Browne Jacobson

EMI Group Ltd v The Prudential Assurance Company Ltd [2020] EWHC 2061 (Ch)

The court interprets the guarantee provisions in a lease to uphold their validity under the Landlord and Tenant (Covenants) Act 1995.

02 October 2020

The court interprets the guarantee provisions in a lease to uphold their validity under the Landlord and Tenant (Covenants) Act 1995.

Facts

The claimant (EMI) guaranteed the liabilities of the original tenant (HMV) under a lease granted for 25 years from 29 September 1999. Prior to an assignment of that lease in 2011, HMV entered into an authorised guarantee agreement (AGA) guaranteeing the obligations of the prospective assignee.

Under the lease, EMI covenanted with the landlord "that while the Principal is bound by the tenant covenants of this lease" it will pay the rents and comply with the tenant covenants. It also covenanted that the Principal will observe and perform its obligations under any AGA that it enters into (known colloquially as a GAGA covenant). Crucially, the "Principal" was defined as:

"the person who is or is to become the Tenant and whose obligations under this lease and any authorised guarantee agreement the Guarantor has been required by the Landlord to guarantee but shall not include any successor in title".

As the current tenant and the current tenant's guarantor had both become insolvent and HMV had been dissolved in 2015, the current landlord sought to recover outstanding rent and service charges from EMI under the GAGA amounting to nearly £5m.

Issues

1. Were the guarantee obligations entered into by EMI void under section 25(1) of the Landlord and Tenant (Covenants) Act 1995 (the 1995 Act) on the basis that they required EMI to directly guarantee the obligations of a future tenant (section 25(1) renders void any agreement which frustrates the operation of the 1995 Act)?

2. Was EMI released from its obligations when HMV was dissolved given that EMI's liability only subsisted "while the Principal is bound…"?

Decision

1. EMI argued that the words "or is to become" in the definition of "Principal" meant that it was being asked to guarantee not only HMV but also any future tenant. However, the judge rejected this argument and decided that the definition referred to one person only. It catered for the possibility that a future guarantee may be given in a licence to assign before the assignment to an incoming tenant is completed (the lease provided, as a condition of consenting to an assignment, that, if reasonably required, the landlord could require an assignee to procure a new guarantor on the same terms).

   In any event, even if the judge were wrong on this point, she decided that the 'offending words' could be struck out. Section 25(1) only invalidates provisions to the extent that they frustrate or exclude the operation of the 1995 Act and the parties had specifically provided for severance to occur if any part of the guarantee provisions was rendered void by section 25.

EMI also argued that the words “while the Principal is bound by the tenant covenants of this lease” made the provision void as it covered the situation where HMV assigned the lease and then took an assignment back in the future (causing the guarantee to be revived). The judge however rejected this argument and interpreted the words to cover just a single period of time whilst HMV was first a tenant under the lease.

2. EMI was not released from its obligations because the lease specifically provided that the guarantor’s liability would not be affected by the Principal being dissolved or otherwise ceasing to exist.

Point to note/consider

Whilst this case is confined to its own facts and the specific drafting used, it is a useful reminder of how the law has developed in this area.

The starting-point is section 24(2) of the 1995 Act, which provides that a guarantor is released from liability at the same time as the tenant whose obligations it is guaranteeing (i.e. on an assignment of the lease).

In K/S Victoria Street v House of Fraser (Stores Management) Ltd [2011] EWCA Civ 904, the Court of Appeal ruled that section 25(1) of the 1995 Act rendered void a requirement for a guarantor to enter into a further guarantee when a lease is assigned. In other words, a guarantor for a current tenant cannot repeat that guarantee for an assignee, even if it is perfectly willing and happy to do so, as that repeat guarantee would frustrate the guarantor’s release under section 24(2). However, the Court of Appeal thought (without having to decide the point) that a GAGA is valid (i.e. there is no reason why a tenant’s guarantor cannot guarantee that tenant’s liability under an AGA). Although not relevant to this case, the High Court also ruled in EMI Group Ltd v O & H Q1 Ltd [2016] EWHC 529 (Ch) that a tenant could not assign a lease to its guarantor as that would also frustrate a guarantor’s release on assignment under section 24(2).

Contact

David Harris

Professional Development Lawyer

david.harris@brownejacobson.com

+44 (0)115 934 2019

Related expertise