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The latest twist in the AGA saga

The Court of Appeal in the case of *K/S Victoria Street v House of Fraser* has clarified the position of guarantors on the assignment of a lease, but in many cases it might already be too late.

Before 1996 an original tenant under a lease of a property was liable under the terms of that lease for its entire duration, even if he assigned his lease to another tenant. At a time when commercial leases were typically 25 years long this could cause considerable difficulties. If an assignee, or an assignee's assignee, or further, at a later date defaulted in payment of rent, the original tenant could still be sued although it would have no control of or interest in the property.

The Landlord and Tenant (Covenants) Act 1995 ("the Covenants Act") changed all that. It created a brand new system of liabilities whereby, subject to what follows, a tenant would be released from all liabilities under its lease from the date of assignment. In order to prevent landlords and their lawyers exploiting loopholes, section 25 of the Covenants Act creates a blanket ban on "*any agreement*...*[the effect of which is]...to exclude, modify or otherwise frustrate...*' the operation of the Covenants Act.

The one exception to the release for a tenant was the introduction of an Authorised Guarantee Agreement, or "AGA". If required by a landlord an assigning tenant could be obliged to enter into an AGA with the landlord to guarantee a new tenant's obligations. An AGA can only bind a tenant for one assignment: if there is a further assignment, the tenant is automatically released.

What has happened?

A great deal of uncertainty has arisen, recently, about the effect of the Covenants Act upon the role of a guarantor of a tenant.

Under section 24 of the Covenants Act, a guarantor is released from further liabilities under a lease upon an assignment to the same extent as a tenant.

Then, in 2010, a case called Good Harvest considered a previously undecided point. It was generally understood that if there was a contractual provision – perhaps in the lease, or in a licence to assign – which *required* the guarantor of an outgoing tenant also to guarantee the new incoming tenant, that provision would be void under s25 as frustrating the Act. However, the judge in Good Harvest went further, and held that even if the guarantor had voluntarily agreed to guarantee the liabilities of the incoming tenant (perhaps as the only way by which the lease could be assigned), that agreement would still be void. The judge accepted that in

reaching this decision he was interfering with the commercial agreement reached by the parties, but felt that that was what Parliament had intended.

The decision in Good Harvest was, and still is, considered by some to be controversial, but the parties settled the litigation shortly before an appeal was due to be heard.

Shortly after, another case, called K/S Victoria Street v House of Fraser, came before the High Court on an issue involving guarantors, and it was widely expected that the court might take the opportunity to clarify the position of guarantors more generally after Good Harvest. In fact it has taken an appeal to the Court of Appeal, the judgment of which was handed down on 27 July 2011, to provide the hoped-for clarification.

What was the House of Fraser case about?

Although the factual background to the case is a little involved, the basic point which the Court of Appeal confirmed was that unless on an assignment a tenant enters into an AGA with the incoming tenant and its landlord, it will be released from its liabilities, as will any guarantor of its liabilities. A guarantor could not (even voluntarily) guarantee the liabilities of an incoming tenant. On this point the Court of Appeal has confirmed that Good Harvest is good law. This potentially has very serious implications for landlords who might have allowed assignments to take place only on the basis that the guarantor of the outgoing tenant also guaranteed the liabilities of the incoming tenant. In the absence of an AGA such a guarantee is probably worthless.

Of additional concern at the time of the Good Harvest case was that the judge had gone on to speculate (although he did not have to) whether a guarantor of an original tenant could be obliged to guarantee that tenant's liabilities under an AGA – sometimes, and not wholly accurately, described as 'subguaranteeing'. Note the guarantor would not be directly guaranteeing the incoming tenant, but the arrangement would, in most situations, have the same effect.

In Good Harvest the judge thought that 'subguaranteeing' was probably void. In House of Fraser the Court of Appeal thought a subguarantee would be valid, because it simply involved a guarantor entering into an AGA, and AGAs were specifically exempt from the anti-avoidance restrictions of s25 of the Covenants Act. It might be relevant to note that this view did not form part of the Court of Appeal's reasoning in the case itself, and therefore on a strict interpretation might not be considered binding on a later court, but as the judgment was given by the Master of the Rolls Lord Neuberger the opinion is likely to be very influential.

Lessons from House of Fraser

A – if a guarantor of an outgoing tenant has given a guarantee of an incoming tenant's liabilities, a landlord will not be able to call upon that guarantee at a later date, even if this defeats the common intention of all the parties to the arrangement.

B – if an outgoing tenant can be made to enter into an AGA, and that outgoing tenant has a guarantor, then if that guarantor enters into the AGA it will be bound by the arrangement. Therefore, looking forward, new arrangements (based upon AGAs) can be created which might satisfy a landlord, but for assignments which have already taken place it might be too late, and if there is any uncertainty legal advice should be taken.

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