Liability under GAGAs clarified (EMI Group v Prudential Assurance)

10/08/2020

Property analysis: The court held that a guarantee (GAGA) of an authorised guarantee agreement (AGA) was valid and enforceable, despite the dissolution of the original tenant that had provided the AGA. The court clarified the principles of severance applicable in the context of guarantees that would otherwise fail to comply with the Landlord and Tenant (Covenants) Act 1995 (LT(C)A 1995) as a result of either purporting to guarantee the liabilities of subsequent tenants or allowing such a liability to revive at some point in the future after a first assignment (eg on an assignment back). The court also considered what conditions needed to be satisfied for a guarantor to be released from its obligations 'to the same extent' as a tenant, as required by LT(C)A 1995. Written by Maxim Cardew, property and chancery barrister, at Maitland Chambers.

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

What are the practical implications of this case?

This case will be of keen interest for advisors of landlords seeking to enforce GAGAs of AGAs, and guarantors seeking to avoid liability under GAGAs.

The court made clear that validity or otherwise under LT(C)A 1995 was not all or nothing. If a GAGA went beyond what was permitted by LT(C)A 1995, it would only be void to 'to the extent that' it transgressed LT(C)A 1995, provided that what was left was not 'emasculated'. This is so whether or not the relevant transgression is purporting to guarantee the liabilities of future tenants, or purporting to allow a GAGA to revive after a first assignment (although, in this case, on a true construction the lease was compliant).

A prudent landlord can reinforce the statutory position by including a contractual clause making clear that if a GAGA purports to go beyond what is permissible, it is only valid to the extent that it is compliant—such a clause will often be determinative.

The court made clear that the fact that an AGA can only be required when it is reasonable to do so does not invalidate a provision requiring a GAGA to be given in all circumstances where an AGA is required. However, again a landlord can improve its position by a well-drafted lease—if an AGA itself is a condition of assignment under section 19(1A) of the Landlord and Tenant Act 1927 (LTA 1927) on any view the tenant and guarantor will both be released to the same extent on assignment.

Finally, in the worst-case scenario of the giver of AGA (the original tenant) entering liquidation and being dissolved, an express contractual provision will nevertheless prevent the giver of the GAGA (the guarantor) being released from liability.

What was the background?

The case concerned a valuable retail premises on Oxford Street. Prudential is the freeholder and landlord. HMV UK Ltd was the original tenant, with EMI as guarantor. The lease had subsequently been assigned to Forever21 (UK) Ltd. HMV entered into an AGA for the period during which Forever21 was tenant. Forever21 had gone into administration and failed to pay the rent and service charge under the lease. HMV had been dissolved. So Prudential sought to recover the amounts due from EMI, which had given a GAGA in respect of HMV's AGA.

EMI denied liability on four grounds (a fifth ground, that the benefit of EMI's GAGA did not pass to Prudential when it became the landlord under the lease, as there had not been an express assignment of the benefit, was not pursued at trial):

- that as a matter of construction EMI had purported to give an 'embedded repeat guarantee', ie to guarantee the liabilities of future tenants not just the original tenant HMV, contrary to LT(C)A 1995, ss 24(2) and 25
- that under the terms of the lease EMI (as guarantor/giver of the GAGA) was not released upon assignment to the same extent as HMV (as tenant/giver of the AGA), because the

AGA, but not the GAGA, was subject to a requirement of reasonableness, and for this reason also the GAGA was void under LT(C)A 1995, s 24(2) and s 25
- that the lease did not create a valid AGA and EMI's GAGA was therefore necessarily void, because the lease could be assigned back to HMV and it was argued that EMI's liability would then resume, falling foul of LT(C)A 1995, s 16(4)(b), and
- that EMI was released by the dissolution of HMV

Prudential argued that EMI's GAGA was valid and sought payment of the sums due to it.

What did the court decide?

The court found that EMI's GAGA was valid and enforceable, dismissing EMI's claim and finding for Prudential on its counterclaim.

The court summarised the principles relevant to the construction of guarantees in leases. The court noted that while guarantees should be construed strictly, they should nevertheless be fairly construed in their context (*K/S Victoria Street v House of Fraser (Stores Management) Ltd* [2011] EWCA Civ 904; [2012] Ch 497). The canon of construction that a valid (rather than invalid) construction should be preferred is only engaged where there is a realistic rival construction (*Tindall Cobham 1 Ltd v Adda Hotels* [2014] EWCA Civ 1215). Prudential's construction (on which GAGA was valid) was accepted.

The court found in any event that the offending words (if contrary to LT(C)A 1995) could be severed. The relevant principles of severance were contained in LT(C)A 1995, s 25 and *Tindall Cobham 1 v Adda Hotels*, rather than in the common law severance case of *Egon Zehnder Ltd v Tillman* [2019] UKSC 32; [2020] AC 154. Referring to *Inntrepreneur Estates GL v Boyes* (1994) 68 P & CR 77 (not reported by LexisNexis® UK), the court also found that a contractual severance clause in the lease would (if needed) have been effective.

The court rejected the argument that LT(C)A 1995 required a GAGA to be subject to the same reasonableness requirement (imposed by *K/S Victoria Street*) as an AGA. All that mattered was compliance with LT(C)A 1995, s 24(2), namely that the guarantor was released 'to the same extent' as the tenant.

The court found, as a matter of construction, that EMI was not released by the dissolution of HMV. In particular, this was not an implication of section 178(4) of the Insolvency Act 1986 (regarding disclaimers), which deals only with the termination of the lease and not the status of a tenant (ie whether dissolved or otherwise).

Case details

- Court: Business and Property Courts of England and Wales property, Trusts and Probate List (ChD), High Court of Justice
- Judge: Penelope Reed QC (sitting as a Deputy Judge of the High Court)
- Date of judgment: 31 July 2020

Maxim Cardew is a property and chancery barrister at Maitland Chambers. If you have any questions about membership of LexisPSL's Case Analysis Expert Panels, please contact caseanalysis@lexisnexis.co.uk