

AGAs and Guarantors

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Is a weak tenant supported by a strong guarantor as valuable to a landlord as a strong tenant? The recent High Court decision in *Good Harvest Partnership LLP v Centaur Services Limited* would suggest not.

Since the abolition of privity of contracts in leases on 1 January 1996 tenants and their guarantors have been released from liability on a valid assignment of the lease. Tenants are usually required to enter into an authorised guarantee agreement ("AGA") on assigning their lease. The AGA guarantees the assignee's obligations. When the Landlord and Tenant (Covenants) Act 1995 ("the 1995 Act") first became law there was some uncertainty as to whether a landlord could require a tenant's guarantor to guarantee the tenant's obligations under an AGA. As landlords became more comfortable with the 1995 Act, they agreed deals on the assumption that guarantors would remain on the hook.

On 23 February the High Court decided in the case of *Good Harvest Partnership LLP v Centaur Services Limited* that the authors of the 1995 Act intended to release guarantors from any ongoing liabilities under the terms of the lease from the date of an assignment by the tenant, meaning landlords had been operating under a false assumption. The Court held that any attempt to keep the guarantor on the hook by requiring it to enter into an AGA would fall foul of the anti-avoidance provisions in section 25 of the 1995 Act, and would therefore be void and unenforceable.

"The Act is plainly designed to impose restrictions on freedom of contract."
Newey J

So should landlords abandon all hope of recourse to the guarantor under the terms of an AGA? We look at how the judgment relates to four common situations:

What if the tenant has already assigned its lease and the guarantor has guaranteed the tenant's obligations in the AGA?

The judgment implies that any claim against the guarantor could be barred by section 25. Landlords should bear in mind that if the tenant defaults then they are unlikely to be able to recover under these covenants; well advised guarantors will use this case as a defence. However, it is expected that the case may be appealed or that the decision will trigger other litigation which will reconsider the same issues.

What if the guarantor covenants in the lease that it will guarantee the tenant's obligations during the period when it is liable under the terms of an AGA?

Although the judgment does not address this question directly, the judge remarked that the anti-avoidance measures in the 1995 Act should be applied broadly, which implies that this kind of arrangement would also be void.

What if the landlord is considering an application for consent to assign a lease?

Most leases require that the guarantor enters into an AGA as a condition of assignment. Landlords' solicitors have always argued that the guarantor's covenants in an AGA do not contravene section 25 because rather than the guarantor directly guaranteeing the

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assignee's performance in the same way as the assignor does, the guarantor is instead entering into a sub-guarantee.

The judge was unimpressed by this argument, reasoning that the 1995 Act intended to restrict the guarantees which could be offered on assignment to one single form: the AGA given by the assigning tenant.

In practice, guarantors will now rely on this case to resist a request to enter into an AGA. Even if they do not prevail, the landlord should bear in mind that the guarantor's covenants are unlikely to be enforceable.

Landlords considering applications for consent to assign should consider a full range of options including asking a different third party to guarantee the AGA, taking a letter of credit, a bank guarantee or the trusty rent deposit instead. If the proposed assignee is a weak covenant to be backed by a guarantor then the landlord should ask for the substantive covenant to take the place of the proposed tenant, on the basis that it might lose the benefit of the guarantor's covenant on first assignment.

What if the parties are in the middle of negotiating a new lease?

Landlords who are in the middle of negotiations for a new lease may wish to consider trying to take the prospective guarantor as tenant instead. In terms of drafting the alienation provisions, it seems sensible to retain the current drafting while we await any further decisions from the courts, but be aware of the limitations of this approach in practice.

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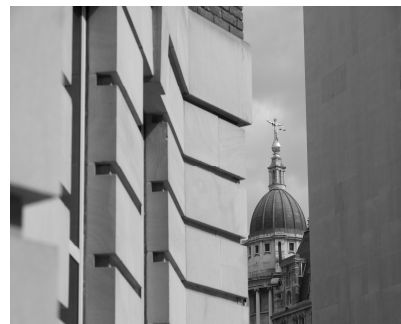
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