Landlords beware: no guarantees after a material variation

The judgment in *Topland* provides a timely reminder to commercial property landlords and their lawyers who have guarantees in place against their tenants, says **Nikolas Ireland**

Nikolas Ireland is a solicitor in the Property Litigation Department at Forsters LLP (www.forsters.co.uk)

Picture the scene. Your client has been approached by his tenant to obtain permission to carry out some alterations to the premises. There is a guarantee in place, however, with tight deadlines and an impatient client, it can be tempting to simply draft the document for execution and never incur the time and costs of obtaining formal surety consent. After all, you may think, it's not as if you are extending the term or drastically altering the tenant's lease covenants. What effect could a licence for alterations really have on the guarantee?

Fast forward 20 years and imagine that your tenant's once flourishing business has dried up and not only do they owe vast rent arrears but they are facing liquidation. With recovery from the tenant looking impossible, you approach the surety who claims that he was discharged some two decades ago after the terms of the lease were varied by a licence for alterations to which he was not a party. As a result, the surety is refusing liability for any of the obligations under the lease, rental or otherwise, and your client is potentially facing an empty building and hundreds of thousands of pounds of bad debt.

A reminder of the rule in *Holme v Brunskill* (1877-1878)L.R. 3 QBD 495, CA and consideration of the recent case of *Topland Portfolio No. 1 Ltd v Smiths News Trading Ltd* [2013] EWHC 1445 (Ch) should be reason enough to ensure that making a surety party to any changes to the existing arrangement under a lease is highlighted as an absolute priority. As *Topland* demonstrates, landlords who fail to involve the surety in a change to the arrangements between a landlord and a tenant run the risk of inadvertently releasing the surety from their obligations completely.

Previously discharged

The case of *Topland* concerned a 1981 lease of which Topland Portfolio No.1 Ltd became the landlord upon purchase of the building in 2001 of which WH Smith Do-It-All Ltd was the tenant. The surety, WH Smith & Son Ltd now known as Smiths News Trading Ltd, was the holding company of the tenant under the lease which was to run for a term of 35 years.

In 1987, a licence for alterations was entered into by the former landlord and the tenant which sought to relax the absolute prohibition on structural alterations contained in the lease. The licence essentially enlarged the demised premises to include the new buildings which were to be erected and extended the repairing covenant over them. There was also an obligation to reinstate the premises if requested at the end of the term. As a result of the licence, the obligations of the tenant were rendered more onerous and therefore the potential liability of the surety was increased by the granting of the licence.

After the purchase of the property by Topland

Portfolio No. 1 Ltd, the tenant fell into difficulties and when it was subsequently dissolved in 2012, the landlord sought to exercise its rights over the surety and claim for rental arrears which at the time of issue were in excess of £280,000 plus interest. Fatally for the landlord, the surety had not been included in the licence for alterations and therefore the court found that the surety had been discharged in 1987 after the licence materially varied the obligations which were originally guaranteed. Even though the surety was the parent company of the tenant, it was not deemed sufficient for the landlord to presume consent as a result of the parties' relationship.

The ruling in this case followed the rule in *Holme v Brunskill* which states that any material variation of the terms of the principal contract will discharge the surety. Materiality of a variation will be apparent where it is not necessarily beneficial to the surety or if it is prejudicial or potentially prejudicial. Where it is argued that a variation is not material then the benefit or lack of prejudice to the surety must be self-evident. The courts have shown that they will not delve into the facts to establish whether there is a possibility the variation would not prejudice the surety and so it must be obvious from an objective viewpoint in order to be deemed immaterial. The case of *Howard de Walden Estates Ltd v Pasta Place Ltd* [1995] 1 E.G.L.R. 79 concerned a lease of a delicatessen which was gradually varied to allow the sale of wine to customers taking meals and for off-licence use.

The variation was deemed to be material and the guarantee was discharged under the rule in *Holme v Brunskill* which provides an illustration of the court releasing sureties where it is not necessarily obvious on the face of it that the variation is insubstantial. The rule provides a narrow scope for variations to be deemed as immaterial and therefore it is always prudent to obtain consent from the surety before varying a contract.

The recognition of the requirement for surety consent has led to the inclusion in many modern leases of clauses which seek to give prior consent for any future variations to the agreement. However, the case of *Triodos Bank NV v Dobbs* [2005] EWCA Civ 630, confirmed that the ability to retain a surety pursuant to such a clause despite varying a contract will depend on the exact nature of the variation. The Court of Appeal found that while a guarantee may survive a variation which reschedules an existing obligation, it may not survive a variation which increases liability or is not within the anticipation of the original agreement. While the court gave some brief guidance as to when these clauses may successfully operate, the salient point here was that the rule in *Holme v Brunskill* cannot easily be displaced. As such, these clauses should be treated with care and, where possible, landlords should obtain formal surety consent in any event.

Exercising rights

The judgment in *Topland* provides a timely reminder to commercial property landlords and their lawyers who have guarantees in place against their tenants. The current climate is such that it is not uncommon to see tenants falling into financial difficulties, so landlords will be looking to exercise their rights over sureties with increasing frequency. However, where guaranteed agreements have been varied it is clear that unless the variation is of no real consequence or unless the surety has formally consented then the obligations of the surety will be discharged.

Not only is this an important point of practice for all lawyers drafting documents which are supplementary to guaranteed agreements, it is also vital for lawyers acting for purchasers of properties subject to guaranteed leases. In *Topland*, the landlord purchased the property some 24 years after the licence for alterations was entered into, presumably on the belief that the guarantee was effective. The courts have demonstrated that they will strictly interpret the rule in *Holme v Brunskill* therefore conveyancers must be careful to advise their clients as to the enforceability of any guarantees which may be in place having regard to the documents entered into after the grant of the lease. **SJ**

The current climate is such that it is not uncommon to see tenants falling into financial difficulties, so landlords will be looking to exercise their rights over sureties with increasing frequency