

Real Estate Bulletin

An unexpected rent bill

In the current economic climate, landlords are likely to be looking far more closely at their options against former tenants or guarantors if a current tenant falls into arrears. The question many landlords will be asking is “can I recover these arrears from a former tenant?”. The answer is: probably.

The Landlord & Tenant (Covenants) Act 1995 introduced a procedure which a landlord must follow to recover arrears from former tenants. The procedure involves service of a notice commonly known as a s17 notice.

Below we look at some of the frequently asked questions from those who may have received such a notice.

I have received a s17 notice. What should I do?

- Investigate liability. Former tenants or their guarantors, whether the original tenant or an intermediate tenant, may remain liable for the arrears (including interest) of its successors. Under old leases (pre-1 January 1996), the original tenant and any subsequent tenants remain liable, provided that they have entered into a direct covenant with the landlord. These covenants are usually included in standard licences to assign. A former tenant of a new lease will be liable if it entered into an Authorised Guarantee Agreement on assignment; acting as a guarantor of the next tenant’s obligations.

- **Timing.** The s17 notice must be served within six months of the date on which the arrears fell due. The landlord is only entitled to backdate arrears for six months, but can continue to claim future arrears. The landlord can serve fresh notices in respect of any further arrears which it is seeking to recover, or for any amounts which were previously unascertained. This can include the ability to reserve increased amounts, for example following a rent review. This means a tenant will not necessarily be forewarned that further notices for increased amounts are to follow.
- The recent House of Lords decision in *Scottish & Newcastle v Ruzuz*¹ confirmed that s17 notices only need to be served by landlords within six months of a rent review being finalised. This could be some time following the actual rent review date.
- **Variations of the lease.** Former tenants will not be liable for any increased amounts which result from a variation of the lease which they were not party to.

What am I entitled to having settled the landlord's s17 demand?

What initially appears unfair, is that the former tenant effectively receives nothing in return for settling the current tenant's debts. However, the 1995 Act also instituted a procedure which former tenants and their guarantors can instigate to give them some control of events. The procedure operates by way of the grant of an overriding lease.

What is an overriding lease?

- This is a new lease granted to the former tenant, which slots in between the interests of the landlord and the current, defaulting tenant. The former tenant will, therefore, become the direct tenant of the landlord, and in turn becomes the landlord of the existing tenant.
- The benefit of an overriding lease is that the former tenant once again acquires an interest in the premises, and the ability to regain control and occupation of the premises.

What are the conditions for the grant of an overriding lease?

- The former tenant can only call for an overriding lease if and when it has settled the s17 arrears (including any interest).
- It is important for former tenants to note that they should not pay the landlord for any arrears until they have received a s17 notice. It is receipt of the s17 notice (and payment) which entitles them to call for an overriding lease.
- The former tenant is obliged to make a request in writing for the overriding lease, no later than 12 months after the s17 arrears have been settled.

¹ [2008] UKHL 65

What will be the terms of the new overriding lease?

- The Act provides that the overriding lease will be on the same terms as the existing lease, except for:
 - any personal covenants between the landlord and the tenant; and
 - any changes which are agreed between the parties.
- The lease term will be three days longer than the unexpired residue of the existing lease, so that it survives the expiry of the undertenant's lease.
- The overriding lease will be a new tenancy if the existing lease is a new tenancy, and an old tenancy if the existing lease is an old tenancy.
- The tenant should remember that it will be obliged to pay the landlord's reasonable costs in connection with the grant of the overriding lease. SDLT will also be payable on the new lease.

What happens if I am an intermediate tenant?

Only a tenant who settles the arrears, pursuant to a s17 notice, is entitled to call for an overriding lease. A landlord may serve a s17 notice on, for example, an original tenant, who may settle those arrears and then make a claim for payment under the indemnity given by the intermediate tenant on assignment. It is important to note that the intermediate tenant has no right to an overriding lease because it has not received a s17 notice.

What happens next?

- Completion of the overriding lease gives the tenant an interest in the premises. However, the grant of the overriding lease will be subject to the underlease and so it will not necessarily entitle the tenant to occupy and use the premises or otherwise deal with them. The underlease will have to be forfeited (subject to relief from forfeiture) if the tenant is to regain occupation.
- Another point to consider is that the tenant is once again subject to the usual tenant covenants in the overriding lease, as well as the landlord's covenants in the underlease.

Conclusion

Receiving a s17 notice can be an unpleasant shock for former tenants or guarantors who have long forgotten about these sorts of ongoing liabilities.

The overriding lease procedure is an important tool for a former tenant or guarantor who finds themselves liable to remedy breaches by their successors.

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