BUSINESS TENANCIES—TWO PROBLEMS

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UK Real Estate Alert

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INTRODUCTION

On his long journey home, Odysseus confronted many difficulties. However, one monster he never had to grapple with was the Landlord and Tenant Act 1987 (1987 Act). It has fallen to the Law Commission to do this as part of its wide-ranging consultation on business tenancies.

Whilst consulting on the principal Act dealing with business tenancies - the Landlord and Tenant Act 1954 (1954 Act)—the Law Commission is also consulting on problems for business tenancies in other statutes. The proposals we discuss below are in our view to be welcomed but there is no timeline for their implementation, assuming the result of the consultation is positive, so landlords and tenants must remain alive to the issues.

1987 ACT

The Issue

The Landlord and Tenant Act 1987 is the Act that provides that, subject to various exceptions, if a landlord wishes to dispose of its interest in a building containing flats, it must first offer to make the disposal on the same terms to the tenants of the flats (acting collectively).

The 1987 Act has a well-deserved reputation for being badly drafted. It has thrown up many problems, some of which have been litigated and some addressed by amending legislation. One so far unremedied problem relates to whether the owner of a mixed-use building can grant a lease of a commercial unit in the building without first offering it to the owners of the residential units under their statutory pre-emption rights. Commentators hold differing views on this question, and there are of course ways of structuring the legal ownership to prevent the issue from arising.

The Proposal

The Law Commission take the perhaps cautious view that the effect of the 1987 Act is that the landlord must first offer the lease of the commercial unit to the residential tenants (collectively). Their proposal is that a disposal of a part of the building that is exclusively occupied or used (or intended to be so occupied or used) for nonresidential purposes should not trigger the residential tenants' pre-emption rights.

Comment

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It is difficult to see what public benefit is served by the pre-emption rights applying in such a case. And as certain well-known authors point out, if the 1987 Act does catch this situation how do you resolve the conflict between the pre-emption rights of the residential tenants with the 1954 Act renewal rights of a sitting commercial tenant?

Whilst we retain some doubt that the 1987 Act does apply to this situation, our view is that it would be sensible to put the issue beyond doubt by implementing the proposal.

1995 ACT

The Issue

The Landlord and Tenant (Covenants) Act 1995 (1995 Act) is the Act that provides that on an assignment of a lease, the original tenant is automatically released from the tenant covenants, although it is permitted for the outgoing tenant to give a guarantee (an AGA) in respect of the incoming tenant.

One effect of the anti-avoidance provisions of the 1995 Act is that where a tenant wishes to assign its lease, the guarantor of the outgoing tenant cannot act as guarantor for the incoming tenant. This creates difficulties on intra group reorganisations: where a lease is held by one subsidiary and is guaranteed by the parent company and that subsidiary wishes to assign the lease to another subsidiary, the parent company cannot give a guarantee of the incoming tenant. Further, the tenant subsidiary cannot assign the lease to the parent guarantor.

The Proposal

The Law Commission provisionally proposes that, where the assignor tenant, assignee, and relevant guarantor are members of the same group of companies, the 1995 Act should facilitate intra-group assignments and guarantees, including permitting the existing guarantor to guarantee the assignee. Separately, it proposes that a tenant should be permitted to assign its lease to its guarantor, whether or not they are members of the same group.

Comment

This seems to us to be a sensible proposal and addresses a genuine issue.

CONCLUSION

The consultation paper is wide ranging and covers various proposals for “overcoming barriers to transactions” affecting business leases. The two issues discussed above address practical difficulties frequently encountered in commercial real estate transactions and, if implemented, are likely to be welcomed by the real estate industry.

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