

## From gold to dust

**Leases** often suffer in economic downturns, with tenants wanting to offload premises and landlords protecting their investment. *Daniel Levy* and *Philip Freedman* survey the landscape. Illustration by *Clare Nicholas*

News of planned store closures seems to be a daily occurrence in the current economic climate, but where administrators have not been called in, the usual rules of the game still apply. Both tenants and landlords will benefit from a good understanding of these rules as the pressures on occupiers to reduce liability and on landlords to preserve their investments compete. While no single case or Act contains everything that a surveyor needs to know, it is important to keep up with the latest developments. A summary of the position is set out below.

### Assignment or underlet

What options are available to tenants? Calling in the administrators is one, but questions of insolvency are outside the scope of this article. Another is to offer back the property by way of a surrender, but this is unlikely to succeed in most circumstances. It is also possible to close the premises, but this might encourage a return to the “keep open” issues of the late 1990s. The preferred choice is to seek an assignment or underletting.

Parties should read the lease and any relevant ancillary documents with care. If the lease was granted before 1996, the assignment provisions will no doubt be simple and will probably provide that the landlord’s consent for the assignment cannot be unreasonably withheld; this will be implied where the clause allows assignment with consent: section 19(1) of the Landlord and Tenant Act 1927. Older leases, however, sometimes impose preconditions for seeking consent to assign (*Bocado SA v S&M Hotels Ltd* (1979) 252 EG 59), such as requiring the tenant to offer to surrender the lease to the landlord instead of assigning it. This could open up a number of complex legal questions and it would therefore be wise to consult a solicitor, since the validity of these clauses will depend largely upon the circumstances

and wording: *Allnatt London Properties Ltd v Newton* (1982) 265 EG 601.

A lease granted after 1995 is likely to be a “new tenancy” governed by the Landlord and Tenant (Covenants) Act 1995 and the Landlord and Tenant Act 1927, as amended. It will probably provide that the landlord can refuse consent for assignment in stated circumstances (section 19(1A)(a) of the 1927 Act) and may allow the landlord to impose specified conditions when giving consent: section 19(1A)(b) of the 1927 Act. The tenant should carefully analyse these provisions when preparing its consent application in order to minimise opportunities for the landlord to refuse consent or to impose conditions that the tenant is not ready to meet.

Generally, these provisions fall into two categories, one for the existing tenant and

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another for the proposed assignee. Provisions for tenants often include the requirement for rent to be paid up to date, lease covenants to be performed, landlord’s costs to be paid and the provision of an authorised guarantee agreement (AGA), if the assignment goes ahead, under sections 16, 16(1) and 25(3) of the 1995 Act. Proposed assignees frequently face financial tests and requirements for guarantees or rent deposits.

Tenants should check if any of these provisions purport to give the landlord, or any other party, discretion in deciding whether they have been fulfilled. Any provision that enables a party to exercise

that type of judgment must require that party to act reasonably or provide for an independent determination in the event of a dispute: section 19(1C) of the 1927 Act. Clauses that fail to meet these requirements will be invalid. For example, a lease provision may be void if it states that the landlord can refuse consent if it considers that the proposed assignee is not of sufficient financial standing, but does not require the landlord to act reasonably in forming that view or to provide for third-party determination in the event of a dispute.

Detailed provisions setting out grounds for refusing consent or conditions for granting consent will normally apply in addition to the basic provision that the landlord’s consent cannot be unreasonably withheld. Under that provision, the landlord can refuse consent if a reasonable landlord would consider that it had proper reasons to do so, even if another reasonable landlord would be willing to give consent: *Pimms Ltd v Tallow Chandlers Co* [1964] 2 QB 547 and *Ashworth Frazer Ltd v Gloucester City Council* [2001] UKHL 59; [2002] 05 EG 133.

### Reasons for refusal

The landlord has to use proper reasons when refusing consent, reflecting the ongoing landlord and tenant relationship, and not objections that have an ulterior motive, such as trying to secure a surrender of the lease: *Lord Tredegar v Harwood* [1929] AC 72, *Oriel Property Trust v Kidd* (1949) 154 EG 500, *Anglia Building Society v Sheffield City Council* (1982) 266 EG 311 and *Bromley Park Gardens Estates Ltd v Moss* (1982) 266 EG 1189.

Consent is often refused on the ground that the proposed assignment would adversely affect the value of the landlord’s reversion; this test is generally accepted by the courts: *Ponderosa International Development Inc v Pengap Securities (Bristol)*



*Ltd* (1985) 277 EG 1252 and *NCR Ltd v Riverland Portfolio No 1 Ltd (No 2)* [2005] EWCA Civ 312; [2005] 22 EG 134. However, this is not the only or overriding test. Consent can be refused where the proposed assignee is clearly unacceptable, even if diminution in the value of the reversion cannot be shown: *Royal Bank of Scotland plc v Victoria Street (No 3) Ltd* [2008] EWHC 3052 (Ch).

However, the court has to balance the interests of the partner where reasonable, and there may occasionally be special circumstances in which a court might apply the “undue hardship” rule in favour of the tenant. This will prevent the landlord from withholding consent for the assignment: *International Drilling Fluids Ltd v Louisville Investments (Uxbridge) Ltd* (1985) 277 EG 62. However, it is likely to be confined to cases where there is no prospect of the landlord suffering loss, and where the hardship to the tenant from being unable to assign the lease outweighs any detriment “on paper” to the landlord.

#### Landlord considerations

In deciding whether to give consent, the landlord is entitled to take account of all relevant circumstances, including the financial status of the proposed assignee. Accordingly, the tenant should prepare a pack for the landlord providing adequate information on the financial standing and business track record of the proposed assignee as well as meeting any other particular requirements of the lease. At a minimum, the landlord is entitled to be shown, to its reasonable satisfaction, that the assignee will be able to meet the rents and other tenant liabilities under the lease. This applies notwithstanding that the assigning tenant may remain under continuing liability to the landlord for the same obligations: *Ponderosa International and Royal Bank of Scotland*.

A test to see whether the proposed assignee’s accounts show pre-tax profits of not less than three times the rent payable under the lease has sometimes been applied. In some cases however, where profits fail such a test other financial data may provide sufficient evidence of a proposed assignee’s financial ability to meet the lease obligations: *Venetian Glass Gallery Ltd v Next Properties Ltd* [1989] 30 EG 92.

One area of uncertainty is whether a landlord can insist upon the assignee meeting the required financial status or whether it would have to accept an otherwise inadequate assignee alongside an adequate guarantor.

In some older cases, a landlord was able to reject the offer of a suitable guarantor as a matter of principle: *Geland Manufacturing Co v Levy Estates Co Ltd* (1962) 181 EG 209 and *Warren v Marketing Exchange for Africa* [1988] 2 EGLR 247. However, that point has



not always been argued, and in *British Bakeries (Midlands) Ltd v Michael Tetler & Co Ltd* (1986) 277 EG 1245, the court had to consider if the landlord had been reasonable in rejecting a proposed guarantor. It applied a test of whether that party had sufficient free assets or income outside of the business that the proposed tenant intended to conduct.

The strength of the landlord’s conceptual argument against having to accept a guarantor may be reinforced by the uncertainty as to whether: (i) a guarantor’s liability has to end, under section 24(2) of the 1995 Act, on a permitted assignment by the relevant tenant; or (ii) the lease can make the guarantor liable for the period after such an assignment. If, for that period, the landlord can only rely upon the assigning tenant’s AGA without recourse to the guarantor, there is an argument for having a sound tenant rather than a sound guarantor.

Each case will turn on its own facts, and it is the transaction as a whole that the landlord may need to consider.

#### Information packs

Preparing a pack for the landlord will also enable the tenant to take advantage of the Landlord and Tenant Act 1988. In cases where consent cannot be unreasonably withheld, the Act imposes a duty on the landlord to give its decision within a reasonable time and allows the tenant to sue the landlord in damages if it fails to comply with that duty or unreasonably refuses or withholds its consent. The 1988 Act does not, however, allow a tenant to ignore requirements that are validly imposed in the lease: *Air India v Belabel* [1993] 30 EG 90 and *Dong Bang Minerva (UK) Ltd v Davina Ltd* [1996] 31 EG 87.

If the tenant fails to provide the landlord with any information to which it is entitled, the landlord must ask for it without delay, otherwise it may be in breach of its duties under the 1988 Act: *Blockbuster Entertainment Ltd v Leakcliff Properties Ltd* [1997] 08 EG 139.

#### Underletting

The majority of leases allow tenants to underlet the entire premises but some permit the underletting of part only. However, there is no standard rule. Once again, the provisions of the lease in respect of the underletting and tenant requirements need to be scrutinised.

If underletting is permitted, it will invariably be subject to the landlord’s consent, which cannot be unreasonably withheld. Since the 1995 Act does not apply to underletting, it is rare to find detailed provisions concerning the minimum financial standing of a proposed underlessee. Nevertheless, the basic requirement for consent allows the landlord to have regard to this standing, particularly where the underlease has the protection of the 1954 Act so that the landlord may have the underlessee as its direct tenant when the lease expires: *NCR Ltd*.

#### Onerous rents

Detailed provisions concerning the terms of any underlease are usual, especially with regard to the extent of the premises, the minimum level of rent, the repairing and other terms to be imposed on the undertenant and the inclusion or exclusion of security of tenure.

Provisions requiring the rent to be at least the same as the passing rent have been largely discredited as being unduly onerous upon tenants and unnecessary for landlords. However, if these or other requirements of any underlease are clearly set out in the lease they must be adhered to, even if they are not objectively reasonable: *Crestfort Ltd v Tesco Stores Ltd* [2005] EWHC 805 (Ch); [2005] 37 EG 148 and *Clinton Cards (Essex) Ltd v Sun Alliance & London Assurance Co Ltd* [2002] EWHC 1576 (Ch); [2002] 37 EG 154. It is worth noting that several major landlords have announced that they will not enforce a provision for the minimum rent to be the passing rent as long as it is at least level with the market rent.

Property is often the largest single cost to a business after its staff. Occupiers’ desire for flexibility in accommodation arrangements has perhaps never been more pronounced than now. In turn, landlords are keener than ever to protect their investments and not to agree to anything that might dilute them. More than 20 years have passed since parliament last legislated on consent for alienation and, in that time, it has been left to the courts to shape the landscape. As the new economic cycle runs its course, the courts will no doubt again be asked to provide further guidance and government, too, may come under pressure to codify further both parties positions.

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