EMI Group: An unwelcome decision

Claudia Orpin and **Charlotte Ross** consider the impact of the *EMI Group* case on assignment to a guarantor and discuss two unopposed lease renewal cases

Claudia Orpin, pictured, and Charlotte Ross are solicitors at Forsters
@ForstersLLP
www.forsters.co.uk

The recent High Court case of *EMI Group v O&H Q1 Ltd* [2016] EWHC 529 (Ch) has confirmed Lord Neuberger's *obiter* comments in *K/S Victoria Street v House of Fraser* [2011] EWCA Civ 904 – namely, that a lease cannot be assigned to an entity which has also guaranteed the obligations of the assignor.

Retailer HMV was granted a lease in 1996, guaranteed by its parent company EMI Group. In 2013, HMV went into administration and the landlord granted consent to assign the lease to EMI. The terms of the licence to assign contained the usual covenants from EMI as assignee to observe and perform the tenant's lease covenants for the remainder of the term. Immediately following the assignment, EMI granted a new company (HMV Retail Ltd) an underlease of the premises.

EMI later sought a declaration that, while the lease vested in it following the assignment, the tenant covenants could not be enforced against it. The judge upheld this, citing the principle tenet of the Landlord and Tenant (Covenants) Act 1995 (LTCA): on assignment (in the absence of an authorised guarantee agreement having been given) both the outgoing tenant and their guarantor should be 'off the hook' in terms of their liabilities under the lease. If a guarantor became the new tenant on assignment, they would not be released from the lease covenants, which would frustrate the anti-avoidance provisions of the LTCA.

While the decision follows the letter of the LTCA, it limits the scope for lease assignment as part of a corporate restructuring and creates further practical concerns for landlords, tenants, and solicitors.

Where a void assignment has been registered, the Land Registry title will be inaccurate. In addition, any subsequent assignments may be invalid and, while the impact on an undertenant was not expressly covered, a party in either of these positions will need to consider whether they in fact have any rights of occupation to the premises and, if not, how the situation might be regularised. Much will depend on the circumstances – for instance, whether an implied tenancy could be inferred from the parties' conduct.

Finally, where there are any arrears of rent, landlords must be careful to consider on whom a section 17 notice should be served, with former tenants potentially in for an unpleasant surprise.

Practitioners will need to consider the impact of this decision both on due diligence exercises and when dealing with proposed assignments. Whichever party you are advising, it will be prudent to look at the history of the lease as well as at the transaction immediately in front of you.

Turnover rent or flat rate?

Reported cases on unopposed lease renewals are usually a fairly rare occurrence. Recently, however, there has been a spate of judgments, two of which are discussed below.

National Car Parks Ltd v Hawksworth Securities plc (12 May 2016, Cambridge County Court) concerned the renewal of the leases of two car parks to National Car Parks Ltd (NCP). The existing leases provided for payment of a base rent and an additional turnover rent, in each case requiring NCP to pay an amount equal to 60 per cent of receipts over a specified amount. The court was asked to decide whether the new leases should also contain a turnover rent, or whether a flat rate should be imposed.

The landlord's evidence was that it had received recent offers for the site from two established operators, at levels which were substantially above the figure proposed by the tenant. At least one of those offers had been made on a 'turnover' basis. In view of this market evidence, and taking

into account the provisions in the existing leases, the court held that a turnover rent would be appropriate but that there were no grounds to exceed the 60 per cent level in the present leases. Its view was that it did have the power to fix rents structured in this way.

It was accepted by the court that the rent payable under a lease protected under the statutory security of tenure provisions of the Landlord and Tenant Act 1954 (LTA) would command a rent which is 10 per cent higher than a lease that is not protected.

The judgment contains interesting guidance as to the extent to which a party can alter its position during the course of litigation. In the run-up to trial, the parties had been proceeding on the basis that the new leases would commence on 25 December 2014, a fact which had been reflected in the travelling leases. Shortly before trial, however, NCP altered its position and sought to argue that the new leases should commence three months and 21 days after the delivery of the judgment.

The court held that there had been a written agreement that the new leases should commence on 25 December 2014, and that NCP could not backtrack from this. This underlines the need for the travelling lease to reflect the parties' positions, and to reserve those positions where necessary.

Despite the early term commencement date, the judgment made clear that the valuation date for the rent under the new leases was the date of the hearing. The new rent will take effect from the date when the new leases are executed. The rent for the period from the term commencement date through to the date of execution of the new leases should be dealt with by way of an interim rent.

Break clause

Britel Fund Trustees Ltd v B&Q plc (11 March 2016, Central London County Court) concerned the renewal of a large purpose-built DIY retail warehouse, let to B&Q. The parties had agreed the new lease should be for ten years and that, in view of the landlord's redevelopment plans, there should be a mutual break clause in June 2018. The only disputed terms were the level of rent and interim rent.

The court was asked to consider:

- Whether allowance should be made for a three-month rent-free period; and
- What the level of the open market rent should be, in light of the break clause.

In relation to the first issue, the court found that section 34 of the LTA assumes that the premises are empty and free from tenants' fixtures. Since a three-month rent-free period would be granted on the open market, allowance should be made for this on renewal, despite the fact that B&Q was already in occupation and had fitted out. The rent-free period should be applied to the whole term of the new lease, which, in this case, resulted in a 2.5 per cent rental discount.

In relation to the second issue, the court held that the reality was that no DIY retailer would take the lease with the agreed break clause. The hypothetical tenant had to be assumed to be a discount retailer, which would be willing to trade for a short term and would carry out a 'quick, cheap, and dirty' fitting out. This had a significant negative impact on the market rent: the rent for a DIY retailer would have been £12.22 per square foot (psf) whereas the rent for a discount retailer was £10.10 psf.

Although the judge in *NCP* commented that it was 'very unfortunate' the litigation did not settle, the judgments are likely to be welcomed by practitioners. The cases provide useful insight into how the court may approach frequently discussed but rarely litigated issues. **SJ**

> **The court held the reality was that no DIY retailer would take the lease with the agreed break clause**