VARIOUS POINTS ON CONSENT TO ASSIGN OR SUBLET

By DAVID HOLLAND

INTRODUCTION

1. The position, at common law, of a tenant who sought consent to assign or sublet was invidious. Assuming that there was no absolute prohibition, when faced with an unreasonable refusal of consent, he could only seek a declaration in advance or proceed with the assignment or subletting and then defend any forfeiture claim. Neither of these courses of action was particularly attractive to most tenants

2. The common law position still applies in relation to applications for consent to carry out alterations and for change of use. For recent judicial discussion of the common law principles, see ASHWORTH FRAZER V GLOUCESTER CC [2001] 1 WLR 2180 and SARGEANT V MACEPARK [2004] 38 EG 164.

3. Market forces these days mean that leases containing an absolute prohibition on assignment or subletting are rare indeed.

4. Further, the common law position in relation to consent to assign or underlet has been ameliorated by statutory intervention on three occasions.

5. Section 19(1) of the Landlord and Tenant Act 1927 makes any term in a lease which prevents a tenant assigning or subletting without his landlord's consent subject to a proviso that the consent is not to be unreasonably withheld.

6. More significantly, the Landlord and Tenant Act 1988 makes three fundamental changes to the common law position.

7. Firstly, it imposes a statutory duty on a landlord who receives a written application for licence to assign or sublet to give consent unless it is reasonable grounds not to do so. He must also notify the tenant of his decision and his reasons within a reasonable time. Further, if the consent is subject to any conditions, not only must these be reasonable but they must also be spelt out in the landlords reply.

8. Secondly, the act places on the landlord the burden of showing that any refusal or the imposition of any conditions was reasonable. He need only show that his conclusions were such as might have been reached by a reasonable man in the circumstances, but it is for him and not the tenant to prove this.

9. Finally, the act gives a tenant the right to sue for damages suffered as a result of a landlord's unreasonable refusal.

10. The third statutory intervention is the Landlord and Tenant (Covenants) Act 1995. This allows the parties to a lease to stipulate in advance situations in which the landlord can refuse consent. Refusal by a landlord to consent based on the failure to comply with these stipulated criteria will not be unreasonable. Post 1995 leases often combine the new and the old by requiring that once the stipulated criteria are satisfied, consent will not be unreasonably withheld. Thus the landlord can set minimum criteria which have to be fulfilled, whilst still being able to refuse consent on any other reasonable ground.

CASE LAW ON UNREASONABLE REFUSAL

General principles

11. The principles applicable to the reasonableness of a landlord's requirement for his consent to an assignment were authoritatively stated by the Court of Appeal in INTERNATIONAL DRILLING LTD V LOUISVILLE INVESTMENTS [1986] 1 Ch 513 and in MOUNT EDEN LAND V STRAUDLEY INVESTMENTS

(1996) 74 P&CR 306, (a case involving consent to sublet). For present purposes, it is sufficient to refer to the judgment of Phillips in Mount Eden (at 310):

> *"The principles which apply to the present case may be extracted from a rather longer list in the judgment of Balcombe LJ in International Drilling Ltd v Louisville Investments CA [1986] 1 Ch 513 at p 519:*
>
> *'1. The purpose of a covenant against assignment without the consent of the landlord, such consent not to be unreasonably withheld, is to protect the lessor from having his premises used or occupied in an undesirable way, or by an undesirable tenant or assignee...*
>
> *2. As a corollary to the first proposition, a landlord is not entitled to refuse his consent to an assignment on grounds which have nothing whatever to do with the relationship of landlord and tenant in regard to the subject matter of the lease...*
>
> *4. It is not necessary for the landlord to prove that the conclusions which led him to refuse consent were justified, if they were conclusions which might be reached by a reasonable man in the circumstances…"*

In ASHWORTH FRAZER V GLOUCESTER CC , in addition to emphasizing the last two principles, Lord Bingham emphasized that in any case where the requirements of these two principles are met, the question whether the landlord's conduct was reasonable or unreasonable will be one of fact to be decided by the tribunal of fact. These three principles he described as "overriding". In addition, in the Mount Eden case Phillips LJ identified two further principles which he derived from the authorities:

> *"1 It will normally be reasonable for a landlord to refuse consent or impose a condition if this is necessary to prevent his contractual rights under the headlease from being prejudiced by the proposed assignment or sublease.*

2. It will not normally be reasonable for a landlord to seek to impose a condition which is designed to increase or enhance the rights that he enjoys under the headlease."

Cases prior to NCR v Riverland Portfolio

12. Prior to the Court of Appeal decision in NCR V RIVERLAND PORTFOLIO [2005] EWCA Civ 312, the more recent case law had illustrated how far the pendulum had swung in favour of tenants as a result of the 1988 Act.

13. In GO WEST V SPIGAROLO [2003] QB 1140, the tenant had applied for consent on 13th March 2001. The landlord had written refusing consent on 30th May 2001. However, correspondence continued until the date of issue of proceedings on 10th July 2001. The judge found that, whereas the landlord's refusal of consent on 30th May was unreasonable, as a result of the subsequent correspondence, it was not unreasonable in refusing consent on the day proceedings were issued. He thus dismissed the tenants claim.

14. The Court of Appeal overturned his decision. The court emphasised that a landlord cannot rely upon reasons for refusing consent which he has not put forward in writing within a reasonable time. The reasonableness of a landlord's refusal must be judged as at the expiry of the reasonable time. When this period expires, in turn, must depend upon all the circumstances of the case, including, if relevant, events after the tenant's application. If, for example, a tenant applies for consent and the landlord, within a reasonable time, reasonably asks for further information, the time within which the landlord must respond will not expire until after the tenant has given satisfactory replies. Similarly if, following the expiry of what otherwise might be deemed to be a reasonable time, the tenant writes giving the landlord a further deadline within which to respond, then it seems that the landlord's time for responding will not expire until after this deadline has passed.

15. However, once a landlord has responded, the reasonable time automatically expires. Thus, in this case the reasonable time expired on 30th May 2001 and the subsequent correspondence was irrelevant.

16. Perhaps of most significance, the court said this:

> *"...I find it hard to imagine that a period anything like as long as that which elapsed from 13 March to 10 July 2001--a period of almost four months--could ever be acceptable, save perhaps in the most unusual and complex situations. I repeat, and for my own part would wish to emphasise, Sir Richard Scott V-C's references in the* Norwich Union *case [1999] 1 WLR 531 to the landlord dealing with his tenant's application "expeditiously" and "at the earliest sensible moment"...It may be that a reasonable time....will sometimes have to be measured in weeks rather than days; but even in complicated cases, it should in my view be measured in weeks rather than months."*

17. In BLOCKBUSTER ENTERTAINMENT V BARNSDALE [2003] EWHC 2912, the lease contained a clause compelling the tenant, in the event of a proposed subletting, to provide the landlord with a "certificate" setting out the rent and service charges under the proposed sublease. The tenant wrote asking for consent to underlet on 28th May 2002. Despite the fact that the letter did not contain a certificate, the judge held that the statutory duty on the landlord arose from that date. He held that the landlord had all the necessary information by 19th June 2002 and should have granted consent on or before 26th June. In fact the landlord did not give its consent until 15th July 2002 and was thus in breach. It was held liable in damages when the proposed underletting went off.

18. In MOUNT EDEN V FOLIA [2003] EWHC 1815 Ch, there was some dispute as to whether the tenant's application for consent to sublet had been sent on the 11th or 17th June 2002, however Peter Smith J. accepted that it had been received on 18th June 2002. The judge found that the landlord had considered the application

on 20th June 2002 and decided on that day to refuse it on a number of grounds. Thereafter, the landlord had instructed a solicitor and taken advice. Despite a chasing letter from the tenant dated 10th July 2002, the landlord did not respond until 15th July 2002, when it refused consent for the reasons decided on 20th June.

19. In addition to finding that none of the grounds put forward was reasonable, the judge held that the letter of 15th July 2002 was not served within a reasonable time of either 11th or 17th June. Given that the decision had already been made on 20th June, he was of the view that the reasonable time had expired "by a few days after 21st June 2002". Given that the landlord had not given any grounds for refusing consent by that date, it was under a duty to consent.

20. In relation to the subsequent letter from the tenant dated 10th July 2002, which asked for a response "by return", he said:
"....if [the landlord] had responded by return then it would have been difficult for [the tenants] to contend that they had not responded within a reasonable time."

21. Thus he granted the tenant a declaration and, for good measure, awarded indemnity costs against the landlord. He also added, albeit obiter, that there was no reason why, in an appropriate case, exemplary or punitive damages should not be awarded to the tenant.

22. This was a theme to which the same judge returned in the latest of the cases, DESIGN PROGRESSION V THURLOE PROPERTIES [2004] EWHC 324. In that case the tenant applied on 21st January 2002 for licence to assign the two year residue of the lease. The premises were under-rented and the assignee had offered a premium of £75,000. The judge found that the landlord adopted a deliberate strategy designed to achieve the maximum rental income from the property. It wanted to obtain possession of the premises to re-let at a higher rent. When the tenant refused to surrender for no premium, the landlord set out to frustrate the proposed assignment and "see off" the assignee. The landlord raised a series of

requests for further information and for references which the judge styled as "delaying tactics".

23. The judge however found that the landlord had all the necessary information by 21st March 2002 and that the reasonable time for it to respond expired then. It should have consented on or before that date. Despite this the landlord, for the next month, made further demands for information which the tenant and the assignee attempted to answer. The landlord never expressly refused or granted consent. The assignee however went elsewhere.

24. The case is most interesting for the following point. Having considered his previous decision in FOLIA and the House of Lords case of KUDDUS V CHIEF CONSTABLE [2002] AC 122, the judge held that he could award exemplary damages. Having awarded well over £100,000 in compensatory damages, he awarded an extra £25,000.

NCR v Riverland Portfolio

25. Briefly, the facts were that the tenant formally asked for consent to underlet on 30th June 2003. After considerable correspondence and the provision of a considerable amount of information by the tenant about the proposed underlessee, the judge found that the application for consent to underlet was fully "submitted" by 28th July 2003. That was the date by which the tenant had provided to the landlord all the information which could reasonably have been required. That was the date from which the reasonable time for the purposes of section 1 (3) of the act would be measured. Having reviewed all the documents and heard oral evidence, the first instance judge found that the reasonable time expired on 11th August, that is two weeks or 11 working days from the date the application had finally been submitted. Indeed he found that a period of seven days should have been sufficient. The landlord had not replied until 20th August (when it refused consent) and thus had not consented within a reasonable time and was therefore in breach of its statutory duty.

26. The reasons advanced by the landlord for refusing consent were (a) the unusual terms of the proposed underlease and (b) the inadequate covenant strength of the proposed undertenant. In addition, the judge found that these were not reasonable.

27. Two factors weighed heavily on the judges mind. The first was the fact that the tenant was applying, not for consent to assign, but for consent to underlet. The tenant would thus still be liable to the landlord under the terms of the lease. In those circumstances, the financial status of the proposed underlessee was of no great or vital significance to the landlord. Secondly, much of the relevant information had been in the hands of the landlord well before 28th July and from as early as 30th June.

28. Perhaps of more interest, the first instance the judge summarised the principles to be applied. He put forward ten propositions:

> *"(1) A landlord owes a duty to a tenant to give a decision on an application for consent within a reasonable time: section 1 (3) of the Act.*
>
> *(2) What will amount to a reasonable time will depend upon all of the circumstances of a particular case….*
>
> *(3) The assessment of whether a reasonable time has elapsed in which the landlord has to give a decision will be made at the time at which it is claimed that a reasonable time has elapsed, and in the light of the facts at that time…. Amongst the factors that will be borne in mind in assessing whether a reasonable time has elapsed is that the purpose of the Act is to "enable there to be fair and sensible dealing between landlords and tenants [and] a state of certainly to be achieved at the earliest sensible moment"..*

(4) If, within a reasonable time, a landlord gives notice refusing consent, reasons must be given for the refusal: see section 1(3) (b) (ii) of the Act.

(5) The burden is on the landlord to show that it was reasonable, by reference to the reasons given in the notice, to refuse consent. "... [I]t is not now open to a landlord to put forward reasons justifying the withholding of consent if' those are reasons which were not put forward in accordance with section 1(3)(b), that is they were not reasons which were put forward in writing within a reasonable time…

(6) Once a notice has been given by a landlord, that landlord cannot subsequently justify a refusal of consent by referring to reasons which are not set out and relied upon in that notice...

(7) An unreasonable refusal of consent renders a landlord liable to pay damages to a tenant for breach of statutory duty. The measure of damages will be the tortious measure: see section 4 of the Act.

(8) A failure to give a decision within a reasonable time will be treated as equivalent to a refusal of consent without reasons. This conclusion necessarily follows from the fact that it is the landlord's obligation to make a decision within a reasonable time.

(9) It also follows that a failure to communicate a decision on a tenant's application within a reasonable time, will also make a landlord liable to pay damages to a tenant. That liability will not be avoided or mitigated even if a landlord is able subsequently to show that there were reasonable grounds for withholding consent...

(10) A landlord will discharge the burden of proving that a refusal of consent is reasonable if it can show that some landlords, acting reasonably, might have refused consent for the reasons given, even though some other reasonable landlords might have given consent."

29. This recitation of the relevant principles was (at least impliedly) approved by the Court of Appeal (see paragraph 11 of the judgement).

30. The landlord appealed and the Court of Appeal allowed the appeal. There are a number of interesting points in the judgment of Carnwath LJ (which was the only reasoned judgment given).

31. The court drew a distinction between "informal exchanges" between the parties, on the one hand, and "the formal process of application and decision" on the other. This was because:

> *"The serious legal consequences resulting from the statutory scheme require that the process of application and decision should be subject to a reasonable degree of formality".*

That said, the court held that the judge was correct to hold that the letter of 28th July was the formal "application" for consent.

32. In relation to the time within which the landlord had to make his decision, although they recognised that the assessment of the proposed underlessee's financial strength was a relatively simple task, the court felt that that was not the end of the matter. Due to the potentially serious consequences of an unreasonable refusal, the landlord was entitled to further time to consider whether its misgivings about the financial strength of the underlessee justified a refusal of consent. The court felt that the judge had been too harsh on the landlord. It found that the letter of 20th August refusing consent **was** sent within a reasonable time of 28th July:

> *"In the absence of exceptional circumstances, a period of less than three weeks (particularly in the holiday period) cannot in my view be categorised as inherently unreasonable.."*

33. The main issue was whether the judge was correct to find that the reasons advanced by the landlord justified refusal under the act. The court emphasised that the landlord's reasons did not have to be justified by reference to some objective standard of correctness. It is enough if the landlord has genuine and not unfounded concerns on matters relevant to the value of his interest. Equally importantly, in assessing the tenant's application the landlord was entitled to have regard to his own interests alone, without considering the potential effect of a refusal on the tenant. Those cases (such as INTERNATIONAL DRILLING FLUIDS V LOUISVILLE INVESTMENTS) in which it would be unreasonable for the landlord not to consider the effect of a refusal on the tenant, were described as "exceptional".

34. The court held that the judge was correct to find that the landlords attempt to justify refusal of consent because of the unusual terms of the lease was not reasonable within the act. However it found that the judge was wrong to hold unreasonable the landlord's refusal on the ground of the proposed subtenant's lack of covenant strength.

35. Both parties accepted that the covenant strength of both the proposed underlessee and its proposed guarantor was very weak. The judge however had found that this was irrelevant given the continuing liability of the tenant. To meet this, the landlord had relied upon the evidence of an expert valuer. He gave evidence to the effect that the present value of the landlord's reversion with the proposed underlease was £500,000 less than its value without it (about 6.5 % of the total value). This was on the basis that, if the underletting went ahead, at the end of the term of the lease the underlessee could apply for a new lease of the whole premises under the 1954 Act. The rent which the landlord would receive in that situation would probably be less than it would receive if it acquired vacant possession of the premises at the end of the term (on the assumption that the tenant would **not** want to renew) in which case it could let the premises in parts.

36. The tenant did not call any evidence in rebuttal, but challenged the landlord's valuer's evidence in cross-examination. The judge made no adverse finding about the expertise or credibility of the landlord's valuer but discounted his evidence on the basis that the damage to the reversion of which he spoke was "speculative and remote". The Court of Appeal held that he was wrong to do so. They held that it was wrong to dismiss this, effectively unchallenged, evidence as no more than remote speculation about the future. Although the valuation evidence involved a degree of speculation about the future, it reflected the discount which a current investor might be expected to apply to the value of the landlord's reversion. More importantly, the court again emphasised that:

> *"The question for the judge was, not whether he himself regarded the evidence as "speculative and remote", but whether it helped to show the [the landlord's] concerns about the weakness of [the proposed underlessee's] covenant had been reasonable (even if not "correct or justifiable")".*

Nor was this one of those exceptional cases where the landlord had to have regard not only to his own interest but also to the interests of the tenant.

37. Can any lessons be learned from this case? Of course each of the cases described above can (correctly) be categorised as decided on its own facts. There is still no doubt that the 1988 Act is a very "tenant-friendly" piece of legislation. However, there is also no doubt that, in the Court of Appeal decision in NCR v Riverland Portfolio, the "mood music" changed. The whole tenor of the judgment is much more sympathetic to the position of landlords than had been the case in the cases immediately prior to it. Of particular note are the following:

(i) The courts willingness to "extend" the time in which the landlord had to respond to the tenants request;

(ii) Its emphasis on the need for a degree of formality in the communications; and

(iii) Its emphasis on the fact that the landlord's decision need only be one at which a reasonable landlord might arrive and need not be objectively correct or justifiable.

38. At the end of the day, the key to the outcome may lie in the following passage in Carnwath LJ's judgment (at paragraph 20) in which he castigated the judge for categorising the proposed transaction as "uncomplicated". He went on to state that:

> *"[the judge's] view of the relative simplicity of the issue sits oddly with the overall effect of his judgment, which was that [the landlord], even with the assistance of experienced legal advisers, arrived at the wrong answer and thereby incurred a lawsuit involving a claim of some £3m."*

Cases since Riverland

39. Two recent cases highlight two different aspects of the common law test as et out in the first section above.

40. In THE ROYAL BANK OF SCOTLAND V VICTORIA STREET [2008] EWHC 579 and 3052 (Ch), the lease provided that consent to an assignment was "not to be unreasonably withheld in the case of a respectable and responsible assignee". In a letter dated 3rd October 2007 the claimant tenant sought consent to assign to a newly incorporated company. The application described the proposed assignee, offered a three-month rent deposit and stated that references in respect of the directors would be provided. It asked for a speedy response. The landlord replied within a working week (10th October 2007). It refused consent because the proposed assignee had been incorporated for only two months and was not therefore respectable and responsible. The tenant issued proceedings seeking a declaration that this refusal was unreasonable. It applied for summary judgment which application was rejected by Lewison J. The the matter went to full trial before Morgan J.

41. Morgan J agreed with Lewison J's approach at the summary application to the construction of the terms of the lease. Although the lease stated (and the landlord's agent erroneously thought) that the test was whether the proposed assignee was "respectable and reasonable", the true test was the statutory one of reasonableness. If and insofar as the words of the lease imported a test that was less strict than that contained in the 1988 Act they were overridden by section 19 (1) (a) of the 1927 Act.

42. Lewison J had held (and Morgan J agreed) that: the letter of 3rd October was a formal application for consent to assign and that the letter dated 10th October was a refusal (such that any reasonable time thereby expired).

43. The law is clear that, when seeking to prove that its refusal was reasonable, the landlord is not entitled to add to its initial written reasons. However it can explain and amplify those reasons. Importantly, it was accepted that the landlord was not obliged to solicit further information from the tenant. Lewison J said:

> *"the landlord is entitled to make a decision on the basis of the application as presented by the tenant. If the tenant wishes to make alternative proposals in order to overcome the landlord's reasons for objection, it is up to the tenant to do so. There is no bar on the making of multiple applications for consent to assign. I do not consider that the landlord has a statutory duty imposed by the Landlord and Tenant Act 1988 to facilitate the tenant's overcoming the landlord's reservations no doubt it is courteous and good landlord and tenant relations to do so but I do not consider that the Act imposes a duty to that effect."*

44. Morgan J accepted that the landlord's evidence at trial (which was considerably expanded from the terms of the letter dated 10th October) did not set out new reasons; it amplified the refusal letter and could therefore be taken into account. He also rejected the tenant's suggestion that this evidence had been compiled after

the event with a view to substantiating the reasonableness of the landlord's approach.

45. The judge was satisfied that the landlord's agent had taken the view that a newly incorporated company could not prove its financial strength. The agent regarded the offer of references for the directors as irrelevant - the company was to be the tenant and there was no offer of a guarantee from the directors. The agent thought that a three-month rent deposit was inadequate; the rent for the premises was £405,000 pa, the property had been vacant for some time and there was a risk of a substantial dilapidations liability at lease end in four years' time.

46. Another interesting point was this. The landlord's agent had not taken serious account of the fact that the lease predated 1996 and that the claimant would, as the original tenant, remain liable for the remainder of the lease. (In fact, she incorrectly believed that RBS would remain liable only for the rent and would not be responsible for dilapidations.) Morgan J rejected the tenant's assertion that, as a question of fact, any reservations that the landlord may have had on the proposed assignee's ability to meet the lease obligations should have been removed by the continuing liability of the original tenant (a "the strong covenant"). This rejection had nothing to do with any (current) view of the strength of RBS. It was based upon the more important point that a landlord can reasonably prefer the tenant in possession to be one that can meet the lease obligations and consider that resort to a former tenant has distinct practical disadvantages. He also rejected the tenant's contention that, as a matter of law, a landlord that has the benefit of the original tenant's covenant can object to the covenant strength of the proposed assignee only where it proves that the value of its reversion has been diminished. He ruled that it is unnecessary to prove diminution in value where the landlord is concerned about the performance of the lease obligations.

47. In short the landlord had arrived at a decision at which a reasonable landlord could have arrived.

48. A decision which however goes the other way is LANDLORD PROTECT V ST ANSELM [2009] EWCA Civ 99. In that case the Appellant had entered into a contract to purchase from the Respondent the unexpired term in a pre 1995 lease of commercial premises. The sale contract incorporated the RICS Common Auction Conditions. These provided that the Buyer had to execute "such licence or other direct deed of covenant as may be required and provide guarantees, a rent deposit or other security". The Appellant had eventually purported to rescind the contract and sought the return of its deposit.

49. The Appellant was a dormant company which had never traded. It therefore had no accounts and could provide no accountant or bank references. The landlord was only prepared to give its licence to the proposed assignment if the Appellant's sole director and the principal shareholder, was prepared to guarantee the Appellant's performance of its obligations as assignee of the head lease. The Director was only willing to offer a guarantee if it was limited in duration for a period of 3 years. This was unacceptable to the landlord. The Appellant therefore issued the first set of proceedings in the Central London County Court against the landlord claiming declarations that it had unreasonably refused its consent to the assignment and/or had imposed unreasonable conditions for the giving of its consent. Specifically, the Appellant sought a declaration that it was unreasonable for the landlord to impose a requirement for the Director to provide a guarantee more extensive than that which had previously been offered. In these proceedings His Honour Judge Cowell gave judgment dismissing the claim, holding that, in all the circumstances of the case, the landlord had not been acting unreasonably in rejecting the offer of a guarantee limited in duration to a period of only 3 years.

50. However that was not the end of the matter. Debate about the precise terms of the reasonably required guarantee continued. In particular there was debate about the provision dealing with release of the Director on any future assignment.

Eventually the landlord insisted on a provision (clause 6.6 of the draft licence to assign) in the following terms:

> *"In the event of a subsequent assignment of the lease effected with the consent of the Landlord the Guarantor shall be released from his liability pursuant to the covenants on the Guarantor's part in this deed* ***provided that a reasonable alternative security is provided by the assignee pursuant to such subsequent assignment***." (emphasis added)

51. The Appellant took the view that, by insisting on the inclusion of this provision (and in particular the highlighted passage) the landlord was being unreasonable; this condition was not "properly required" pursuant to condition 9. The Court of Appeal agreed.

52. The Court highlighted the passage from the STRAUDLEY case cited above. They stated that the relevant rights of the landlord created by the lease were as follows:

    (i) as against the **original lessee**, to have the rents paid and the covenants on the part of the lessee performed throughout the term (this being an old lease).

    (ii) as against an **assignee** of the term of the lease, to have the rents paid and the lessee's covenants performed while the term is vested in that assignee.

    Therefore the Court held that that a lessor cannot normally reasonably require a guarantor of the liabilities of an assignee to undertake a liability extending beyond the period during which the term is vested in the assignee. Such a requirement would increase or enhance the rights which the lessor enjoys under the lease. They further held that the consequence of clause 6.6 of the draft licence required by the landlord was that the liability of the guarantor might continue after a subsequent permitted assignment by the Appellant. On the proper interpretation of clause 6.6 there would thus be two requirements for the release of the guarantor: a subsequent assignment with consent **and** the provision of reasonable alternative

security. The landlord was not reasonably entitled to add this second requirement for the release of the guarantor because it would always be entitled to refuse to consent to a further assignment if the proposed assignee was not of sufficient substance, or was unable or unwilling to provide adequate security for the payment of rent and the performance of the lessee's covenants. The head landlord was thus entirely protected against an assignment to an insubstantial assignee. Its protection was the right to refuse consent, not the right to refuse to accept the discharge of the assignor's guarantor. It further exposed the guarantor to a potential dispute as to whether the landlord had reasonable security. The landlord's requirement was thus unreasonable and the Appellant had been entitled to rescind the contract.

CONSENT TO ASSIGN OR SUB LET AND WAIVER

53. One particular problem which might arise is as follows. If you are advising a landlord whose tenant has sought consent to assign or sublet, you are of course mindful of the landlord's duty under the 1988 Act. What if, having carried out sufficient investigations, it is apparent that your client is minded to give consent and you can see no reasonable grounds for withholding it. The tenant's solicitor is pressing for a decision. Your client then informs you that he has just discovered that the tenant is in breach of one or more of the covenants in the lease. What do you do?

54. There are it seems three relevant questions:
    a. Can you refuse consent because of the breach?
    b. If your client grants consent or continues to deal with the tenant's application for consent, as a matter of law will he waive the right to forfeit?

c. Is it reasonable in any event to refuse consent or refuse to deal further with the tenant's application for consent because of the risk that this might be deemed to be a waiver?

55. The answer to the first question is briefly stated although more difficult to apply in practice. As the House of Lords emphasised in ASHWORTH FRAZER V GLOUCESTER CC, it is all a question of fact. Whether or not a landlord is justified in withholding consent to assign or sublet because of a breach of covenant by the tenant will depend upon whether the landlord reasonably perceives the breach to be a serious one, whether the breach is likely to be remedied and whether his position will be prejudiced by the proposed transaction. For example, a minor breach of repairing covenant in a 125 year lease with 119 years of the term unexpired was held not to entitle the landlord to withhold consent to assign in STRAUDLEY INVESTMENTS V MOUNT EDEN [1997] EGCS 175. However in ORLANDO INVESTMENTS V GROSVENOR ESTATES [1989] 2 EGLR 74 a landlord was held reasonably to have refused consent to an assignment in circumstances in which there were serious breaches of repairing obligation and it reasonably perceived there to be real doubt as to whether they would be remedied.

56. The answers to the second and third questions are not so clearly stated.

57. If a tenant commits a breach of covenant which entitles the landlord to forfeit the lease, the landlord has a right to elect whether to treat the lease as forfeited or as remaining in force. He cannot retract his election once made. An election to treat the lease as continuing is of course commonly described as a waiver of the right to forfeit. Waiver was described as follows by Buckley LJ in CENTRAL ESTATES V WOOLGAR [1972] 1 WLR 1048 (at 1054):

> *"If the landlord by word or deed manifests to the tenant by an unequivocal act a concluded decision to elect in a particular manner, he will be bound by such an election. If he chooses to do something such as demanding or*

receiving rent which can only be done consistently with the existence of a certain state of affairs, viz. , the continuance of the lease or tenancy in operation, he cannot thereafter be heard to say that that state of affairs did not then exist."

Further, as the Court of Appeal emphasised in EXPERT CLOTHING V HILLGATE HOUSE [1986] 1 Ch 340 (at 360) the legal effect of an act relied upon as constituting a waiver must be considered objectively, without regard to the subjective intention or motives of the landlord or the actual understanding of the tenant. One looks at all the circumstances and considers whether the act relied on was "so unequivocal that, when considered objectively, it could only be regarded as having been done consistently with the continued existence of a tenancy".

58. It is of course well settled that the demand or acceptance of rent, even if expressly "without prejudice" to the right to forfeit, will constitute a waiver of the right to forfeit in respect of all breaches of covenant of which the landlord was aware at the time-see e.g. SEEGAL V THOSEBY [1963] 1 QB 887. However these cases have been described as falling into a "special category" (see EXPERT CLOTHING at page 360 E) and courts have been reluctant to extend such a strict approach to other acts said to amount to waiver. Given the principles set out in the preceding paragraph this is perhaps unsurprising. If the effect of a particular act is to be judged objectively it is difficult to see why an express reservation of one's rights is not effective. Further, is it really just that a landlord who has a tenant in breach of his lease has to refuse payment as well? In EXPERT CLOTHING Slade LJ was less than enthusiastic about this strict approach. He reasoned that the established legal effect of acceptance of rent "is so clear that, whatever the particular circumstances of the case, it is probably not open to the landlord to submit that he has not waived the relevant breach". In YORKSHIRE METROPOLITAN V CO-OP [2001] L&TR 26 Neuberger J pointed out that the strict rule in cases of demand and acceptance of rent was developed at a time when the power to grant relief from forfeiture was very much more restricted than

it is now. Thus courts were more anxious to find a waiver than they perhaps are now. He said it would be "inappropriate" to extend the strict rule to case not involving demand or acceptance of rent as rent was "self-evidently in a very different category from any other benefit which the landlord receives under the lease".

The question of whether the grant of consent to assign or sublet will waive a right to forfeit has been considered in three first instance decisions

59. The first case in time is that of YORKSHIRE METROPOLITAN V CO-OP. That case involved a lease of a shopping centre for a term of 40 years. The relevant facts were as follows. In March 1987 the tenant breached the covenants in the lease by sub-letting the whole of the premises without consent. On 9th January 1989 the tenant wrote to the landlord informing it of the sub-letting and seeking consent to assign. The rent due on 25th March 1989 having been paid by bankers order was returned and on 31st March the landlord wrote stating that it was considering its position and would not accept rent. On 18th April the landlord refused consent to assign because of the breach and it served a section 146 notice on 15th September 1989. However on 30th September the landlord's agent sent the tenant an invoice for insurance premium due for the period 30th September 1989 to 29th September 1990. The tenant sent a cheque for the amount demanded but this was returned. The tenant had issued proceedings seeking a declaration that the landlord had unlawfully withheld consent to the assignment whilst the landlord counterclaimed for possession on the ground of forfeiture. The tenant in turn alleged that the right to forfeit had been waived by the demand for the insurance premium.

60. Amongst the issues which Neuberger J had to decide were: whether the landlord had waived the right to forfeit and whether the landlord was reasonable in withholding consent out of a fear of waiving its right to forfeit as a result of the breach. The insurance premium was said in the lease "to be recoverable by

distress in the same way as rent in arrear" and was to be paid on a specified "quarter day for payment of rent". The judge proceeded on the assumption that, if under the terms of the lease the insurance premium was rent then the right to forfeit had been waived. However he held that, under the terms of the lease, it was not recoverable as rent as it was not reserved as such. He further held that the strict approach to waiver embodied in the cases concerning demand for and acceptance of rent should not be applied to a demand for insurance. Finally on this point he held that, on the facts, the demand for insurance had not waived the right to forfeit as it was not in the circumstances so unequivocal that when considered objectively it could only be regarded as being consistent with the lease continuing. He regarded the following points as significant: the act was a demand for and not an acceptance of payment; the demand had been sent by the landlord's agent and not by the landlord itself, it was a "routine administrative act" on behalf of a landlord with a large number of properties; the landlord had previously made it clear that it was not going to accept rent the, only reason for which was a desire not to waive the right to forfeit; the landlord had also made it clear that it intended to bring forfeiture proceedings and had served a section 146 notice only 14 days before the demand which gave a period of 28 days in which to remedy the breach.

61. The judge t hen went on to consider whether he landlord had acted reasonably in refusing consent because of the breaches which rendered the lease liable to forfeiture. The tenant argued that once it had had an adequate opportunity to appraise itself of what had happened, then the landlord was not entitled to refuse consent. The judge held that the landlord **could** have preserved its right to forfeit by granting consent expressly without prejudice to any accrued right to forfeit:

"…, if a landlord gives consent to an assignment expressly stating that it is without prejudice to any accrued right to forfeit which he might have, and this stipulation is accepted by the assignor and assignee, then the landlord will not in fact lose his right to forfeit."

He continued:

"Another way of reaching the same conclusions is along the following lines. [The tenant] asked for licence to assign the lease. [The landlord] refused consent making it clear that its concern was that, if it were to entertain the application or to give consent to the proposed assignment, then it might be said that any right it had to forfeit the Lease would be lost. As it seems to me, it was then up to [the tenant] to come back to CRS with the proposal that licence to assign could be given on the basis, agreed on all sides, that any accrued right to forfeit vested in [the landlord] at that time was not lost by the giving of consent or by the proposed assignment."

However, he reminded himself of the principle that the landlord does not have to show that his reasons for refusing consent were justifiable or right, simply that his conduct was reasonable and stated:

"In my judgment, it is not possible to say that, as at October 1989, no well-advised and reasonable landlord could have taken the view that, however it couched its consent for licence to assign, there was not a real danger that would subsequently be argued by the assignor and/or the assignee of the lease that the effect of its granting consent to assign the lease was to waive any right it had to forfeit the lease."

Thus the landlord had acted reasonably in refusing consent.

62. STRAUDLEY INVESTMENTS V MOUNT EDEN LAND [1997] EGCS 175, concerned a 125 year lease granted in 1991. On 24th July 1996 the tenant applied for consent to assign. On 29th July the landlord served a section 146 notice alleging breaches by way of unauthorised alterations and failure to decorate. In a letter of 8th August the landlord's agents referred to the application for consent to assignment and stated that the landlord regarded the lease as at an end by reason of forfeiture on account of the breaches. A schedule of dilapidations was served on 20th August by the landlord. The tenant then issued proceedings seeking a declaration that the landlord had unlawfully refused consent to assign. The judge found that there had been no breach of the alteration or decoration covenants and

that there was only minor disrepair. One of the points raised by the landlord was that it could not grant consent as that might waive its right to forfeit for the disrepair. It relied on the YORKSHIRE METROPOLITAN V CO-OP case. The case is not extensively reported but it appears that HHJ Bromley QC sitting as a deputy judge of the Chancery Division rejected this argument and, in doing so, distinguished the YORKSHIRE METROPOLITAN case on the basis that the relevant breaches were continuing and not once for all. Whilst it might be correct to say that the right to forfeit for any breaches continuing after the grant of consent will not be waived and whilst the decision on its facts might be correct, this seems a little harsh on the landlord. One might well ask: why should the landlord, in granting consent to a tenant in breach of covenant, risk losing the right to forfeit for any breach whether continuing or once for all? As Neuberger J said in the earlier case immediately after the first passage quoted in paragraph 9 above:

"...it is one thing for me to reach such a conclusion [i.e. that a right to forfeit will not be waived if the consent is granted "without prejudice"] after hearing detailed argument from both sides. It is quite another thing to expect a landlord, who might well have already thought that his tenant was a person who was prepared to take any point that was legally open to him, however unattractive it might be, to accommodate the tenant by granting licence to assign in circumstances where he would be advised that there was a risk that, by taking such a course, his accrued right to forfeit might be waived."

Quite.

63. The final case is MOUNT EDEN V FOLIA [2003] EWHC 1815. That case involved a lease for a term of 6 years granted in 2000. On 18th June 2002 the tenant applied for consent to underlet. The judge held that, in fact, the landlord had decided to refuse consent on 20th June for reasons which were not justifiable. The decision was not in fact communicated to the tenant until 15th July, a period which the judge held separately was outside the reasonable time allowed by the 1988 Act. One of the reasons put forward by the landlord at the trial to justify the

delay was that its solicitors were concerned that, by entertaining the application for consent, there was a risk that the right to forfeit for breaches of the lease would be waived. This argument was given short shrift. In characteristically forthright terms the judge, Peter Smith J, stated (at paragraph 60):

"Thus [the landlord's solicitors] believed that doing anything in relation to the licence to underlet would constitute a waiver of the right to forfeit. I do not accept that that is the correct analysis of the law. I do not see why, provided the right to forfeit was properly preserved, dealing with the licence to underlet (which [the landlord] had a statutory duty so to do) could possibly amount to a waiver. Other than waiver by acceptance of rent it is a question of fact, in the circumstances of the case, to see whether or not the act relied upon as amounting to a waiver was so unequivocal, that when considered objectively it can only be regarded as having been done consistently with the continued existence of the tenancy (see generally Woodfall paragraph 17.103). Bearing in mind the fact that the Landlord had a statutory duty to comply with the request for licence to underlet I do not see how the response to that on a "without prejudice" basis could be regarded as a waiver. The suggestion of [the solicitors] is that the landlord faced with that has to do nothing, which would be quite extraordinary. That would have a very serious effect on the ambit of the [1988 Act] where there were breaches of covenant. On that basis a landlord faced with an application when there are breaches is enabled to do nothing and so frustrate the purpose of the [1988 Act]."

64. These remarks of course bear a striking similarity to the views of Neuberger J in the YORKSHIRE METROPOLITAN case on the issue of waiver (that is the second question set out in paragraph 2 above). However the views of Peter Smith J appear to be in marked contrast to those of Neuberger J on the third such question. Whatever might have been the position adopted by a reasonable landlord (as identified by Neuberger J) in October 1989, it is clear that as at June 2002 (according to Peter Smith J) the reasonable landlord could not refuse or refuse to deal with an application for consent to assign or underlet merely because

of the risk that in doing so he will waive the right to forfeit for an existing breach of covenant.

65. Thus, the answer to the second question posed in paragraph 2 above appears to be: no, provided he expressly states that he is considering the application and granting consent without prejudice to his right to forfeit. The answer to the third question is probably: no.

WHEN IS CONSENT REQUIRED?

66. Finally, it is worth mentioning an interesting case at first instance which deals with the question of whether a landlord's consent is in fact required.

67. The case of CLARENCE HOUSE V NATIONAL WESTMINSTER BANK [2009] 1 WLR 1651 involved a complex agreement (or rather series of agreements) known as a "virtual assignment". This is an arrangement under which all the economic benefits and burdens of the relevant lease (including any management responsibilities) are transferred to a third party, but without any actual assignment of the leasehold interest or any change in the actual occupancy of the premises in question. It is typically employed where the relevant lease contains covenants against assigning or parting with the possession of the demised property without the consent of the landlord, and either (i) there are concerns that the landlord may be unwilling to consent to a legal assignment of the lease because of perceived concerns about the financial standing of the assignee, or (ii) the landlord's consent may not be available in advance of the scheduled date for completion of the transaction (such as when there is a transfer of a large portfolio of properties).

68. The device was originally invented more than 10 years ago in the context of public sector property outsourcing arrangements. Various government departments contracted to occupy such of their properties as they wished to retain,

effectively on a serviced occupancy basis, for a fee. Private sector organisations such as various Banks quickly followed suit and others extended the approach to large portfolio sales and leasebacks where the prime commercial driver was to raise capital from disposal of the property portfolio (to reinvest in the business), but retain the right to occupy those properties that were essential, albeit for a rent.

69. In these cases, the parties quickly appreciated that, where consent was needed for the transfer or assignment of the property, they could avoid significant delay and cost (and sometimes ultimate frustration of the transaction) if they could achieve the purpose of the arrangement without any actual legal disposal of the premises. Thus, the virtual assignment was born, allowing the deal as a whole to go through swiftly, with the formal consents and documents for those properties that need them being tidied up afterwards. The virtual assignment seeks to put the parties in as close a position as possible to that resulting from the legal assignment of the lease. It, therefore, purports to transfer from assignor to assignee all day-to-day property management responsibilities and to entitle the assignee to receive the income from any subleases, but all without breaching the alienation regime in the lease, thus avoiding any risk of consequent forfeiture by the landlord.

70. Such an arrangement had been considered in the context of the VAT legislation in ABBEY NATIONAL V CCE [2006] STC 1961. In that case the tenant had successfully argued that the virtual assignment had not transferred any proprietary interest in the property to the virtual assignee and that it did not transfer to the virtual assignee any contractual right to occupy the premises. Thus the tenant's status as tenant remained the same.

71. In the CLARENCE HOUSE case, the intention behind this arrangement was expressed as follows:

> *"The Intention of the Virtual Assignment is to pass to the Buyer all of the economic benefits and burdens of the Leases and Underleases in respect of the Properties, together with the obligation to manage all dealings with*

the Landlords and Undertenants as if the Properties had been assigned to the Buyer. Therefore any monies from any Undertenants pursuant to any Underleases, together with all proceeds for the surrender of any Underleases, shall belong to the Buyer."

72. In this case a lease of commercial premises for a term of 25 years from 1985 had been subject to a "virtual assignment" entered into by the tenant with a third party. The lease contained covenants on the part of the tenant: (1) not to execute any declaration of trust with regard to the Property or any part thereof or the Lease: (2) not to share or permit sharing of possession or occupation of the Property or any part thereof or part with possession or occupation of the same; (3) not to underlet the whole of the Property or permit the creation of any derivative underlease without the landlord's prior written consent; and (4) not to assign the Property without the landlord's prior written consent. The premises had previously been lawfully sub-let and the sub-tenant at all times remained in occupation.

73. The landlord alleged that, by entering into the "virtual assignment" the tenant had breached these covenants in one or more of the following ways: (1) by making a declaration of trust with regard to the Property or the Lease; (2) by sharing or parting with possession or (subject to any necessary amendment of the Particulars of Claim) occupation of the Property; (3) by assigning the Property without consent; and/or (4) by underletting the Property without consent.

74. The Judge held that, by entering into the virtual assignment, the tenant had not breached the qualified covenants against underletting or assignment. So far as the latter is concerned, it is generally only breached by a legal assignment. Not without some hesitation the judge also rejected the argument that the tenant was in breach of the covenant against executing any declaration of trust. He held that the arrangement was founded in contract rather than equity.

75. However he held that the virtual assignment **was** a breach by the tenant of its obligation not to share or permit sharing of possession or occupation of the Property or any part thereof or part with possession or occupation. Particularly, since "possession" in section 205 of the Law of Property Act 1925 is defined to include "receipt of rents and profits or the right to receive the same", the tenant had parted with possession by agreeing that the third party should receive the rents from the sub-tenant.

76. So far as I am aware, this case has gone to the Court of Appeal and argument has taken place. Judgement is however still awaited.

DAVID HOLLAND
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12TH NOVEMBER 2009