Neutral Citation Number: [2016] EWHC 529 (Ch)

Case No: HC-2015-001165

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Rolls Building, Fetter Lane, London, EC4A 1NL

Date: 16/03/2016

Before:

MISS AMANDA TIPPLES QC

Between :

EMI GROUP LIMITED — **Claimant**

- and -

O &H Q1 LIMITED — **Defendant**

Mr J Seitler QC (instructed by **GSC Solicitors LLP**) for the **Claimant**
Mr K Reynolds QC (instructed by **Clarke Willmott LLP**) for the **Defendant**

Hearing date: 1 December 2015

Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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Miss Amanda Tipples QC:

Introduction

1. The Landlord and Tenant (Covenants) Act 1995 ("the Act") came into force just over 20 years ago on 1 January 1996. The long title to the Act explains that it is:

> "to make provision for persons bound by covenants of a tenancy to be released from such covenants on the assignment of the tenancy, and to make other provision with respect to rights and liabilities arising under such covenants …".

2. The Act implemented, albeit with significant alterations, the recommendations made by the Law Commission in its report *Landlord and Tenant Law: Privity of Contract and Estate* (1988) (Law Com No. 174) and represented a major change in the law.

3. The background to the Act is explained in a number of well known decisions: *Wallis Fashion Group Ltd v CGU Life Assurance* 81 P&CR 393, Neuberger J at [3]-[5], [21]; *London Diocesan Fund v Phitwa (Avonridge Property Co Ltd, Part 20 defendant)* [2005] 1 WLR 3956, HL at [10]-[11] per Lord Nicholls of Birkenhead, and at [37]-[39] per Baroness Hale of Richmond; *Good Harvest Partnership LLP v Centaur Services Ltd* [2010] Ch 426, Newey J at [11]-[13]; and *K/S Victoria Street v House of Fraser (Stores Management) Ltd* [2012] Ch 497, CA (Lord Neuberger of Abbotsbury MR, Thomas, Etherton LJJ) at [14] to [16].

4. The Act applies to the lease in this case and, in November 2014, that lease was assigned by the original tenant to its existing guarantor. This gives rise to the two issues I have to decide, namely:

   (1) whether the Act precludes the guarantor of an assignor from becoming the assignor's assignee (or, using the terminology used in some of the cases, whether the guarantor (G1) of the tenant (T1) is precluded from becoming the assignee of the tenancy (T2)); and

   (2) if this arrangement is precluded by the Act, to what extent are the agreements which purport to give effect to it avoided by section 25(1) of the Act.

5. The Claimant is the guarantor of the original tenant. It maintains that the lease has been assigned to it by the original tenant, so that it is now the tenant. However, the Claimant's case is that, although the legal interest in the tenancy is now vested in it as the assignee of the lease, the tenant's covenants in the lease are void by reason of sections 24(2) and 25(1) of the Act. The Defendant is the landlord. It maintains that this arrangement between the tenant and its guarantor is not precluded by the Act but, if it is, the consequence is that the assignment of the tenancy by the original tenant to its guarantor is rendered void by the Act. Before me the guarantor was represented by Mr Jonathan Seitler QC and the landlord was represented by Mr Kirk Reynolds QC.

6. The conclusion I have reached is that a tenant is precluded under the Act from assigning the tenancy to its guarantor and any agreement which seeks to give effect to

such an arrangement is void by reason of section 25(1) as it frustrates the purpose of the Act. This means that, on an assignment by T1, G1 cannot become T2.

7. The reasons are set out below. However, I first of all need to say something about the facts of this particular case (which are not controversial) and then explain the relevant provisions of the Act, together with the few but important cases in which these provisions have been considered.

Relevant facts

8. By a Lease dated 26 September 1996 ("the Lease") CHB Group Ltd (company number 2356570) as landlord granted to HMV UK Ltd ("the tenant") a tenancy for a term, starting on 24 June 1996 and expiring on 3 February 2021, of retail premises known as 88/89 High Street and Unit 31, Chapel Walk, Crowngate Centre, Worcester. The Lease is a standard form lease of retail premises and it is not suggested that there is anything unusual or remarkable about the terms of it. The Lease, as mentioned above, is a "new tenancy" to which the Act applies.

9. On the same date a Deed of Guarantee ("the Guarantee") was entered into between EMI Group Plc (which is the Claimant, now known as EMI Group Ltd) as guarantor. By Clause 2.1 of the Guarantee the guarantor, in consideration of the landlord granting the Lease to the tenant, unconditionally and irrevocably covenanted with and guaranteed to the landlord:

> "that until the Tenant is released from liability by section 5 of the Landlord and Tenant (Covenants) Act 1995 the Tenant will pay and discharge the Secured Obligations [defined to mean the obligation to pay all sums from time to time due or expressed to be due to the Landlord from the Tenant under the Lease and to perform all other obligations which from time to time are or are expressed to be obligations of the Tenant under the Lease] when the same fall due or are expressed to fall due under the Lease for payment and discharge."

10. Clause 2.4 of the Guarantee provided that:

> "The guarantee and covenant contained in clause 2.1 shall impose upon the Guarantor the same liability as if the Guarantor were itself the principal debtor in respect of the Secured Obligations and such liability shall continue notwithstanding (and shall not be discharged in whole or in part or otherwise affected by): (a) any forbearance by the Landlord to enforce against the Tenant its covenants in the Lease; (b) the giving of time or other concessions or the taking or holding of or varying realising releasing or not enforcing any other security for the liabilities of the Tenant; … and for the purposes of this clause 2 the Tenant shall be deemed to be liable to continue to pay and discharge the Secured Obligations notwithstanding any of the above matters and any money expressed to be payable by the Tenant which may not be recoverable from the Tenant for any such reason shall be recoverable by the Landlord from the Guarantor as principal debtor."

11. At some point in time CHB Group Ltd assigned its interest in the Lease to the Defendant, O & H Q1 Ltd (company number 05277211).

12. On 15 January 2013 the tenant, by then known as Record Shop 1 Ltd, went into administration.

13. On 28 November 2014 a Licence to Assign was entered into, by which licence was given by the Defendant to the tenant to assign the Lease to the Claimant (referred to in the Licence to Assign as "the Assignee"). The Defendant's unchallenged evidence, set out at para 4.3 of Bonnie Martin's witness statement is that:

> "it was the Claimant itself (which was then bound as Guarantor under the Deed of Guarantee) which suggested to the Defendant that there should be an assignment of the Lease to the Claimant with the expressed intent that the obligations of the Claimant as Guarantor should, by virtue of the assignment itself, be replaced by the tenant obligations under the Lease, at the same time as the Original Tenant was released from the tenant obligations by operation of the Act."

I mention this piece of evidence because at one point the Claimant submitted that the Defendant landlord "brought the present situation all on itself" as it could have refused consent to the assignment on the basis that the assignment would be to a party, the Claimant, who would not be bound by the tenant covenants. This contention seems somewhat unfair in the light of Ms Martin's evidence and, to the extent it is of any relevance, I do not accept it.

14. By Clause 4.1 of the Licence to Assign the Claimant, as Assignee, covenanted with the Landlord:

> "at all times after the completion of the Assignment throughout the residue of the Term or until it is released from its covenants pursuant to the 1995 Act to pay the rents and all other sums payable under the Lease and to observe and perform all the covenants and conditions on the lessee's part contained in the Lease."

15. On the same day by a Deed of Assignment made by the tenant, the Claimant and the tenant's administrators, the Lease was assigned to the Claimant. Also on 28 November 2014 an Underlease was granted by the Claimant to a new company, HMV Retail Ltd, for a term starting on the date of grant and expiring on 31 January 2017. The rent is £226,450 per annum, the same amount as that passing under the Lease.

16. On 18 December 2014 the Claimant's solicitors wrote to the Defendant's solicitors stating that that, although the assignment of the Lease and the grant of the Underlease were valid, the tenant's covenants in the Lease could not be enforced against the Claimant. They relied on para [37] of the Court of Appeal's decision in *K/S Victoria Street* in support of this proposition. On 4 March 2015, the Defendant's solicitors responded to this letter setting out their reasons why this argument was wrong.

17. On 11 March 2015 the Claimant issued this claim seeking a declaration that the Lease has "as a matter of law vested in the Claimant by assignment and by operation of law, the tenant covenants thereunder are void and cannot be enforced against the Claimant." On 7 May 2015 the Defendant issued an application seeking permission to bring a counterclaim for alternative declarations, together with a declaration based on mistake in the event a declaration is made in terms set out in the claim form.

18. By a consent order sealed on 2 June 2015 Master Clark directed the trial of the following preliminary issue, namely "Whether the court should declare that, for the purposes of [the Act]:

    (1) (as sought by the Claimant) the Lease has as a matter of law vested in the Claimant by assignment, and by operation of law the tenant covenants therein are void and cannot be enforced against the Claimant; or

    (2) (as sought by the Defendant) notwithstanding that the Lease has been vested in the Claimant, the tenant covenants therein are valid and can be enforced against the Claimant; or

    (3) (as sought by the Defendant in the alternative) the purported assignment of the Lease to the Claimant is void and of no effect, with the result that the Lease remains vested in the Original Tenant, and that the Claimant remains bound as Guarantor of the Original Tenant's obligations under the Lease by virtue of [the Guarantee] and has not been released from its obligations under the Deed of Guarantee by the operation of [the Act]."

19. On 6 July 2015 the tenant's Administrators filed notice to move from administration to dissolution and the tenant was duly dissolved on 14 October 2015. The Lease is now vested in the Crown as bona vacantia. In relation to the alternative declaration sought by the Defendant, it is also relevant to mention that in 2015 the Defendant gave written notice to the Claimant pursuant to clause 3.1 of the Guarantee that the Defendant, as landlord, required the Claimant, as Guarantor, to take a new Lease of the Premises.

The Act

(a) *Section 5*

20. Sections 5(1) and (2) provide:

> **"5. Tenant released from covenants on assignment of tenancy.**
>
> (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 –
>
> (1) is released from the tenant covenants of the tenancy, and

> (2) ceases to be entitled to the benefit of the landlord covenants of the tenancy,
>
> as from the assignment."

21. Section 28 provides that "tenant covenant", in relation to a tenancy, means a covenant falling to be complied with by the tenant of premises demised by the tenancy and "covenant" includes term, condition and obligation, and references to a covenant (or any description of covenant) of a tenancy include a covenant (or covenant of that description) contained in a collateral agreement.

22. Section 5 only applies to "new tenancies", being tenancies granted on or after 1 January 1996, the date the Act came into force: sections 1(1) and 1(3).

23. In *London Diocesan Fund* Baroness Hale of Richmond (who was a member of the Law Commission at the time of the report) explained that (para [39]):

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

24. In *K/S Victoria Street* Lord Neuberger of Abbotsbury MR (giving the judgment of the court) said that "this aim is centrally achieved through section 5, subsection (2)(a)" (para [16]). In *London Diocesan Fund* Lord Nicholls described sections 5 to 8 of the Act as "relieving provisions" and in relation to these provisions:

> "16. They are intended to benefit tenants, or landlords, as the case may be. That is their purpose. That is how they are meant to operate. These sections introduce a means, which cannot be ousted, whereby in certain circumstances, without the agreement of the other party, a tenant or landlord can be released from a liability he has assumed. The object of legislation was that on lawful assignment of a tenancy or reversion, irrespective of the terms of the tenancy, the tenant or landlord should have an exit route from his future liabilities. This route should be available in accordance with the statutory provisions.
>
> 17. Thus the mischief at which the statute was aimed was the absence in practice of any such exit route…"

25. However, if an assignment has been made in breach of covenant or by operation of law then section 5 does not have any effect in relation to that assignment: section 11(2)(a).

26. The only exception to the operation of section 5 (and also section 24(2), set out below) is an authorised guarantee agreement or AGA under section 16 under which the existing tenant whose covenants would be released under section 5 agrees to guarantee the performance of those covenants by the assignee only until any subsequent assignment of the lease: section 25(3). However, the issues in this case do not concern AGAs.

(b) *Section 24(2)*

27. Section 24(2) is concerned with the position of any party, other than a tenant, who is bound by any of the tenant's covenants in a tenancy (see *K/S Victoria Street* at para [17]). This sub-section provides:

> "(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."

28. At para [24] of *K/S Victoria Street* the Court of Appeal explained that:

> "the whole thrust of section 24(2), indeed of the 1995 Act itself, is that a person should not remain liable under a tenancy after the tenant with whose liability he is associated has been released from his liability."

29. Further, just as section 5 is intended to benefit tenants, section 24(2) is intended to benefit guarantors: *K/S Victoria Street* at para [37] (p. 511D). It is therefore a "relieving provision" and, applying by analogy what was said by Lord Nicholls in *London Diocesan Fund*, the guarantor "should have an exit route from his future liabilities" which "cannot be ousted".

30. The background to this is explained at paras 4.53 to 4.55 of the Law Commission's report:

> **"Guarantors**
>
> 4.53 The position of those who enter into leases as guarantors must be considered. The liability of a true guarantor is dependent upon the liability of the principal debtor. When the latter ceases to be liable, there is no obligation for the former to guarantee. Accordingly, if the result of our proposals would be to release a party to a lease, be he landlord or tenant, that would automatically end the responsibility of that party's guarantor.
>
> 4.54 Most of the people now named in leases as guarantors for the tenant actually assume liabilities which make them principal debtors, with obligations independent of those of the party whose covenants they are said to guarantee. They have rights of reimbursement against their principals, but they will not, as a matter of law, be released from

> their obligations merely because the principal is released. To permit such guarantors, or more strictly indemnifiers, to remain liable when the tenant has been wholly released under our proposals, would undermine the thrust and purpose of those recommendations. We therefore go further. *Whenever the liability of a tenant would be wholly cancelled under our recommendations, we recommend that liabilities which had been undertaken in parallel and are essentially to the same effect would also be terminated.*
>
> 4.55 When a tenant is partially released from his obligations under our proposals, we recommend that a third party who has entered into a parallel obligation supporting the tenant's liability be released to the same extent. This effect will be automatic, without the third party having to take any action." (*emphasis* added)

31. The Claimant in this case is not simply a guarantor, but is also a principal debtor with primary liability in respect of the obligations under the Lease: see clause 2.4 of the Guarantee set out at paragraph 10 above.

(c) *Section 25*

32. Section 25, so far as material, provides:

> **"25. Agreement void if it restricts operation of the Act.**
>
> (1) Any agreement relating to a tenancy, is void to the extent that –
>
> (1) it would apart from this section have effect to exclude, modify or otherwise frustrate the operation of any provision of this Act, or
>
> (2) 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
>
> (3) 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.
>
> ...
>
> (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."

33. Section 25 is, as Lord Nicholls explained in *London Diocesan Fund*, a "comprehensive anti-avoidance provision" which is "of course to be interpreted generously, so as to ensure the operation of the Act is not frustrated, either directly or indirectly" (paras [14] and [18]).

34. Section 25(1)(a) was considered in detail by the Court of Appeal in *K/S Victoria Street*. In that case the claimant, referred to in the judgment as "Victoria", had agreed to purchase the freehold of a large department store from the then freehold owner, House of Fraser (Stores Management) Ltd, referred to in the judgment as "Management", which was a subsidiary of House of Fraser plc, referred to in the judgment as "HoF". The agreement provided that, immediately upon completion of the purchase, Victoria would grant, and Management would accept the lease, with HoF acting as guarantor of Management's liabilities. Victoria did not regard Management as a satisfactory tenant and the parties agreed that the lease would be assigned to another company within the HoF group (with the default position being that the lease should be assigned to a company referred to in the judgment as "Stores") and, in relation to that assignment, HoF would enter into a deed of guarantee of that assignee's liabilities as surety. The obligation of HoF to enter into a further guarantee was recorded in clause 3.5(iii) of the agreement. The lease was not assigned and remained vested in Management. The claimant, Victoria, contended that it should be assigned to Stores, with HoF renewing its guarantee "pursuant to its apparent obligation to do so under clause 3.5(iii)". Management and HoF contended that clause 3.5(iii) was unenforceable and refused to effect the assignment to Stores.

35. Victoria then brought proceedings, seeking an order that the lease be assigned to Stores with HoF as guarantor of Stores' liability. The defendants' contention was that clause 3.5(iii) was rendered void by section 25(1)(a), as it would "frustrate the operation" of section 24(2)(b). The defendants' argument is recorded at para [20] of the judgment of the Court of Appeal:

> "The argument proceeds as follows. On the assignment of the lease by Management to Stores in accordance with clause 3.5(ii), Management will be released from all further liability under the lease, by virtue of section 5(1), so section 24(2)(a) is satisfied; and, as HoF is "another person" who is "bound by [the] covenant[s] of the [lease]", section 24(2)(b) also applies. Accordingly, it is the effect and intention of section 24(2)(b) that, as from the release of [Management]", ie on the assignment to Stores, HoF should be released from its liabilities as guarantor under the lease. Any provision such as clause 3.5(iii), which stipulates in advance that HoF must re-assume precisely that liability

> as a term of the assignment, would therefore "frustrate" the operation of section 24(2)(b), and its therefore rendered void by section 25(1)(a)."

36. The Court of Appeal held that this argument was correct (para [21]), and the reasons for doing so are set out at paras [21] to [29] of the judgment of the court. Lord Neuberger explained:

> "21. ... If a landlord could (a) when granting a tenancy, impose an obligation on the tenant's guarantor to guarantee the liability of the assignee in the event of an assignment, and (b) on an assignment by a tenant, enforce that obligation, it would, as a matter of ordinary language, "frustrate" the operation of section 24(2). If it were otherwise, it would mean, for instance, that a landlord, when granting a tenancy, could require a guarantor of the tenant's liabilities, on every assignment of the tenancy, to guarantee the liability of each successive assignee. Such an obligation ("a renewal obligation") would plainly be wholly contrary to the purpose of section 24(2), as it would enable a well-advised landlord to ensure that any guarantor was in precisely the position in which it would have been before the 1995 Act came into force."

37. Pausing there, Mr Seitler, counsel for the Claimant, submitted that there is no distinction to be drawn between the example given by Lord Neuberger in the first four lines of para [21], and the present situation. This is because the Claimant is the tenant's guarantor falling within (a) and, in relation to (b), the Claimant guarantor having become the tenant, will be liable as the assignee, and the landlord can enforce that obligation, which is the very same obligation it had as guarantor before the assignment. Further, he submitted it does not make any difference whether the landlord's requirement that the tenant's guarantor provide the guarantee has been agreed in advance, or whether the request for such a requirement had been made "spontaneously" (by which I think he meant "freely offered" by the assignor and guarantor), as this point had been resolved in *K/S Victoria Street*. He therefore submitted, in this case, there was a "renewal", but not a "renewal obligation" as such.

38. Returning to the judgment in *K/S Victoria Street,* Lord Neuberger continued:

> "22. If a renewal obligation were enforceable, in many cases, for instance where the prospective occupier of commercial property was a member of a group of companies, a landlord could also effectively avoid the effect of section 5(2) by requiring a subsidiary company in the group to take the tenancy, with the parent company acting as guarantor on terms which included a renewal obligation. Indeed, it could go further than this: as a matter of logic, if such a liability could lawfully be imposed on and enforced against a guarantor of the original tenant, it is hard to see why it could not be imposed on the original tenant itself.

> 23. Given the plain purpose of the 1995 Act, and the widely expressed terms of section 25(1)(a) and 25(4), any contractual arrangement contained in the tenancy (or in a prior agreement), which imposes an obligation, on an existing or prospective guarantor of the tenant's liabilities, to guarantee the liabilities of a future assignee should be void. That conclusion is supported by what was said in the *Avonridge* case [2005] 1 WLR 2956, paras 14 and 18, by Lord Nicholls of Birkenhead. He described section 25 as a "comprehensive anti-avoidance provision", which was "to be interpreted generously, so as to ensure the operation of the Act is not frustrated, either directly or indirectly".
>
> 24. For the avoidance of doubt, this conclusion would also apply to a contractual arrangement contained in a later document, for instance a renewal obligation imposed on a guarantor of an assignee's liabilities in an assignment or a licence to assign. Subsection (4) makes it clear that section 25 applies to agreements "whether or not" they are made in, or prior to, a tenancy. Accordingly, if, as we consider, a renewal obligation imposed on a guarantor of the original tenant is void, it must follow that the imposition of a renewal obligation on the guarantor of an assignee would also be void."

39. The claimant, Victoria, ran two arguments against this conclusion. The first argument, recorded at para [26] of the judgment, was that the purpose of section 24(2) was "solely to ensure that the release of a tenant under section 5(2) was effective", so that the tenant's guarantor is unable to "to seek through subrogation an indemnity from the tenant as the principal creditor, even though the tenant had been released from primary liability" and on that basis "a provision such as clause 3.5(iii), or indeed a renewal obligation, does not "frustrate" the purpose of section 24(2)". This argument was rejected by the Court of Appeal on the following basis:

> "27. … we do not accept that section 24(2) has the limited purpose for which [counsel for Victoria] contended. Its language does not suggest such a limited purpose, and the whole thrust of section 24(2), indeed of the 1995 Act itself, is that a person should not remain liable under a tenancy after the tenant with whose liability he is associated has been released from his liability. Further, paras 4.53 and 4.54 of the Law Commission report (Law Com No 174), which were relied on by [counsel for Victoria], do not support the notion that the section has such a limited purpose. The former paragraph states that when the lessee's liability ceases "that would automatically end the responsibility of [his] guarantor". Para 4.54 says that if a guarantor remains liable after the lessee is released, it "would undermine the thrust and purpose of [the Commission's] recommendations"."

40. Victoria's second argument was that, on the unusual facts of the case, section 25(1)(a) should not apply. In particular, Victoria's counsel pointed to the fact that the parties did not have any intention of evading the provisions of the Act (para [28]). The Court

of Appeal expressed "considerable sympathy" with this second argument. However, it was also rejected. This was explained by Lord Neuberger at para [29]:

> "... it seems to us that it would be wrong to accede to the argument, both as a matter of principle and as a matter of practice. It would be wrong in principle because section 25(1)(a) applies to any provision which would "have effect to ... frustrate the operation of", inter alia, section 24(2). In other words, it is the objective effect of a particular provision, and not the subjective reasons for its existence, which determine its validity for the purpose of section 25(1). It would be wrong in practice to adopt the approach inherent in the submission, because it would introduce an element of uncertainty, and the opportunity for disputes of fact, into an area where it is important to have predictability".

41. The Court of Appeal then said that the discussion, which I have set out above, was "enough to dispose of Victoria's appeal". However, it then went on to consider the reasoning and decision of Newey J in *Good Harvest* because, amongst other things, the decision in *Good Harvest* seemed to have led to some controversy and uncertainty in the field of landlord and tenant.

42. At para [34] Lord Neuberger said:

> "For the reasons already discussed, an agreement which *requires* a guarantor to provide a further guarantee in the future falls foul of section 25(1), because it involves a guarantor, at a time that he is, or is agreeing to become, the tenant's guarantor, *committing himself to re-assume his liabilities on a future assignment*, when the plain purpose of section 24(2) is to ensure that he is released from his liabilities with affect from the assignment." (*emphasis* added)

43. Lord Neuberger then said "what is less clear, however, is how much further the ambit of section 25(1) goes". He then turned to two interpretations of section 25(1) which he referred to as "interpretation (i)" and "interpretation (ii)". Interpretation (i) was the interpretation given by Newey J to section 25(1) in *Good Harvest* "which meant that [section 25(1)] invalidated any agreement which involves a guarantor of the assignor guaranteeing that assignor's assignee". The alternative interpretation, interpretation (ii), is that "section 25(1) only invalidates such an agreement if it was entered into at the insistence of the landlord". The Court of Appeal began by considering this issue without regard to AGAs.

44. Lord Neuberger continued:

> "36. Where a lease contains a tenant's covenant against assignment in the normal form, namely that it requires the landlord's consent, which is not to be unreasonably withheld, the landlord may often reasonably refuse consent to a particular assignment unless a suitable guarantor of the assignee is provided. If interpretation (i) is correct, the assignor could not offer his own guarantor, because a guarantor of

> the present tenant is, in effect, absolutely precluded from providing a subsequent guarantee of that tenant's assignee. Interpretation (i) would thus appear to give the 1995 Act an unattractively limiting and commercially unrealistic effect.
>
> 37. As Newey J accepted, interpretation (i) would mean that, even where it suited the assignor, the assignee and the guarantor that the assignee should have the same guarantor as the assignor (because, for instance, the assignor and the assignee had the same parent company, or shared a common bank, which was the guarantor), they could not offer that guarantor. *It would also appear to mean that the lease could not be assigned to the guarantor, even where both tenant and guarantor wanted it.* Lord Nicholls said in the *Avonridge* case [2005] 1 WLR 3956, para 16, that section 5 was "intended to benefit tenants …That is [its] purpose. That is how [it is] meant to operate". So, too, section 24(2) is meant to benefit guarantors. It can therefore be argued that, where the assignor and the guarantor who want the guarantor to guarantee an assignee, or who want the lease to be assigned to the guarantor, such a renewal, or such an assignment, would not "frustrate the operation of any provision of [the 1995 Act]".
>
> 38. All this provides some support for the contention that a guarantee of the assignee by the assignor's guarantor may not fall foul of section 25(1) if it is freely offered by the assignor and guarantor. On the other hand, there is much to be said for interpretation (i). It leads to a clear and simple position. It avoids argument, after, possibly long after, the subsequent guarantee has been given, as to whether it really had been insisted on by the landlord or freely offered by the assignor. Such problems could be particularly acute where the landlord's interest had been assigned after the subsequent guarantee had been obtained, and the current landlord therefore may have no knowledge of the circumstances in which it had been obtained."

45. The advantages and disadvantages of interpretation (i) having been identified, Lord Neuberger then turned to interpretation (ii):

> "39. Interpretation (ii) is, in many ways, more attractive in terms of commercial sense, as it is consistent with the idea that section 25 is to be treated as an anti-avoidance provision which (in a case involving an assignment of the tenancy rather than the reversion) protects the assignor and its guarantor, but does not work to their disadvantage…
>
> 41. However, as already mentioned above [para 29], section 25(1) appears to be concerned with "the effect" of a particular agreement, which suggests that what it aims to invalidate is the objective effect of an agreement, rather than its subjective purpose. It does appear that interpretation (ii) runs rather counter to that approach, as it looks to the subjective reason for the guarantor guaranteeing the assignee, rather than its objective effect."

46. So the Court of Appeal had to choose between interpretations (i) and (ii). The court chose interpretation (i), but subject to a very important qualification, which relates to AGAs under section 16, and "removes most of the unsatisfactory commercial consequences to which interpretation (i) appears otherwise to give rise" (para [44]). Interpretation (i) was chosen because it leads to "a clear and simple position" and "avoids argument … as to whether [the guarantee] had really been insisted on by the landlord or freely offered by the assignor" (para [38]). That was even though interpretation (i) gives the Act "an unattractively limiting and commercially unrealistic effect" (para [36]). The decision of Newey J in *Good Harvest* was therefore correct.

47. In *UK Leasing Brighton Ltd v Topland Neptune Ltd* [2015] EWHC 53 (Ch) Morgan J summarised the other propositions established by *K/S Victoria Street* as a result of interpretation (i) as follows (para [15]):

> "(5) there was no distinction between a guarantee freely offered by the guarantor and a guarantee insisted upon by the landlord: [40] – [43];
>
> (6) there was no distinction as to the effect of the 1995 Act on an agreement to give the guarantee and a guarantee actually given: [43];
>
> (7) the [very important qualification, which relates to AGAs under section 16], was that if the assignor gave an AGA in relation to the assignee, the guarantor of the assignor (whilst it was the tenant) could also give a guarantee in relation to the assignor's liability under that AGA: [46] – [48].
>
> (8) if a tenant assigns and the tenant and the tenant's guarantor are thereupon released, there is nothing to stop that guarantor becoming a guarantor again on a subsequent assignment: [51];
>
> (9) the proposition in (8) above applies not only where the subsequent assignee is a new party but also where the subsequent assignee is an earlier tenant whose liabilities were guaranteed by that guarantor; [51]."

48. Therefore, having accepted interpretation (i) of section 25(1) as the correct approach, one of the consequences of that interpretation was identified as follows (per Lord Neuberger at para [37]):

> "It would also appear to mean that the lease could not be assigned to the guarantor, even where both tenant and guarantor wanted it."

49. The focus of the argument before me has been whether, on the correct interpretation of the Act, this statement is actually correct. This point was raised, but not decided, in *UK Leasing Brighton Ltd* at paras [28] to [30] and [41]. It is, of course, important to consider the statement in the context in which it was made and, for that reason, I have

set out in some detail above the relevant passages from the judgment of *K/S Victoria Street*.

50. Before I turn to the facts of *UK Leasing Brighton Ltd*, I need to set out the provisions of section 3 of the Act.

(d) *Section 3*

51. Sections 3(1), (2) and (4) provide:

> "**3. Transmission of benefit and burden covenants.**
>
> (1) The benefit and burden of all landlord and tenant covenants of a tenancy –
>
> (a) shall be annexed and incident to the whole, and to each and every part, of the premises demised by the tenancy and of the reversion in them, and
>
> (b) shall in accordance with this section pass on an assignment of the whole or any part of those premises or of the reversion in them.
>
> (2) Where the assignment is by the tenant under the tenancy, then as from the assignment the assignee –
>
> (a) becomes bound by the tenant covenants of the tenancy except to the extent that –
>
> (i) immediately before the assignment they did not bind the assignor, or
>
> (ii) they fall to be complied with in relation to any demised premises not comprised in the assignment; and
>
> (b) becomes entitled to the benefit of the landlord covenants of the tenancy except to the extent that they fall to be complied with in relation to any such premises.
>
> ...
>
> (3) In determining for the purposes of subsection (2) or (3) whether any covenant bound the assignor immediately before the assignment; any waiver or release of the covenant which (in whatever terms) is expressed to be personal to the assignor shall be disregarded."

52. The background to section 3 is also explained in the Law Commission's report. The law as it then stood in relation to covenants in leases is set out at para 2.20 (p. 8):

> **"B. Privity of Estate**
>
> *(i) Covenants enforceable by landlord and tenant and their successors*
>
> 2.20. Covenants in leases may be divided into two groups:
>
> (a) those which "touch and concern the land" or have "reference to the subject matter of the lease", term which have the same meaning; and
>
> (b) those which impose personal or collateral obligations.
>
> Most leases probably impose obligations of both types. The original parties remain bound by *all* the covenants in the lease by virtue of privity of contract. In respect of the first group of covenants only, there is also liability, by way of privity of estate, between the persons, who for the time being, stand in the shoes of the original landlord and the original tenant.
>
> 2.21. Thus, when the original tenant assigns his lease, the assignee (and any subsequent assignee) automatically becomes directly liable to the landlord, with whom he has privity of estate, in respect of those covenants which "touch and concern" the land. Examples of such covenants are covenants to pay the rent; to repair buildings; to insure them against fire ..."

53. The Reform Proposals are set out at Part IV of the report. At para 4.1 (p. 19) the Law Commission explains that their proposals for reform recognise the importance of two principles:

> "First, a landlord or tenant or property should not continue to enjoy rights nor be under any obligation arising from a lease once he has parted with all interest in the property.
>
> Secondly, all the terms of the lease should be regarded as a single bargain for letting the property. When the interest of one of the parties change hands the successor should fully take his predecessor's place as landlord or tenant, without distinguishing between different categories of covenant."

54. There is then a section entitled "General" in Part IV of the report (p. 27). The first part of this section deals with the "distinction between covenants" and explains:

> "4.46 Although to accord with our first principle it may be necessary to differentiate between covenants which apply to different parts of property let by a lease, our second principle suggests that covenants should not be put into different categories for other reasons. We accordingly recommend that there should be no distinction between lease covenants which touch and concern the land and other

> covenants. Abolishing this distinction will of itself simplify the law, because the current parties to leases will be able to be sure that they are bound by and benefit from all the obligations set out in the lease."

55. The tenth recommendation in the summary on p. 33 of the report was that "the distinction between lease covenants which touch and concern the land and those which do not should be abolished". Mr Seitler relied on these passages from the Law Commission report and submitted that the purpose of section 3 is to enable the Act to provide a "complete and self-contained framework" so that the Act applies to all landlord and tenant covenants. Section 3 is not, he submitted, directed at the main thrust of the Act, which is that a tenant or any other person who is associated with the tenant's liability should not remain liable under a tenancy after the tenant has been released from his liability.

56. Indeed, section 3 is not referred to in the arguments, or in the decision of the court, in *K/S Victoria Street*. This is perhaps not surprising given that the issue in that case was about imposition of a renewal obligation on the tenant's guarantor, and not about the consequences of an assignment on the assignee of the lease. In the course of his submissions Mr Reynolds accepted that section 3 was part of the "tidying up", which took place as part of the reforms recommended by the Law Commission in its report.

57. In *UK Leasing Brighton Ltd* a lease, to which the Act applied, was granted to a tenant (T1). T1's obligations under the lease were guaranteed by a guarantor, G. In breach of covenant T1 assigned the lease to a new tenant, T2. The assignment was therefore an "excluded assignment" and T1 and G were not released from their liabilities in relation to the tenant covenants in the lease. The parties wished to resolve the situation, but were concerned about the impact of the Act in relation to the solutions proposed. The landlords suggested that T2 could re-assign the lease to T1, with G giving a fresh guarantee of the obligations under the lease. This solution was considered by Morgan J at paras [20] to [33] of his judgment and, in relation to these steps, he said this:

> "21. I consider that the way in which the 1995 Act would operate in relation to these steps is, prima facie, as follows:
>
> (1) T2 will be released from the tenant covenants: section 5(2)(a);
>
> (2) T1 will be released from the tenant covenants entered into at the time the lease was granted to T1: section 11(2)(b);
>
> (3) G will be released from the earlier guarantee which it gave: section 24(2);
>
> (4) On the re-assignment to T1, T1 again becomes bound by the tenant covenants: section 3(2)(a).
>
> 22. If this is right so far, the problem would then be: if G is released under section 24(2) from the earlier guarantee which it gave, can it effectively be bound by a fresh guarantee entered into on the re-assignment to T1? The concern is that the decision in *Victoria Street*

> would produce the result that the re-imposition of such a liability on G would frustrate the operation of a provision of the 1995 Act (ie section 24(2)) and would therefore be invalid."

58. Counsel for the landlords in that case submitted that this analysis did not correctly describe the effect of the Act. His first point was based on the interpretation of section 11(2)(b) which the judge described as a "radical argument", and rejected. Counsel for the landlords' second point was that:

> "28. … it was not possible under the 1995 Act to assign the term of the lease back to T1 because to re-impose liability on T1 would be contrary to a release of T1 under section 11(2)(b). This somewhat improbable argument was said to be supported by a statement in *Victoria Street* as to the position of a guarantor. In that case, Lord Neuberger said at [37]: "It would also appear to mean that the lease could not assigned to the guarantor, even where both the tenant and the guarantor wanted it."

59. Morgan J then made the following observation about Lord Neuberger's statement at para [37] of *K/S Victoria Street*:

> "29. What Lord Neuberger was referring to in this statement was the possible conflict between a release of a guarantor under section 24 and the re-imposition of liability on the former guarantor as assignee. The statement is obiter and somewhat tentative. For present purposes, I do not need to consider whether I should follow that statement in a case to which it applies. In the present case, there is no suggestion of an assignment to G so the statement is not directly applicable. I am not prepared to extrapolate from that statement about a guarantor so as to reach the result that it is not possible in the present case for T2 to reassign to T1. As explained in paragraph 21 above [set out at para 57 above], the position of T1 is governed by two provisions, first section 11(2)(b) and, secondly, section 3(2)(a). I am not prepared to hold that the release under section 11(2)(b) means that section 3(2)(a) cannot take effect. I consider that both provisions take effect. Accordingly I will adopt the analysis set out in paragraph 21 above [set out at para 57 above]. "

60. Morgan J concluded that it was open to the parties to proceed with a direct assignment by T2 to T1 with T1's obligations being guaranteed by G (para [33]). Finally, Morgan J commented on a "third way" which he had identified, but the parties had not themselves put forward, and said this:

> "41. The other possibility is an assignment by T2 to G followed by an assignment by G to T1, guaranteed by a fresh guarantee from G, but without any commitment prior to the assignment to G that the assignment to T1 (and the fresh guarantee by G) would be entered into. Would these steps be effective under the 1995 Act? I do not

> think that a problem would arise in relation to the fresh guarantee given by G on the assignment by G to T1. The fresh guarantee could be an AGA within section 16, which would therefore be effective under the 1995 Act. However, a problem could arise in relation to the earlier assignment, or purported assignment, from T2 to G in view of the statement at [37] in *Victoria Street*, which I have quoted at paragraph 28 above. This statement is obiter and somewhat tentative. A question was raised in the course of argument as to whether this statement was really correct. However, I was not asked to rule on that point. If I had been asked to hold that the statement was incorrect, I would have required further argument before being persuaded not to follow this dictum of the Court of Appeal. In the circumstances, it would not be right for me to consider the matter further in this judgment."

61. At the hearing I was told by Mr Seitler that Lord Neuberger's statement at para [37] of *K/S Victoria* had given rise to considerable debate in the property sector. I was therefore curious to know whether there had been any academic writing on this topic. Counsel checked this, and were unable to find any articles which were directly relevant. I then became aware of talk delivered by Morgan J to the Property Bar Association on 4 November 2015 entitled "The Landlord and Tenant (Covenants) Act 1995: 20 years on". I drew this talk to the attention of Counsel and invited them to provide me with written submissions, if they wished to comment on it. I received written submissions from both Counsel in respect of the talk on 28 January 2016.

62. In his talk, Morgan J referred to his decision in *UK Leasing Brighton Ltd* and said this:

> "71. In my judgment, I left open the question of whether Lord Neuberger had been right to suggest that where the lease was vested in T and T's obligations were guaranteed by G, then the lease could not be assigned to G even where T and G wanted that to happen. Let me now consider that proposition. The argument is that the Act is intended to produce the result that G is released under section 24(2) on an assignment by T1. If G becomes the assignee, it will be bound by the tenant covenants and so will not be released. Therefore, the assignment to G has effect to frustrate the operation of the Act.
>
> 72. What this argument misses is that the reason the assignment to G makes G liable on the tenant covenants is that section 3(2)(a) so provides. So the Act operates in two different ways. On the assignment, section 24(2) operates to release G from its earlier guarantee and section 3(2)(a) operates to impose the burden of the tenant covenants on G as assignee. So the Act operates in two consecutive ways. Why should it not operate to the full in both of these ways? The operation on one way does not frustrate the operation of the Act in the other way. The release under section 24(2) does not frustrate the operation of section 3(2)(a). The imposition of the burden of the covenants under section 3(2)(a) does not frustrate the release under section 24(2).

> 73. This reasoning was essentially the reasoning that appealed to me when I decided what the position would be when the term was assigned by T2 to T1. Although I did not need to say so in the case I decided, in truth, the same logic ought to dispose of Lord Neuberger's tentative suggestion also. There is no conceivable policy reason not to give effect to this logic."

63. In their written submissions, both Counsel reminded me that these observations were made by Morgan J in the context of a talk (rather than as a result of legal argument), and they should not be given more weight than "the words of any reputable author": see *Cordell v Second Clanfield Properties Ltd* [1969] 2 Ch 9, per Megarry J at 16F-17B. In any event, Mr Reynolds adopted everything said by Morgan J at paras [72] and [73] of his talk, whereas Mr Seitler disagreed with the judge's analysis.

(e) *The effect of section 25*

64. The last case I need to mention is *Tindall Cobham 1 Ltd v Adda Hotels (an unlimited company)* [2014] EWCA Civ 1215. In *Tindall Cobham 1 Ltd* the tenant assigned the lease to an associated company without the landlord's consent, and then sought to justify this by reference to section 25 as interpreted in *K/S Victoria Street*. The alienation provision in the relevant leases provided that:

> "3.14.6 The Tenant shall not assign this Lease to any Associated Company of the Tenant without the prior consent of the Landlord **Provided Always** that for the purposes of Section 19(1A) of the Landlord and Tenant Covenants Act [1927], the Landlord shall be entitled to impose any or all of the following conditions set out in sub clauses (a) and (b) below:
>
> (a) that the Tenant shall provide the Landlord with notice of any such assignment within 10 Working Days of completion of the same;
>
> (b) that on any such assignment, the Tenant shall procure that the Guarantor and any other guarantor of the Tenant shall covenant by deed with the Landlord in the terms set out in the Sixth Schedule at the Tenant's sole cost
>
> and subject to the Tenant's compliance with such conditions the Landlord's consent shall be given."

65. The first point before the Court of Appeal concerned a point on the construction of this clause in the lease. The Court of Appeal then moved on to consider the effect of section 25 on clause 3.14.6. The arguments raised "the more fundamental question which applies to all the agreements about the effect of s.25 which is how far the section should be regarded as avoiding the contractual provisions in this case". This issue was dealt with by Patten LJ in relation to the facts of that case as follows:

"45. The arguments on s.25 which I have already outlined, the landlords' argument that s.25(1) avoids the entirety of the proviso to clause 3.14.6 (which the judge accepted) and the further argument advanced by Mr Reynolds [counsel for the landlord] that it should be taken to avoid not only the proviso but the whole of clause 3.14.6 all turn on the words "to the extent that" in s.25(1). It is clear that s.25 was intended to provide a comprehensive anti-avoidance provision which, as Lord Nicholls said in *London Diocesan Fund v Phithwa* [2005] 1 WLR 3956, ought to be interpreted generously to ensure that the operation of the 1995 Act is not frustrated either directly or indirectly. Mr McGhee [counsel for the tenants] made the point that that legislation which operates to avoid the whole or a part of a contract may produce consequences in terms of the legal position which the parties are left with that may be both capricious and uncommercial. I accept that. Any alteration of the contract will necessarily change the parties' legal relationship from what they intended it to be and the actual impact upon them in terms of the remaining balance of liabilities and obligations may be fortuitous. But that should not be regarded as an invitation to assume that such will necessarily be the case, still less to attribute to Parliament an intention that the legislation should be interpreted and applied in that way when other alternatives are available.

46. Although the words "void to the extent that" indicate that Parliament did not intend to invalidate more of the relevant agreement than was necessary to safeguard the objectives of the Act in the context of the particular assignment under consideration, those words do not in my view preclude the Court from taking a balanced approach to invalidation which, while neutralising the offending parts of the contract, does not leave it emasculated and unworkable....

47. ... We are not concerned with whether the Court is able to sever an illegal contract on these common law principles because s.25 makes it clear in terms that it operates only to invalidate limited parts of the relevant agreement. The rules of severance are not therefore of much assistance even by analogy to a determination of how much of the contract by the Court is required to treat as invalid or unenforceable for the purpose of s.25. *But in carrying out that exercise I can see nothing in s.25(1) which prevents the court from looking at the structure of the agreement in an objective and common sense way.*

48. The difficulty I have with Mr McGhee's argument that it is necessary only to remove sub-clause (b) of the proviso is that this would treat conditions (a) and (b) as independent and self-sufficient rather than as parts of a composite, interdependent proviso under which the landlords must consent to the assignment if the conditions are fulfilled. The removal from the proviso of the most important condition from the landlords' point of view seems to me to call both logically and as a matter of drafting for the removal as well of the

> concluding two lines of the proviso which apply only if "such conditions" are complied with. Mr McGhee accepts that those words have to be changed but submits that his clients should remain entitled to the benefit of the requirement on the landlords to give consent. *That is to create an imbalance in the contractual provisions which in my view the legislation was not intended to create unless unavoidable.* The far more obvious solution which both respects the structure of the contract and gives effect to the provisions of s.25(1) is to regard, as the judge did, the whole of the proviso as being avoided by legislation. This realistically treats the proviso as a complete term of the contract (which is what it is) and leaves clause 3.14.6 as a qualified covenant against assignment which can be operated according to its terms.
>
> 49. For the same reasons, I regard Mr Reynolds' other argument that the whole of clause 3.14.6 should be regarded as invalidated as excessive and I reject it." (*emphasis* added)

66. The Court of Appeal therefore concluded that the whole of the proviso to clause 3.14.6 was avoided by section 25(1). Ryder LJ and Longmore LJ agreed with the reasons of Patten LJ (paras [51] and [52]).

The parties' submissions

(a) *The Claimant's submissions*

67. Mr Seitler, counsel for the Claimant, contends that it is absolutely clear that an existing guarantor of an assigning tenant cannot be made to guarantee the liabilities of an assignee. He says, the whole thrust of the Act, from the time of the Law Commission's report, is to draw no distinction between the liabilities as tenant and the liabilities as guarantor. This means that, if a guarantor cannot guarantee the liabilities of assignor's assignee, then it cannot assume them itself either. So, on the release of the original tenant, the original tenant's guarantor must be released from the tenant's covenants to the same extent. Mr Seitler maintains that the guarantor must be released – that is the central policy of the Act – and not re-instated as tenant. That is why, he says, in *K/S Victoria Street*, the Court of Appeal held that it would not be legitimate for the term to be assigned to the guarantor, but that the guarantor can lawfully guarantee a second assignment (para [51]).

68. This conclusion, Mr Seitler submits, is not undermined by section 3(2)(a). This is because: (i) that is not what the Court of Appeal has said, albeit *obiter*, at para [37] of *K/S Victoria Street*; (ii) section 3(2)(a) is not what the thrust of the Act is directed to (see paras 51 to 55 above) and, in any event, section 3(2)(a) is subject to sections 5, 24 and 25 of the Act; (iii) if liability can be re-imposed on G1 when it becomes T2, this would "drive a coach and horses through the Act", as landlords could easily devise schemes to disable the Act (e.g. he said that a landlord could provide in a lease that the original tenant, T1, could only assign to a joint tenancy T1 and T2 and, if this was permitted, then there would be no release for T1 at all, and that would frustrate the purpose of the Act); (iv) the point was not decided in *UK Leasing Brighton Ltd*; and (v) Morgan J's extra-judicial views, set out in his recent talk to the Property Bar Association, about the effect of section 3(2)(a) are wrong.

69. Mr Seitler then submits that there are two consequences of section 25(1)(a) in the present circumstances. First, clause 4.1 of the Licence to Assign (being an agreement relating to a tenancy) is rendered void. Second, the tenant covenants in the Lease are void as against the Claimant, but the Lease itself still exists and is vested in the Claimant. In relation to this second consequence, Mr Seitler says this is possible as a matter of law. In support of this submission he referred to *Woodfall's Law of Landlord and Tenant* (Vol 1) para 1.003 and *City of London Corporation v Fell* [1994] 1 AC 458, HL at 465D-E, where Lord Templeman approved what Nourse LJ had said in the Court of Appeal:

> "The contractual obligations which touch and concern the land having become imprinted on the estate, the tenancy is capable of existence as a species of property independently of the contract."

70. Mr Seitler argued that the tenant covenants are, on assignment, void as against the Claimant because:

(1) The Lease contains a standard form forfeiture clause providing that the landlord can re-enter if the tenant does not comply with the tenant covenants and that forfeiture clause still exists and is binding on the Claimant (or G1). This is because the forfeiture clause is not a landlord or tenant covenant and, in support of this proposition, he pointed to section 4 of the Act. The consequence of this, he argued, is that the tenant covenants are "in suspense" against the Claimant (or G1). However, notwithstanding this, he accepted that the landlord is quite entitled to forfeit the lease if the tenant covenants are not complied with. Therefore, on this analysis (i) the Lease is vested in the Claimant, (ii) the Claimant is not under any obligation to pay the rent, as the tenant covenant is void, but (iii) if the Claimant does not pay any rent, the Defendant can forfeit the Lease.

(2) If the point at (1) above is wrong then, in order to take a "balanced approach" (per Patten LJ in *Tindall Cobham 1 Ltd*), if the landlord cannot enforce the tenant covenants, then the tenant cannot enforce the landlord covenants either.

(b) *The Defendant's submissions*

71. Mr Reynolds, counsel for the Defendant landlord, contends that the Court of Appeal in *K/S Victoria Street* was right to decide that interpretation (i) of section 25(1) was correct (a proposition accepted by the Defendant for the purposes of this hearing). He accepted that the statement at para [37] of *K/S Victoria Street* that it appears a lease cannot be assigned to the guarantor was "obviously carefully considered by the court". However, he submitted that this statement made by Lord Neuberger should not be applied in the way contended for by the Claimant. He identified three principal reasons in support of this submission.

72. First, great difficulties arise when applying this statement in practice, whereas no such difficulties arise in striking down as void a *guarantee* which has been given, or an obligation *to give such a guarantee*, in relation to an assignment the efficacy of which is not dependent upon the giving of the guarantee.

73. Second, the Claimant's argument is inconsistent with section 3 of the Act, and the Defendant adopts everything said by Morgan J extra-judicially in relation to the effect of section 3(2)(a) after section 24(2) has operated (see paras [72] and [73] of the talk set out at paragraph 62 above). Indeed, the Claimant's interpretation of the Act contravenes section 25(1) because it frustrates the operation of section 3 of the Act.

74. Third, the Claimant's argument as to the effect of section 25(1) in the present circumstances offends against all the principles of landlord and tenant, and it creates a tenancy which is not one that we would ordinarily recognise as a tenancy. Indeed, as Mr Reynolds colourfully put it, it is a "Frankenstein's monster" of a tenancy and the Claimant's argument in this regard is absurd.

75. Alternatively, Mr Reynolds submitted that if the Lease could not be assigned to the Claimant, as the guarantor, then the assignment dated 28 November 2014 is a nullity. This means that the conflict between section 3 and second 25 is avoided and, if this alternative argument is correct, then the present position is that the Lease remained vested in the tenant until its recent dissolution and is now vested in the Crown as bona vacantia. The consequence of this is that the Claimant as guarantor remains liable by virtue of the Guarantee (and its obligation to take a new lease pursuant to clause 3.1 thereof).

76. I should add here that I am indebted to both Counsel for the detail of their written arguments and oral submissions.

Conclusion

77. The Law Commission in its report recommended that, whenever the liability of a tenant would be wholly cancelled by their recommendations, then liabilities which had been undertaken "in parallel and are essentially to the same effect" should also be terminated.

78. The "whole thrust of the Act" is that there should be no re-assumption or renewal of liabilities, whether on the tenant or the guarantor. That is the effect of 5(2)(a) in the case of tenants and section 24(2)(a) in the case of a guarantor (or "other person" bound by the tenant covenants). This means that, if a tenant and the tenant's guarantor are each liable for the same or essentially the same liabilities as a result of the tenant's covenants of the tenancy, the guarantor cannot as a result of assignment by the tenant to it of the tenancy re-assume those very same, or essentially the same, liabilities as the tenant. Or, using the terminology used in some of the cases, G1 cannot on an assignment by T1, become T2.

79. This is because on the assignment by T1 to G1:

(1) T1 is released from the tenant covenants of the tenancy, as from the assignment: section 5(2)(a).

(2) G1 is released from the tenant covenants of the tenancy, as from the release of T1: section 24(2).

(3) It is the effect and intention of section 24(2) that "as from the release of [T1]", ie on the assignment to T2 (formerly G1), G1 should be released from its liabilities as guarantor under the lease.

(4) However, as from the assignment to T2 (formerly G1), T2 becomes bound by the tenant covenants: section 3(2)(a).

The assignment therefore releases G1 from the tenant covenants of the tenancy but, at the very same moment in time, binds G1 (but now as T2) with the tenant covenants of the tenancy. In practical terms therefore, there is no release at all for G1 in respect of its liabilities under tenant covenants. This is because the liabilities under the tenant covenants are simply re-assumed by the guarantor, but this time as an assignee (and not as a guarantor). Further, the liability re-assumed by G1 as T2 is the very same in a case such as the present, where the guarantor is also primarily liable in respect of the tenant covenants. The objective effect of the assignment is that G1 re-assumes precisely the same liability in respect of the tenant covenants as a result of becoming T2 pursuant to the assignment. It is that consequence which "frustrates" the operation of section 24(2)(b) and the assignment is rendered void by section 25(1)(a), an anti-avoidance provision which is to be interpreted generously. The guarantor is therefore absolutely precluded from becoming the assignee, on an assignment by the tenant whose tenant covenants he is guaranteeing.

80. It seems to me that this is what Lord Neuberger is referring to in *K/S Victoria Street* when he says "it would appear to mean that the lease could not be assigned to the guarantor, even where both tenant and guarantor wanted it" (para [37]). Further, it also seems to me, that there is additional support for this conclusion when one looks at the main part of the judgment in *K/S Victoria Street* at para [27]. Here the Court of Appeal gave its reasons for rejecting Victoria's argument based on section 24(2) and said "the whole thrust of section 24(2), indeed of the 1995 Act itself, is that *a person* should not remain liable under a tenancy after the tenant with whose liability he is associated has been released from his liability" (*emphasis* added).

81. In *UK Leasing Brighton Ltd* Morgan J explained that what Lord Neuberger was referring to in this statement was the possible conflict between a release of a guarantor under section 24(2) and the re-imposition of liability on the former guarantor as an assignee under section 3(2)(a) (para [29]). I have given this point a considerable amount of thought, particularly in the light of the observations contained in Morgan J's recent talk to the Property Bar Association. However, I am not sure that I agree with this. This is because, what I think Lord Neuberger is referring to is the consequence of interpretation (i) and the policy of the Act that a tenant or guarantor cannot, as the result of an assignment, re-assume the very same, or essentially the same, liabilities in respect of the tenancy.

82. It is, as I have mentioned above, correct to say that section 3 of the Act is not mentioned in terms in the judgment of the Court of Appeal in *K/S Victoria Street*. However, in the light of what was said by Lord Neuberger at para [37], it would appear that the Court of Appeal did have section 3 in mind (and this is what Morgan J thought in *UK Leasing Brighton Ltd* (para [29])). It is therefore necessary to consider whether section 3 alters the conclusion that, on an assignment of the tenancy, the guarantor cannot re-assume its liabilities by becoming the assignee.

83. I agree with the submission made by Mr Seitler that section 3 is not directed to the main thrust of the Act, namely that a person should not remain liable under a tenancy after the tenant with whose liability he is associated has been released from his liability. It is, as Mr Reynolds pointed out, part of the "tidying up" that took place as a result of the reforms recommended in the Law Commission's report.

84. Nevertheless, Mr Reynolds submitted that section 3(2)(a) is significant. This is because what is happening under the Act in the present circumstances (and as part of the same transaction) is that, first, the guarantor is released from liability under section 24(2) then, as a second step, or sequentially, the same liability is imposed on the very same person, but this time as assignee, under section 3(2)(a). This he submits is how the Act operates, and the operation of the Act in this way is not contrary to section 25(1)(a). In support of this contention he pointed to *UK Leasing Brighton Ltd* and submitted that the facts of that case are not that dissimilar from facts of the present case.

85. The difficulty I have with this argument is that there is nothing in the Act, which provides for there to be sequential steps in relation to the release of the guarantor from his liabilities under the tenant covenants, and the re-assumption of those very same liabilities on him as the assignee. Rather, sections 5(2), 3(2) and 24(2) provide that these events should all happen at the very same moment in time, which is "as from" the assignment. There is therefore no moment in time when a person who is the guarantor, and then becomes the assignee, is actually released from, or otherwise freed from, his liabilities in respect of the tenant covenants. This means that, whether as guarantor or as assignee, the liabilities in respect of the tenant covenants have continued unchanged. Indeed, the need for an actual period of release is clear from *K/S Victoria Street* at para [51] when Lord Neuberger explained:

> "51. ... [If] the original tenant and the original guarantor are released from liability under the tenancy on the first assignment, and the fact that they choose subsequently, namely on a further assignment, to reassume liability under the lease cannot be said to "frustrate" their release on the first assignment."

86. Therefore, in my view, there is nothing in section 3(2)(a) which alters the conclusion expressed above that the guarantor is absolutely precluded from becoming the assignee, on an assignment by the tenant whose tenant covenants he is guaranteeing. As is clear from *K/S Victoria Street*, the fact such a conclusion is unattractively limiting and commercially unrealistic is neither here nor there.

87. In this case the assignment of the Lease was executed on 28 November 2014. The next question is to what extent is the assignment, or the Licence to Assign, avoided by section 25(1). It is quite clear from *Tindall Cobham 1 Ltd* that the court is required to take "a balanced approach to invalidation which, whilst neutralising the offending parts of the contract, does not leave it emasculated and unworkable", and the court is entitled to look at "the structure of the agreement in an objective and common sense way".

88. To my mind, Mr Seitler's submissions as to what happens to the Lease on an assignment to the Claimant do not make any sense at all. I do not see how, on the one

hand, the tenant covenants are rendered void or kept in "suspense" and, on the other, the landlord is entitled to exercise his rights of re-entry if they are not complied with (which, on any footing, would be enforcing by the "back door" covenants rendered void by the Act). This cannot work as a matter of law. Take, for example, the obligation to pay rent. If Mr Seitler is right and the obligation to pay rent is void, then it must follow that the landlord cannot re-enter if he is not paid any rent by the assignee, in this case the Claimant. This is because no rent will be due from the assignee to the Defendant landlord as that obligation will be void by reason of section 25(1) and, if that obligation is void, then a right of re-entry cannot arise in respect of it under the Lease. The position must be the same in respect of all the other tenant covenants under the Lease which, on Mr Seitler's argument, have been rendered void by section 25(1). This Mr Seitler says is a "shell" of a lease. However, as Mr Reynolds contends, it is not a tenancy as we would ordinarily know it, but an arrangement which is unbalanced as well as "emasculated and unworkable" (per Patten LJ in *Tindall Cobham 1 Ltd*).

89. It seems to me that the obvious consequence of section 25(1)(a) in the present circumstances is that the assignment is void. The assignment, an "agreement relating to a tenancy", purports to make the Claimant, as the assignee, liable in respect of the very same covenants from which it had just been released as the guarantor. This has the effect of frustrating section 24(2) and, in order to safeguard the objectives of the Act, the assignment itself must be void, and the consequence of this is that the assignment will not take effect to vest the Lease in the Claimant, as an assignee.

90. This leads to a clear and simple position and one which is certain. This conclusion is re-inforced by the actual statement of Lord Neuberger in *K/S Victoria Street* that "*the lease could not be assigned* to the guarantor, even where both the tenant and guarantor wanted it" (*emphasis* added). It is not a question of picking and choosing which aspects of the lease will survive the assignment from the original tenant to the guarantor. Rather, as Lord Neuberger said, such an assignment is a transaction which cannot be done and the assignment will be struck down as void in the event that the tenant seeks to assign the lease to its guarantor.

91. I will dismiss the claim and make the declaration in the alternative form sought by the Defendant, namely the purported assignment of the Lease to the Claimant is void and of no effect, with the result that the Lease remains vested in the Original Tenant, and that the Claimant remains bound as Guarantor of the Original Tenant's obligations under the Lease by virtue of the Guarantee and has not been released from its obligations under the Guarantee by the operation of the Act.