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Good Harvest – The Saga of the AGA Settles

The landmark decision of the High Court in **Good Harvest Partnership LLP -v- Centaur Services Limited (Good Harvest)** on 23 February 2010 was due to go before the Court of Appeal on the 29th June. However, contrary to market expectation, the case has been settled at the last moment, and this means that we will all have to live with the first instance decision.

At first instance it was held that any attempt by a landlord to insist that an existing guarantor of an outgoing tenant enter into an AGA Authorised Guarantee Agreement) to guarantee the new tenant's obligations, under a post 1995 lease, will be void. Newey J also stated that even a new guarantee, entered into voluntarily in respect of a new tenant, and given willingly by the outgoing tenant's surety, would also be void.

This decision, and the obiter comments made by the Judge, caused much commentary in the market and have been widely reported on. It was not therefore unexpected, given the repercussions of the decision, that the landlord appealed. What is surprising is that the case has been settled at the last moment, and no doubt many landlords and their lawyers will be disappointed that we now have to live with the decision, at first instance, including the obiter comments. Below is a reminder of the facts of the **Good Harvest** Case, and what they mean in practice for landlords, tenants, guarantors and lenders.

Background - Landlord and Tenant (Covenants) Act 1995

The 1995 Act was principally aimed at making sure that a party who had disposed of leasehold property would not carry on being liable on the tenant's covenants for the rest of the lease term. The only exception to this is that the 1995 Act permits an outgoing tenant to guarantee the obligations of its immediate assignee (the new tenant) by way of an AGA. AGAs were introduced by the LTCA 1995 and are used only in connection with the assignment of post 1995 "new" leases. The terms of an AGA are governed by the provisions of the LTCA 1995, in particular, section 16.

The LTCA 1995 describes what an AGA must do, what it may do, what it must not do and the circumstances in which it can be entered into. In practice the AGA will often form part of the licence to assign entered into by a landlord, tenant and assignee although there may be circumstances when a discrete document is required. The AGA then takes effect when the assignee becomes bound by the tenant covenants of the lease (section 16(1) and sections 3 and 5, LTCA 1995).

In the **Good Harvest** Case, the facts of which are set out below, Mr Justice Newey, at first instance carefully analysed the relevant provisions of the 1995 Act.

Facts of Good Harvest

The tenant in this case (Gladman Homes) had granted a sublease of the property to the subtenant (Chiron CS Limited). Centaur Services Limited (Centaur) acted as the subtenant's guarantor. The sublease contained a number of provisions, the main details of which are set out below:

- (a) A covenant not to assign the whole of the property without consent, not to be unreasonably withheld or delayed.
- (b) A right for the tenant, as a condition for granting consent to assign, to:
 - (i) **require** the subtenant and the subtenant's guarantor to enter into an AGA;
 - (ii) insist that the assignee enter into direct covenants with the tenant, to perform the subtenant covenants in the sublease;
 - (iii) require the subtenant to provide continuing security (a guarantee) for its liability under the AGA; and
 - (iv) require the assignee to provide a guarantor where reasonable.

The sublease was assigned with the tenant's consent, to Total Home Entertainment Distribution Limited (Total Home). In this case the AGA was incorporated in a licence to assign. It was entered into by the tenant, the subtenant and the subtenant's guarantor. The tenant subsequently surrendered its lease. A month later, Good Harvest became the freehold owner of the property and therefore, the direct landlord to Total Home.

When Total Home failed to pay two quarterly instalments of rent, Good Harvest claimed the money due from Centaur and then applied to the High Court for summary judgment of its claim for the outstanding sums from Centaur.

Centaur disputed the application on the grounds that the guarantee agreement was void and unenforceable against it by virtue of the anti-avoidance provisions in section 25 of the LTCA 1995. Section 25 provides that any "agreement relating to a tenancy is void to the extent that it would apart from this section have effect to

exclude, modify or otherwise frustrate the operation of any provision of" the 1995 Act.

Decision

The decision at first instance, which will now stand, is in essence that the AGA was void on the grounds that:

- a. Tenants and their guarantors are released from liability in relation to the tenant covenants in a lease upon an assignment which is lawful. This is pursuant to s5 and s24 of the Act.
- b. This release is only limited pursuant to s16 of the Act, which provides that a tenant may give an AGA guaranteeing the incoming tenant's liability. However S16 does not refer to guarantors at all and therefore Mr Justice Newey thought that parliament didn't intend guarantors to be able to provide AGAs.
- c. S25 of the Act contains the anti-avoidance provisions, and requiring that a guarantor enter into an AGA, would frustrate those measures. S25 of the Act states that any attempt to "exclude modify or otherwise frustrate the operation of the Act" is void and, therefore, unenforceable.

Mr Justice Newey also considered 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 Centaur to provide a sub-guarantee as an alternative to guaranteeing the assignee's obligations.

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

Comment

Many landlords have been awaiting the outcome of the Good Harvest appeal eagerly and have been hoping that some of the Judge's comments would be dealt with. However given that the case has settled, it seems that we will have to wait now for another party to bring a claim so that the decision is tested.

Landlords are going to have to continue to change the way they deal with applications for consent to assign. The focus now is more likely to continue to be on the covenant strength of the proposed assignee and whether any additional security should be required. There are various options including insisting on rent deposits or bank guarantees and to that extent this decision is also of interest to lenders as well as landlords, tenants and guarantors.

Where the proposed assignee is weak, the landlord could also request that a new guarantor takes the lease in its own name. Landlords may wish to incorporate more stringent criteria to assess the covenant strength of any assignees. In terms of negotiating new leases, covenants prohibiting intra-group transfers may become more common again.

What is clear is that landlords who were relying on guarantees given by former tenant's guarantors before the decision in January can now only rely on the guarantees given by the former tenants.

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