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GOOD HARVEST – BAD DECISION

By Simon Hartley

Almost 15 years after the Landlord and Tenant (Covenants) Act 1995 ("**the Act**") came into force, the High Court decided in *Good Harvest Partnership LLP v Centaur Services Limited* ("Good Harvest") that a tenant's guarantor is released on a lawful assignment of a lease (entered into after 1 January 1996) and cannot be required to enter into an authorised guarantee agreement ("**AGA**").

Centaur Services Limited ("**CS**") was a guarantor under a lease granted in 2001. In 2004 the tenant ("**T**") assigned the lease with the landlord's consent. As a condition of the landlord's consent being granted the lease required that both CS and T enter into an AGA, which they duly did.

In June 2009, the landlord issued proceedings against CS. Relying upon the AGA, it sought recovery of rent arrears owed by T's assignee. CS defended the claim, arguing that the AGA was void on the basis that it contravened the Act. The High Court agreed.

Mr Justice Newey concluded that the AGA was void on the following grounds:

- Tenants and their guarantors are released from liability in relation to the tenant covenants in a lease upon a lawful assignment pursuant to s5 and s24 of the Act.
- The release is limited only by the provisions of s16 of the Act, which says that a tenant may provide an AGA guaranteeing the incoming tenant's liability. S16 does not refer to guarantors, which Mr Justice Newey interpreted as evidence of a parliamentary intention that guarantors should be unable to provide AGAs and, therefore, should be released unconditionally from them.
- Any attempt to require a guarantor to enter into an AGA would frustrate the Act, which is contrary to the anti-avoidance measures in s25. S25 of the Act states that any attempt to "exclude modify or otherwise frustrate the operation of the Act" is void and, therefore, unenforceable.

Although irrelevant to the facts in *Good Harvest*, Mr Justice Newey went on to consider two further questions:

1. Whether a tenant's guarantor can also volunteer to act as a guarantor of the assignee?
2. Whether the landlord could have required CS to provide a sub-guarantee (a guarantee of T's obligations in the AGA) as an alternative to guaranteeing the assignee's obligations?

Simon Hartley *is a senior associate in the Litigation and Dispute Resolution group at Mayer Brown International LLP.*

+44 20 3130 3928
shartley@mayerbrown.com

The Court held that both arrangements would be void. He went further: saying that where one subsidiary assigns a lease to another subsidiary the tenant's parent company guarantor cannot provide a guarantee for the assignee "however much it wished to and however commercially desirable that it was".

The decision in *Good Harvest* means that landlords cannot require a guarantor to guarantee an assignee's obligations either by way of an AGA or a direct guarantee. Further, landlords will not be able to recover arrears owed by an assignee from a former tenant's guarantor even if it has entered into an AGA or guarantee stating otherwise. The covenants being offered by the existing tenants in that position have, therefore, effectively decreased in strength.

This is an issue of particular concern in relation to data centres as the relatively high rents payable under leases of larger data centres mean that landlords require strong financial covenants, either directly or, commonly, via a parent company guarantee.

For data centre tenants, flexibility is an issue to ensure that the data centre can continue to meet the needs of this business plan. Inter-group transfers are one element of this. The original parent company guarantee regularly remains in place to secure the obligations of the inter-group assignee.

The additional observations made in *Good Harvest* about the voluntary provision of guarantees and sub-guarantees were not related to the subject matter of the case. They are, therefore, not binding authority. However, the comments will still be treated as persuasive by other Courts and so should not be overlooked, particularly when dealing with inter-group assignments and parent company guarantees. Accordingly:

1. Landlord's should be cautious in accepting parent companies as an assignee's sole guarantor where the parent company is a guarantor for the tenant. According to *Good Harvest*, the landlord would be left without valid security;
2. Where assignments have already occurred, effectively transferring a parent guarantee from a former tenant to the assignee, a landlord cannot assume it will be able to rely upon the guarantee and so should consider alternative options for recovery;
3. On an application to assign, landlords should look more carefully at the covenant strength of proposed assignee and, where appropriate, demand additional security from the assignee in the form of a new guarantor, rent deposit or bank guarantee;
4. Provisions requiring for guarantors to enter into sub-guarantees or AGAs should not be deleted from leases as the decision in *Good Harvest* may be overturned by the Court of Appeal.
5. For the same reason, where the current tenant is in arrears, it would, be advisable for landlords to continue to protect their positions by serving notice on any former tenant's guarantors under s17 of the Act within the prescribed 6 month time limit from the date of accrual. The landlord will otherwise lose the right to recover those arrears from the former tenant's guarantor should the *Good Harvest* decision be overturned.

It has always been the case that tenants' guarantors are not released on an under-letting. While landlords are unlikely to be able to insist that a tenant under-lets rather than assigns, if a landlord has reasonable grounds for objecting to an assignee on the basis of its covenant strength, it may be able to compel

the tenant to under-let and, in that way, secure the benefit of the tenant's and the guarantor's continuing liability under the head lease. This may not be a particularly attractive option for tenants, who will not be released from their covenants upon the assignment of the under-lease in the way they would have been on a subsequent assignment of the lease.

Another alternative is to restructure a transaction so that the tenant assigns the lease to itself and the guarantor before they both assign it to the intended new tenant. Assigning to the guarantor has the effect of making the guarantor a tenant and, therefore, it should be able to enter into an AGA pursuant to s16 of the Act. However, given the Court's wide interpretation s25 of the Act, it is possible that this may be held to contradict the anti-avoidance provisions.

The *Good Harvest* decision has created considerable uncertainty but is being appealed. The appeal is due to be heard on 24 June 2009 before a Court of Appeal including Master of the Rolls, and former property barrister, Lord Neuberger. It is hoped that the Court of Appeal will take the opportunity to address the many questions posed by the judgment of the High Court and restore some commerciality to the protection of guarantors afforded upon the assignment of a lease.

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James Dodsworth
+44 20 3130 3827
jdodsworth@mayerbrown.com

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June 2010