

# Validity of Real Estate Lease Guarantees Still Not Resolved



## Key Issues

### Position to Date

### Landlords and their Lenders' Options

### Tenants and Guarantors' Options

### Case Summary

### Glossary of Terms

## Position to Date

In April this year we reported on the case of *Good Harvest Partnership LLP v Centaur Services Limited* EWHC [2010], which questioned the validity of certain common types of lease guarantees. As discussed in our previous briefing, many commentators disagreed with the judge, Newey J, view's (see Case Summary below) and hoped, on appeal, that Newey J's obiter comments would be challenged in order to restore much needed market confidence. Though the case was appealed, we understand that it has now settled. The Real Estate industry is therefore left in a hiatus with a question mark over the validity of **Sub-Guarantees** and **Repeat Guarantees** (see Glossary of Terms below for an explanation of all terms in bold). Values may be depressed further by this uncertainty. Until there is another case on this issue, landlords and their lenders and tenants and their guarantors should consider whether to implement all or any of the relevant options below in order to try and limit the impact of this case.

## Landlords and their Lenders' Options

- From a valuation point of view, review their portfolios to ascertain the nature of all their **Outgoing Tenant's Guarantors'** liabilities i.e. is it a **Guarantor AGA** or a **Sub-Guarantee** and consider the impact on value if there are, in particular, **Guarantor AGAs**.
- From a management point of view:
  - reconsider their policy of accepting tenants with covenants backed up by a guarantor and instead insist that the "good covenant" is the tenant;
  - where a lease provides for a **Guarantor AGA** on a licence to assign, ask the **Outgoing Guarantor** to give a **Sub-Guarantee** instead by arguing that it is reasonable to do so under the general terms of the assignment clause; and
  - refuse to accept **Repeat Guarantees** on all applications for licence to assign. In such circumstances, a landlord is unlikely to be found to be unreasonably withholding its consent in breach of its statutory duty because of Newey J's comments, see *Norwich Union Life & Pensions v Linpac Mouldings Ltd* EWHC 1602 (Ch) [2009].

If you would like to know more about the subjects covered in this publication or our services, please contact:

[Franc Peña](#) +44 (0)20 7006 8963

[Damian Perry](#) +44 (0)20 7006 4227

[Bryan Johnston](#) +44 (0)20 7006 4707

[Maureen Romeril](#) +44 (0)20 7006 4451

To email one of the above, please use [firstname.lastname@cliffordchance.com](mailto:firstname.lastname@cliffordchance.com)

Clifford Chance LLP, 10 Upper Bank Street,  
London, E14 5JJ, UK  
[www.cliffordchance.com](http://www.cliffordchance.com)

## Tenants' and Guarantors' Options

- On a tenant's application for licence to assign a lease which provides that the guarantor is to give a **Guarantor AGA** and the landlord asks the **Outgoing Tenant** to enter into a **Guarantor AGA**, refuse to do so. In the unlikely event that the landlord insists on a **Guarantor AGA** a strong argument can be made that the landlord is unreasonably withholding consent in breach of its statutory duty. Alternatively, the **Outgoing Tenant's Guarantor** can enter into the **Guarantor AGA** on the basis that it reserves its right to challenge the validity of the **Guarantor AGA** at a later date.
- On a tenant's application for licence to assign a lease which provides that the guarantor is to give a **Guarantor AGA** but the landlord asks for a **Sub-Guarantor**, try to argue that the landlord is being unreasonable in asking for a **Sub-Guarantee**. Much will turn on the circumstances of each case i.e. the covenant strength of the new tenant. Beware, however, that this argument will hold up the transfer of the lease. Where timing is critical the tenant may not want to give the landlord an excuse to delay the licence and therefore agree to the landlord's demands. In this case, the argument is not that **Sub-Guarantees** are invalid but that the landlord is not entitled to ask for one. If the **Tenant's Outgoing Guarantor** does enter into a **Sub-Guarantee**, the **Tenant's Outgoing Guarantor** should do so on the basis that it reserves its right to challenge the validity of the **Sub-Guarantee** at a later date.
- On a tenant's application for licence to assign a lease which provides that the guarantor is to give a **Sub-Guarantee**, do not challenge the validity of this provision if you want the licence to proceed quickly. Even if you are prepared to argue the issue, as mentioned above, case law suggests that the landlord is unlikely to be found to be unreasonably withholding consent.
- Where a landlord is seeking to enforce a **Guarantor AGA**, do not pay any sums demanded on the basis that the **Guarantor AGA** is invalid. Where sums have already been paid, consider demanding a refund from the landlord.
- Where a landlord is seeking to enforce a **Sub-Guarantee** or **Repeat Guarantee** use Newey J's comments to try to force the landlord to agree to a more favourable settlement.
- Where a landlord refuses to accept a **Repeat Guarantee**, offer another "good covenant" within the group or, alternatively, a rent deposit or bank guarantee.

## CASE SUMMARY: Good Harvest Partnership LLP V Centaur Services Limited

**Guarantor AGAs:** Newey J held that a **Guarantor AGA** given on assignment by an **Outgoing Guarantor** was invalid. This judgment was not a surprise to commentators as most had recognised, when the legislation was introduced in 1996, that only an **Outgoing Tenant** can enter into an **AGA**. As a result, it is unusual for a lease to require an **Outgoing Guarantor** to enter into a **Guarantor AGA**. Instead, most leases require an **Outgoing Guarantor** to enter into a **Sub-Guarantee** of the Tenant's **AGA**.

**Sub-Guarantees:** Newey J also considered **Sub-Guarantees**, though he was not required to find on this issue. It was his view that a **Sub-Guarantee** given on assignment by an **Outgoing Guarantor** was also invalid. His reasoning was based on the fact that the Landlord and Tenant (Covenants) Act 1995 did not expressly state that a landlord can require the **Outgoing Tenant's Guarantor** to guarantee the **Outgoing Tenant's AGA**. A number of commentators have challenged Newey J's reasoning on this point as the Act states that the guarantor is released "to the same extent" as the tenant i.e. if the **Outgoing Tenant** enters into an **AGA** then the landlord is entitled to ask the **Outgoing Tenant's Guarantor** to guarantee the **AGA**. Though this argument has many supporters, the cautious approach is to follow Newey's view until this issue is put beyond doubt.

**Repeat Guarantees:** Newey J also commented on this type of guarantee though it was also not an issue in the case and expressed doubts on the validity of **Repeat Guarantees** as logical consequence of his interpretation of the **Landlord and Tenant (Covenants) Act 1995** (i.e. once a lease is assigned an **Outgoing Guarantor** is released from its obligation). Most commentators were surprised by this view as it would appear to suggest that a company, which had given a lease guarantor, can never again act as a guarantor of the lease even when there have been a number of intermediate assignments.

## GLOSSARY OF TERMS

<b>AGA/Authorised Guarantee Agreement</b>	:	a statutory form of guarantee by way of indemnity given by an <b>Outgoing Tenant</b> to its landlord when assigning its lease to a new tenant. Under this guarantee the <b>Outgoing Tenant</b> guarantees the new tenant's lease obligations until such time as the new tenant assigns the lease, with the landlord's consent, to a 3rd party
<b>Guarantor AGA</b>	:	an <b>AGA</b> given by the <b>Outgoing Tenant's Guarantor</b> to guarantee by way of indemnity the new tenant's lease obligations
<b>Landlord and Tenant (Covenants) Act 1995</b>	:	the Act which introduced <b>Authorised Guarantee Agreements for New Tenancies</b>
<b>New Tenancies</b>	:	generally leases granted after 1 January 1996
<b>Outgoing Tenant</b>	:	the current tenant under a lease, who is proposing to assign its interest to a third party
<b>Outgoing Tenant's Guarantor</b>	:	an entity, often part of the same group as the <b>Outgoing Tenant</b> , who guarantees by way of indemnity the <b>Outgoing Tenant's</b> lease obligations.
<b>Repeat Guarantee</b>	:	a guarantee by way of indemnity given by an <b>Outgoing Tenant's Guarantor</b> on the assignment of the lease from one group company to another company in the group in order to obtain the landlord's consent to the proposed assignment. <b>Repeat Guarantees</b> commonly arise when a lease is assigned between two group companies and the current parent company guarantor agrees also to act as the guarantor for the new incoming group company tenant.
<b>Sub-Guarantee</b>	:	a guarantee by way of indemnity given by <b>Outgoing Tenant's Guarantor</b> to guarantee the <b>Outgoing Tenant's</b> obligations under the <b>AGA</b> .

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to [nomorecontact@cliffordchance.com](mailto:nomorecontact@cliffordchance.com) or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ.

[www.cliffordchance.com](http://www.cliffordchance.com)

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571.

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications.

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Prague ■ Riyadh\* ■ Rome ■ São Paulo ■ Shanghai ■ Singapore ■ Tokyo ■ Warsaw ■ Washington, D.C.

\* Clifford Chance also has a co-operation agreement with Al-Jadaan & Partners Law Firm in Riyadh and a 'best friends' relationship with AZB & Partners in India and with Lakatos, Köves & Partners in Hungary.

© Clifford Chance LLP October 2010