was enforceable) when the Good Harvest case makes it clear it is not.

Landlords may also find themselves in a position whereby there is now no incentive for parent company guarantors to apply pressure on their subsidiaries to pay up where subsidiaries have provided guarantees under an AGA because there is now no recourse against the parent company guarantor.

Practical issues for Landlords

There are a number of things that a Landlord should consider in the light of the Good Harvest decision:

- Whether to obtain a guarantee from a new guarantor whom they know to have solid financial standing.
- Should additional security, such as a rent deposit, be requested from the tenant or assignee on assignment? This may make it harder for assigning tenants to obtain licence to assign.

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- A Landlord could insist that the guarantor become a party to the Lease as joint tenant (with joint and several liabilities) or as a joint assignee. This way the guarantor (as a tenant) can be required to enter into an AGA. Landlords should however be aware that this approach may be deemed by the courts to frustrate the purpose of the Act and might therefore result in the Landlord being unable to enforce against the guarantor-tenant.
- A Landlord could insist that a tenant sub-let a property rather than assign it as this does not release the original tenant or the guarantor from their obligations.
- Landlords could demand that a lease is granted to the main parent company and allow the parent company to sub-let to their subsidiaries. This way the parent company will be liable should the subsidiary default.

Comment

Although the judgement handed down by the Judge in this matter has been described as harsh on Landlords, it does seem as though the Act has been interpreted correctly and that the decision has finally clarified the intention of Parliament, which was to release guarantors from their obligations on assignment.

It could be argued that by requiring guarantors to enter into subsequent AGAs the intention of the Act and of Parliament was being side-stepped.

Many commentators have sided with the Landlords on this issue maintaining that it is too onerous a decision, preventing them from prolonging what was in most cases a very valuable guarantee and one but for which the assignment might not have been permitted. However whilst this is true, one must consider the counter argument which is that the courts have, for now, closed a loop-hole which Parliament had intended to close 15 years ago.

This decision need not be terminal for Landlords; it just means that from now on they will need to choose financially strong tenants rather than weak tenants backed up with strong guarantors. However should the appeal be rejected and the decision upheld, it will cause ructions on assignments of those leases entered into prior to this decision.

We wait to see what the Court of Appeal has to say on this important issue for Landlords.

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If you would like any further information regarding this important issue for Landlords, please contact Keith Miller on the details below.

Need to know more?

Ask us.

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