Law Commission
Reforming the law

Commercial Leasehold: overcoming barriers to transactions

Consultation Paper

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16 June 2026

This publication is available at https://lawcom.gov.uk/project/commercial-leasehold/.

THE LAW COMMISSION – HOW WE CONSULT

About the Law Commission: The Law Commission was set up by section 1 of the Law Commissions Act 1965 for the purpose of promoting the reform of the law. The Law Commissioners are: The Rt Hon Lord Justice Fraser, Chair, Professor Penney Lewis, Professor Solène Rowan, Professor Lisa Webley, and Professor Alison Young. The joint Chief Executives are Joanna Otterburn and Stephanie Hack.

Topic of this consultation: We are consulting on two areas of law posing barriers to commercial leasehold transactions. Specifically, we examine issues with the Landlord and Tenant (Covenants) Act 1995 (in particular, its anti-avoidance provision), and the right of first refusal under Part 1 of the Landlord and Tenant Act 1987 (and its application to disposals of commercial units in mixed-use premises).

Geographical scope: This consultation applies to the law of England and Wales.

Duration of the consultation: We invite responses from 16 June 2026 to 16 September 2026.

Responses to the consultation may be submitted using an online form at: https://consult.justice.gov.uk/law-commission/commercial-leasehold-consultation. Where possible, it would be helpful if this form was used.

Alternatively, comments may be sent:

By email to BusinessTenancies@lawcommission.gov.uk.

By post to Business Tenancies Team, Law Commission, 1st Floor, Tower, 52 Queen Anne's Gate, London, SW1H 9AG.

If you send your comments by post, it would be helpful if, whenever possible, you could also send them by email.

Availability of materials: The Consultation Paper is available on our website at https://lawcom.gov.uk/project/commercial-leasehold/.

We are committed to providing accessible publications. If you require this Consultation Paper to be made available in a different format please contact us (email BusinessTenancies@lawcommission.gov.uk or see the Law Commission's "General Enquiries" details at https://lawcom.gov.uk/contact/).

After the consultation: After reviewing all responses, we will decide on our recommendations about whether the law should change. Once we have reached our conclusions, we will publish a report setting out of final recommendations for reform. It will be for the Government to decide whether to implement our recommendations.

Consultation Principles: The Law Commission follows the Consultation Principles set out by the Cabinet Office, which provide guidance on type and scale of consultation, duration, timing, accessibility and transparency. The Principles are available on the Cabinet Office website at: https://www.gov.uk/government/publications/consultation-principles-guidance.

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Consultation responses are most effective where we are able to report which consultees responded to us, and what they said. If you consider that it is necessary for all or some of the information that you provide to be treated as confidential and so neither published nor disclosed, please contact us before sending it. Please limit the confidential material to the minimum, clearly identify it and explain why you want it to be confidential. We cannot guarantee that confidentiality can be maintained in all circumstances and an automatic disclaimer generated by your IT system will not be regarded as binding on the Law Commission.

Alternatively, you may want your response to be anonymous. That means that we may refer to what you say in your response, but will not reveal that the information came from you. You might want your response to be anonymous because it contains sensitive information about you or your family, or because you are worried about other people knowing what you have said to us.

We list who responded to our consultations in our reports. If you provide a confidential response your name will appear in that list. If your response is anonymous we will not include your name in the list unless you have given us permission to do so.

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Contents

Chapter 1: Introduction

INTRODUCTION AND BACKGROUND TO THE PROJECT

1.1 In this Consultation Paper we consider issues which impact on commercial lettings that arise from two Acts.

(1) **Part 1 of the Landlord and Tenant Act 1987** (the "1987 Act"): which gives to residential leaseholders of blocks of flats the right of first refusal when a landlord proposes to dispose of certain interests.

(2) The **Landlord and Tenant (Covenants) Act 1995** (the "1995 Act"): which is critical to modern leasehold law. In particular, it aims to ensure that, on an assignment and after they have parted with ownership of their interest in the property, the original landlord and tenant to a lease can be released from future liability under the lease.

1.2 The two Acts are relevant to both commercial and residential leasehold premises – albeit to different degrees.

1.3 This is a technical project and is not intended to effect wholesale reform. It focusses upon, with a view to remedying, problems that we are aware of in the commercial leasehold sphere, notably:

(1) **The right of first refusal under Part 1 of the 1987 Act**: where a landlord proposes to make a disposal of all or part of its interest in a block of flats – for example, by selling its freehold interest, or granting a lease of the non-residential parts – it is often under an obligation to give residential leaseholders "first refusal", enabling them to acquire the interest rather than a third party.

Example of the right of first refusal

A landlord (L) owns the freehold of a block of flats where there are a number of leasehold homeowners. The landlord decides to sell its freehold interest to a purchaser (P).

L, in accordance with the right of first refusal established in the 1987 Act, first offers to sell to the leasehold homeowners the freehold interest that L proposes to sell to P.

We are aware that the right may cause unintended consequences if it is triggered in developments where there is a mixture of residential and commercial premises.

(2) **Anti-avoidance provisions in the 1995 Act**: the 1995 Act was introduced, in particular, to avoid the original tenant and landlord to a lease remaining liable

on obligations owed in the lease when it is assigned.[1] However, we understand that anti-avoidance provisions,[2] that were intended to benefit tenants, have since created practical problems in commercially important arrangements.

Example of the effect of the anti-avoidance provisions in the 1995 Act

A tenant (T) is part of a group of companies. It has a parent company (P) and a subsidiary (S). Two years ago, T was granted a ten-year lease of premises on a high-street by a landlord (L). T had few assets of its own and so L required T's performance of the tenant covenants under the lease – including the payment of rent – to be guaranteed by P. All parties were happy with this.

Today, T wishes to transfer its interest in the lease to S and applies to L for consent to assign the lease (which is required under the terms of the lease). L is generally happy, but notes that S also has few assets of its own and so would like P to guarantee directly S's performance of the tenant covenants under the lease (as it has been doing for T). P would be happy to do this, but the effect of the anti-avoidance provision in the 1995 Act is that it cannot do so – any such guarantee would be void.

1.4 This project is a natural, and important, extension of the Law Commission's work considering Part 2 of the Landlord and Tenant Act 1954 (the "1954 Act"), which gives to business tenants a right to renew tenancies that would otherwise come to an end, enabling businesses to remain in their premises.[3] That work started in 2023 and we call it the "Business Tenancies Project" in this Consultation Paper.[4]

1.5 In our first consultation paper published as part of the Business Tenancies Project, we highlighted that there were "wider concerns about [commercial leasehold] law" and that "we [were] open to the possibility of undertaking further work on … commercial leasehold".[5] The issues we consider in this project were amongst those that we mentioned.

OUR PROJECTS AND THE IMPROVEMENT OF COMMERCIAL LEASEHOLD

1.6 This project does not pose fundamental questions that could change the nature of legal relationships, rather it seeks to address technical difficulties with ones that exist.

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1 A party to a lease might transfer their interest under it to another person. Where leases are concerned, it is very common to call those transfers "assignments". The person who assigns their interest in a lease to another is called the "assignor" and the person who receives the interest is called the "assignee". In this Consultation Paper we refer to a landlord's transfer of his or her interest in a freehold as an assignment, as well as any party's interest in a leasehold interest. So, for example, a landlord can transfer or "assign" its freehold interest to another person and a tenant can transfer or "assign" its interest to another person (although see para 3.67 below for a discussion on assignments made in breach of covenant). A more detailed explanation of the operation of the 1995 Act is available in ch 3.

2 An "anti-avoidance" provision is a measure in an Act that is designed to prevent the aims of the Act being circumvented.

3 The right for business tenants to obtain a renewal tenancy that is established by pt 2 of the Landlord and Tenant Act 1954 is often referred to as "security of tenure".

4 Details about the Business Tenancies Project are available at https://lawcom.gov.uk/project/business-tenancies-the-right-to-renew/.

5 Business Tenancies: the right to renew – Consultation Paper 1: models of security of tenure (2024) Law Commission Consultation Paper No 266, paras 1.47 and 1.49.

We are not reviewing whether it is right that leaseholders of flats should have first refusal under the 1987 Act where landlords dispose of interests in their block. Nor, in respect of the 1995 Act, are we looking at the broad principle of whether it is right that the original parties to leases should not be liable on covenants in those leases long after they have parted with the property and their interest in it.

1.7 Instead, we are looking at specific issues within the 1987 Act and 1995 Act that may not be working as intended, so far as commercial leasehold law is concerned, creating pitfalls, delay, uncertainty, unnecessary costs and litigation. Although smaller in scale, this project is no less important than the Business Tenancies Project.

1.8 Following the announcement of our work examining the 1987 and 1995 Acts in our 14th Programme of Law Reform,[6] we prioritised that work so that this Consultation Paper would be published on the same day as our second consultation paper on the Business Tenancies Project, enabling both consultations to take place simultaneously.

1.9 Our aim is to continue to run the projects in tandem so that we publish the final reports, containing recommendations for reform, on both projects at the same time. This approach has significant benefits.

(1) First, many of the stakeholders who are interested in one project will be interested in the other.

(2) Second, and of particular importance, we will have an opportunity to present a wider overall package of reforms to commercial leasehold law, which (assuming we conclude that reform to the law is needed) we currently anticipate being in a position to document in a single draft Bill when our final reports are published.

1.10 This provides a significant opportunity to examine and, where needed, fix critical elements of commercial leasehold law, giving those who use and rely upon it the confidence to build their businesses.

1.11 It follows that the Business Tenancies Project and this project are linked. However, the link is not generally one of substance[7] – where legal issues overlap and where the resolution of an issue in our Business Tenancies Project might affect the resolution of one or other of the issues being considered in this project (or vice-versa) – rather the link is one of theme: the improvement of commercial leasehold law.

THE COMMERCIAL LEASEHOLD CONTEXT

1.12 At the start of 2023, there were around 5.2 million businesses in England and Wales.[8] Some of those businesses trade from the owner's home or garage, or provide

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6 14th Programme of Law Reform (2025) Law Com No 421, para 2.5, https://www.lawcom.gov.uk/14th-programme/. All webpages in this Consultation Paper were last visited on 8 June 2026.

7 We note that there is an area of overlap and uncertainty relating to whether a residential leaseholder's right of first refusal under the 1987 Act or a business tenant's right to a new lease under the 1954 Act has primacy (see para 2.71 below).

8 See Business population estimates for the UK and regions 2025: statistical release (2 October 2025), and supporting data tables, at https://www.gov.uk/government/statistics/business-population-estimates-2025/business-population-estimates-for-the-uk-and-regions-2025-statistical-release.

services at a customer's place of business. However, for many, the business itself will have its own base, for example, a shop on a high street, a workshop on an industrial estate, an office in a city centre, or a warehouse at the junction of a motorway.

1.13 Some small businesses trade from just one property. Other businesses, for example, banks and professional services firms, may have many locations from which they operate; familiar brands on our high streets can have dozens or hundreds of shops, spread across England and Wales, supported by warehouses and a head office.

1.14 While there is no doubt that online trade has increased enormously,[9] many businesses will have both an online and physical presence, whether that be shops and showrooms that sit alongside their virtual stores, offices for their staff, or warehouses for their products.

1.15 While some businesses own the freehold of the properties from which they operate, many occupy their premises as tenants, leasing them from a landlord. There are many reasons why a business may occupy a property as a tenant as opposed to a freeholder, for example:

(1) necessity: a business may not have the funds to purchase a freehold, or there may be no suitable freehold properties available;

(2) flexibility: a business may prefer to take a lease of premises knowing that, when the lease comes to an end, it can move to larger or smaller premises, or a different location altogether, without having to sell its original premises; or

(3) accounting and budgeting: a business may prefer to pay a regular rent for its premises, rather than making an up-front freehold purchase (whether or not with funding from a bank).[10]

THE SCOPE AND TERMS OF REFERENCE FOR OUR PROJECT

1.16 This project is sponsored by the Ministry of Housing, Communities and Local Government and we have agreed with the Government the following terms of reference[11] for it:

> The Law Commission will conduct a focussed review of two areas of law which cause problems for commercial leasehold transactions:

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9 The Centre for Retail Research has indicated that the online share of retail trade in the UK increased from 10.6% to 26.5% between 2012 and 2022. The study showed that, during the COVID-19 pandemic, the percentage was "more than 30%, even reaching more than 35% for a brief period" (see The Centre for Retail Research, "Online Trends & Statistics for UK, Europe & N. America 2022-2024" at https://www.retailresearch.org/online-retail.html).

10 Also see Property Industry Alliance, Property Data Report 2023 (January 2024), p 4, available at https://propertyindustryalliance.org/property-data-report/.

11 We call these terms of reference the "Terms of Reference" in this Consultation Paper.

- Landlord and Tenant (Covenants) Act 1995: the project will examine whether aspects of this Act – in particular, the anti-avoidance provisions – are standing in the way of commercially important transactions.

- Landlord and Tenant Act 1987: the project will review whether aspects of this Act are creating unnecessary confusion or bureaucracy for transactions involving commercial property – in particular, whether the grant of leases of commercial units in mixed-use premises should be excluded from the rights of first refusal given to residential tenants.

The Commission will consider reforms with a view to:

- streamlining commercial leasehold transactions;

- decreasing bureaucracy, delay and costs;

- reducing confusion about how the law applies; and

- aligning the reforms to the wider review of the Landlord and Tenant Act 1954 and ensuring that reforms collectively (when considered alongside reforms under the 1954 Act project) support the objectives of that review.

The following aspects of the law are outside of the scope of the review:

- property taxation;

- planning law (including permitted development rights and use classes);

- residential leasehold; and

- the insolvency regime.

THE POTENTIAL IMPACT OF OUR WORK

1.17 As we explained in our first consultation paper on the Business Tenancies Project, the market for business tenancies in England and Wales is enormous. Figures from 2023 identified that the value of commercial property in the UK was nearly £900 billion and that more than half was rented.[12] However, the economic importance of commercial leaseholds goes beyond the value of the properties themselves. Commercial premises provide a base for businesses which, in turn, support other businesses and communities by providing places of employment and leisure, and by facilitating trade.

1.18 This project is a targeted review of two Acts – whose underlying policies are laudable – to examine whether aspects of them are unnecessarily increasing friction, uncertainty, risk and cost for businesses by standing in the way of commercially useful leasehold transactions and, if they are, to fix them.

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[12] Property Industry Alliance, Property Data Report 2023 (January 2024), p 4 and p 6, available at https://propertyindustryalliance.org/property-data-report/.

1.19 From an economic perspective, the generation of even small savings – in time or expense – on commercial leasehold transactions can deliver considerable benefits. That is due to the scale of the commercial leasehold market. This work has the potential to resolve unnecessary barriers to businesses, whilst preserving the important role performed by two longstanding pieces of legislation.

1.20 In this Consultation Paper, we make provisional proposals for reform to the 1987 Act and the 1995 Act.[13] In order to help inform our final recommendations, we are asking consultees to provide us with their views, together with evidence where possible, on the potential impacts of these proposals. In considering impacts, we are interested in any potential consequences of the reforms. This could include financial impact but it may also include other impacts which are not as easy to monetise, such as environmental impact or changes in market behaviour. We are interested in how the proposals may impact commercial landlords, commercial tenants, their advisers and the wider commercial leasehold market.

1.21 We are also interested in how the proposals may impact residential leaseholders, their advisers and the wider residential leasehold market. Although residential leasehold law is outside of the scope of our review, as mentioned at paragraph 1.16 above, the 1987 Act concerns a right benefiting residential leaseholders and the 1995 Act is relevant to various types of leases, including residential leases. Our provisional proposals are focussed on issues which are causing problems in commercial leasehold transactions. We have been careful not to make provisional proposals which might cause significant and/or adverse impact to residential leaseholders, their advisers, or the wider residential leasehold market. However, we are keen to understand whether our assessment of the impact of our provisional proposals on residential leaseholders is accurate.

Consultation Question 1.

1.22 We invite consultees' views, together with evidence where possible, as to what financial and other impacts our provisional proposals to amend the 1987 Act and/or the 1995 Act will have on:

(1) commercial landlords, tenants and their advisers;

(2) the commercial leasehold market;

(3) residential landlords, tenants and their advisers; and

(4) the residential leasehold market.

Equality impacts

1.23 In addition to the above we are interested in whether any of the possible changes we discuss in this Consultation Paper would affect groups or individuals with a characteristic that is protected under the Equality Act 2010. These characteristics are

[13] See paras 2.103 and following and 4.120 and following.

age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex, and sexual orientation. Although these characteristics have legal protection, there are other ways that proposed changes to the law may have impacts on groups or members of groups that do not necessarily fall within the ambit of a particular protected characteristic. Consideration of the impacts on these groups is also important.

1.24 We ask a general question below about potential equality impacts. Consultees may wish to address equality impact issues as they arise throughout the paper, in relation to issues and questions that we raise, or more generally in response to the question below. The purpose of this question is to encourage consultees to alert us to any equality impacts that they think may exist. Consultees do not need to repeat material here that has been included in their responses to other questions.

Consultation Question 2.

1.25 We invite consultees to tell us if they believe, or have evidence or data to suggest, that changes to either the 1987 Act or the 1995 Act that are being considered in this Consultation Paper could result in advantages or disadvantages to certain groups or to individuals based on certain characteristics (with particular attention to age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex, and sexual orientation).

WELSH DEVOLUTION

1.26 Both the 1987 Act and the 1995 Act extend to England and Wales, and both came into force before the Welsh devolution settlement was established.

1.27 As to whether any reforms to the 1987 Act and/or the 1995 Act would be devolved, the position is currently not clear. Property law (including leasehold law) is not explicitly a reserved matter under the Government of Wales Act 2006 ("the 2006 Act").[14] However, the 2006 Act prevents the Senedd from modifying "private law" unless that modification has a purpose which does not relate to a reserved matter.[15]

1.28 "Private law" includes property law (and leasehold law, including the subject matters of the 1987 Act and the 1995 Act, is an aspect of property law). Accordingly, the Senedd is prevented from modifying those Acts unless a modification has a purpose which does not relate to a reserved matter. Whether a particular modification is devolved, therefore, depends on its purpose.

1.29 The challenge we face is that the purpose of any modification to the 1987 Act and/or the 1995 Act which we might recommend (or which might ultimately be implemented) is not necessarily clear. It may depend not just on what reforms we recommend and why (matters which are, by definition, not decided at the consultation stage of our

[14] As amended by the Wales Act 2017. See the Government of Wales Act 2006, sch 7A.

[15] Government of Wales Act 2006, sch 7B, para 3.

project), but also on which recommendations are ultimately implemented by legislation and why.

1.30 Whether or not any recommended reforms relate to devolved areas, we want to ensure we consult stakeholders in Wales. In doing so, it is important to be clear that we are not asking consultees for their views about whether they think any possible reform is or should be devolved. That is outside the scope of the project.

1.31 What we are asking is whether there are particular considerations or experiences relating to Wales which consultees think we should take into account when considering the case for reform. For example, we would like to understand whether any provisional proposal that we make in this Consultation Paper is more or less suitable for Wales compared to England, or whether the same considerations are likely to apply to both.

Consultation Question 3.

1.32 We invite consultees to tell us about any particular considerations or experiences in Wales, which consultees think are relevant to the potential reforms of the 1987 Act and 1995 Act set out in this Consultation Paper.

THE STRUCTURE OF THIS CONSULTATION PAPER

1.33 **Chapter 2**: in this chapter we set out a history of the 1987 Act and an overview of the current law. We focus closely on the types of disposals – for example, sales of the freehold and the grant of leases – that are caught by leaseholders of flats' right of first refusal. We consider whether the 1987 Act is operating as it should in premises where there is mixed residential and commercial use and make a provisional proposal to prevent the right of first refusal applying to non-residential premises.

1.34 **Chapter 3**: in this chapter we set out an overview of the current law in the 1995 Act, with particular attention paid to the provisions that we believe are contributing to problems and which are considered in Chapters 4 and 5.

1.35 **Chapter 4**: in this chapter we focus on two provisions in the 1995 Act.

(1) First, we consider in detail "authorised guarantee agreements", which are a permissible way for a tenant who assigns their lease to guarantee the performance of the obligations in the lease by the person to whom the lease is assigned.

(2) Second, we consider a provision that is intended to stop landlords and tenants from avoiding the intention of the 1995 Act (a so-called anti-avoidance provision), but which may have gone too far by interfering with commercially useful and/or important transactions.

1.36 **Chapter 5**: in this chapter we consider further issues regarding the 1995 Act that we are aware of that relate to: concurrent leases; covenants with management

companies; agreements for lease; the "registration gap"; and service of notices under the 1995 Act.

1.37 **Chapter 6**: brings together the consultation questions that are asked throughout this Consultation Paper.

AN OVERARCHING CONSULTATION QUESTION

1.38 While we ask targeted questions in respect of the 1987 Act and the 1995 Act in the relevant chapters mentioned above, we are conscious that this project is unusual for the Law Commission. We are examining two Acts that cover both residential leasehold and commercial leasehold, but from the perspective of improving commercial leasehold (whilst not damaging residential leasehold).

1.39 The result is that we are making provisional proposals, and asking questions, that we consider will have real-world benefits in the commercial leasehold sphere. We are conscious that there remain problems and concerns relating to the 1987 Act and 1995 Act either generally, or specifically in the residential leasehold sphere on which we do not consult. This is unavoidable bearing in mind the scope of this project and the limitations in our Terms of Reference.

1.40 We are keen to hear whether consultees believe we have addressed the main issues (taking into account the limitation noted above). To that end, we ask an overarching question here.

Consultation Question 4.

1.41 We invite consultees' views on whether the issues considered in Chapters 2 to 5 are, in the context of the 1987 Act and the 1995 Act, the issues most in need of being addressed by law reform from the perspective of commercial leasehold law.

STAKEHOLDER ENGAGEMENT

1.42 Most of our projects involve significant stakeholder engagement prior to publication of a consultation paper. This project has been unusual because we took it on relatively recently in our 14th Programme of Law Reform[16] and have accelerated the production of this Consultation Paper in order to deliver it at the same time as our second consultation paper in respect of the 1954 Act.

1.43 This has meant we have undertaken less pre-publication stakeholder engagement than ordinarily would be the case. We do, however, have recourse to detailed responses to the consultation that preceded our 14th Programme of Law Reform.[17] These responses have been invaluable in giving us insight into what we believe to be

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[16] 14th Programme of Law Reform (2025) Law Com No 421, para 2.5, https://www.lawcom.gov.uk/14th-programme/.

[17] See 14th Programme of Law Reform (2025) Law Com No 421, para 1.4 and following, https://www.lawcom.gov.uk/14th-programme/.

the main issues that are within the scope of our work. We are keen to hear of any other issues that are causing concern as noted at paragraph 1.40 above.

FURTHER WORK ON COMMERCIAL LEASEHOLD

1.44 This project, and the Business Tenancies Project, are not the only work on commercial leasehold that is anticipated. A further Law Commission project will focus on the law governing the maintenance, repair and upgrading of leased commercial buildings. It is an area where we understand there is concern that the law is causing confusion and unfairness, and has not kept pace with modern priorities (such as the need to improve the environmental sustainability of buildings or to reinvigorate the high street).

1.45 Our future work is a scoping project. It will enable us to understand the problems that exist and to test which might have a law reform solution. It will consider, amongst other things, the law relating to dilapidations, service charges, and the interaction between environmental frameworks and commercial leasehold law.

1.46 That scoping project is expected to commence after both this project, and our Business Tenancies Project, are complete.

A NOTE ABOUT LANGUAGE

1.47 In this Consultation Paper we use language that is common in the landlord and tenant context, and we use some of that language interchangeably. We set out some key words, and how we use them in this Consultation Paper, below.

Lease	The legal device (usually in a written document) that results in a person acquiring a leasehold interest in a property. It is common to refer to a landlord granting a lease to a leaseholder or tenant.
Leasehold	The interest in property that is created by a lease.
Landlord	A person who holds an interest in property out of which a lease has been granted. A landlord may be either the freeholder of the property or hold a leasehold interest in the property. A landlord may also be referred to as a "lessor".
Leaseholder	A person who holds a leasehold interest in property, granted by a person (the landlord) with the freehold interest or a more extensive leasehold interest in the property. A leaseholder may also be referred to as a "tenant" or a "lessee".
Tenant	In this Consultation Paper, "tenant" is used interchangeably with "leaseholder".
Tenancy agreement	In this Consultation Paper, "tenancy agreement" is used interchangeably with lease.
Tenancy	In this Consultation Paper, "tenancy" is, depending on context, used interchangeably with leasehold (that is, the interest created by a tenancy agreement) or as a shorthand for the tenancy agreement itself.

PROJECT TEAM

1.48 The Commissioners would like to record their thanks to the following members of staff who worked on this Consultation Paper: Charlotte Black (lawyer), Rachael Donnelly (lawyer), Colin Oakley (team manager); Daniel Robinson (lawyer); Jack Sims (research assistant); Dhruv Singhal (research assistant).

Chapter 2: The Landlord and Tenant Act 1987

INTRODUCTION

2.1 The Landlord and Tenant Act 1987 confers rights for residential tenants. For example, it establishes a right, in certain circumstances, for tenants (and any other party) to a long lease of a flat to apply to a tribunal to vary the terms of their leases[18] and another for residential leaseholders of flats to apply for an order appointing a manager in respect of the premises.[19]

2.2 In this chapter, and of relevance to this project, we consider Part 1 of the Landlord and Tenant Act 1987. That part gives to residential leaseholders in a block of flats a right of first refusal[20] where the landlord wishes to dispose of an interest in it.[21]

2.3 Unless the context otherwise requires, we refer to Part 1 of the Landlord and Tenant Act 1987 as the "1987 Act" throughout this chapter and we refer to the right of first refusal established in that part as the "Right of First Refusal".

BACKGROUND TO THE 1987 ACT

2.4 It is useful to explain some historical background to the 1987 Act before setting out our analysis about the need – and a provisional proposal – for reform. This historical background helps to make clear what problem the 1987 Act was intended to address and gives an opportunity to explore changes to the legal landscape following the 1987 Act coming into force.

Historical background

2.5 The 1987 Act arose from concerns about the treatment of tenants, for example, their suffering from "excessive service charges" or from "indifference or neglect by the landlord". Those concerns prompted the then Government to establish a committee, in

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18 See the 1987 Act, pt 4.

19 See the 1987 Act, pt 2.

20 The concept of rights of first refusal in relation to land or property was not novel when the 1987 Act was introduced. For example, in Scotland, feudal rights of pre-emption had existed prior to the abolition of the feudal system of land tenure (Abolition of Feudal Tenure etc. (Scotland) Act 2000). In England (and, in some cases, in Wales), under the non-statutory Crichel Down Rules (which date from the 1950s) former owners of land that had been compulsorily acquired may be offered a right of first refusal on a subsequent sale if the land is no longer required.

We also note here potential future developments which relate to rights of first refusal - for example, in our final report making recommendations to reform enfranchisement law – "Leasehold home ownership: buying your freehold or extending your lease" (2020) Law Com No 392 – we recommended that "where a leaseholder of inalienable National Trust land has extended his or her lease under our new regime, the lease should thereafter be subject to a right of first refusal in favour of the National Trust."

21 In this chapter we talk of proposed disposals by landlords of their interest in certain premises being caught by the right of first refusal. For completeness, we note that the Landlord and Tenant Act 1987, s 4(1A) establishes that a mortgagee of such premises that proposes to make a disposal of an interest under its power of sale would also be subject to the right of first refusal, whether or not the disposal is made in the name of the owner or its own name.

1984, to collect evidence about the problems being experienced and to make recommendations for reform. The 1987 Act is based extensively upon the committee's recommendations.[22]

2.6 The 1984 committee was chaired by Edward Nugee QC. The committee completed its report in 1985 (the "1985 Report").[23] The 1985 Report provides useful historical background regarding the changing nature of flat building and leasing that preceded the committee's work and the 1987 Act, which has informed our work.

2.7 The 1985 Report explains the evolution – over an extended period of time – from flats being built for private renting, to flats being built for sale by way of long leases. The 1985 Report also identified changes in the nature of landlords which, the committee concluded, had an adverse impact on the relationships between landlords and tenants, and an "intensification of management problems".[24] The overall picture is one of growing concerns about how landlords were managing properties and disposing of their interests. This explains why the 1987 Act (which contained more tenant protections and rights than just the Right of First Refusal)[25] was implemented.

The development of the wider legal landscape

2.8 It is interesting to note two conclusions set out in the 1985 Report.

(1) The first conclusion concerns the possibility of a right for tenants to acquire the landlord's interest in circumstances where the landlord does not wish to sell.

> The majority of [the committee] do not consider that it would be right to give tenants a right to buy the interest of a landlord who wishes to continue to own and manage his own property, even if it could be shown that the management of the block might be improved if it were under the control of the tenants.[26]

(2) The second conclusion relates to the acquisition by tenants of the management functions of the landlord.

> [The committee] also considered whether tenants should have the right to take over the management of the block without acquiring ownership in certain circumstances. …

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22 See Hansard (HC), 30 March 1987, vol 113, col 764.

23 Report of the Committee of Inquiry on the Management of Privately Owned Blocks of Flats (October 1985). We note that the 1985 Report made additional recommendations and considered options for reform beyond the Right of First Refusal, which are not considered, or not considered in detail, in this Consultation Paper. For example, recommendations were made to replace the general jurisdiction of the High Court to appoint a receiver (see the Supreme Court Act 1981, s 37) with a tailored power for the county court to appoint a receiver and manager in respect of a block of flats where there was "substantial and persistent bad management" (see the 1985 Report, para 7.2.14 and following). Elements of that recommendation were implemented in the 1987 Act (see s 21 and following). Also see para 2.8 and following below.

24 See the 1985 Report, paras 2.2 to 2.10, which are reproduced in the Appendix to this Consultation Paper (save that part only of para 2.10 is reproduced).

25 See n 20 above.

26 1985 Report, para 6.18.

> … self-management is not always a route to better management and in certain circumstances it might substitute one form of tyranny for another for some residents.[27]

2.9 The two possible rights will sound familiar to many reading this Consultation Paper. They are what are known as "collective enfranchisement" and the "right to manage".[28] Neither right existed at the time the Right of First Refusal was implemented, but both are now features of the law.

(1) The right of collective enfranchisement – enabling residential leaseholders of blocks of flats to acquire the interest of their landlord (when the landlord does not wish to sell) – was established in the Leasehold Reform, Housing and Urban Development Act 1993.[29]

(2) The right for residential leaseholders to take over certain of the landlord's management obligations – the right to manage – was established in the Commonhold and Leasehold Reform Act 2002.[30]

The fact that these have subsequently been introduced into law has altered the legal landscape that produced the Right of First Refusal.

THE SCOPE OF OUR PROJECT

2.10 Before summarising the current law, we provide these observations about the scope of our work.

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27 1985 Report, paras 7.9.22 and 7.9.23.

28 The Law Commission undertook a detailed review of residential leasehold law, including the right to enfranchise and the right to manage, with a suite of reports being published in 2020. For more information, see https://lawcom.gov.uk/project/residential-leasehold-and-commonhold/. We note, for completeness, that the committee responsible for the 1985 Report also briefly considered strata title, which is a system of ownership similar to commonhold, but made no recommendation for its adoption (see the 1985 Report, para 7.9.24). Commonhold ownership was enabled in the Commonhold and Leasehold Reform Act 2002 and the reform of commonhold comprised part of the Law Commission's work mentioned in this footnote.

29 We note that a right for leaseholders of houses to enfranchise was established in the Leasehold Reform Act 1967. That right did not extend to leaseholders of flats, but leaseholders of flats were given enfranchisement rights by the Leasehold Reform, Housing and Urban Development Act 1993. The rights in the 1967 Act and the 1993 Act have, subject to being brought into force, been reformed by the Leasehold and Freehold Reform Act 2024. The 2024 Act implements options and recommendations set out in two of our reports: Leasehold home ownership: buying your freehold or extending your lease – Report on options to reduce the price payable (2020) Law Com No 387 and Leasehold home ownership: buying your freehold or extending your lease (2020) Law Com No 392. Various provisions in the 2024 Act came into force when it was passed on 24 May 2024. Other provisions require regulations by the Secretary of State to be brought into force, with some being brought into force on 31 January 2025 (see the Leasehold and Freehold Reform Act 2024 (Commencement No. 2 and Transitional Provision) Regulations 2025 SI 2025/57). Other provisions (including many of those relating to enfranchisement rights) await commencement.

30 The right to manage in the 2002 Act has been reformed by the Leasehold and Freehold Reform Act 2024, which implements some recommendations made in the Law Commission's report, Leasehold home ownership: exercising the right to manage (2020) Law Com No 393. For information on when the 2024 Act was passed, see n 29 above. On 3 March 2025, certain sections which give effect to reforms to the right to manage were brought into force (see the Leasehold and Freehold Reform Act 2024 (Commencement No. 3) Regulations 2025 SI 2025/131, reg 2).

2.11 Our current work examining the 1987 Act has arisen as part of an exploration of issues affecting commercial leasehold and an examination of commercial leasehold law.[31] However, as will be obvious from the material above, the Right of First Refusal is a protection for residential tenants.

2.12 It is our understanding from stakeholders that the Right of First Refusal may inappropriately catch disposals – for example, leases – of commercial premises in mixed-use buildings.

2.13 If an issue with the 1987 Act arises in respect of mixed-use buildings, because some of the premises are used (or intended to be used) for commercial purposes, then the issue is likely to be within the scope of our project. It follows that the concern mentioned in the paragraph above is within the scope of our project and we consider it in detail at paragraph 2.45 and following below and make a provisional proposal for reform.[32]

2.14 We are also aware of criticisms of how the 1987 Act works in a residential context and more generally. For example, criticisms include:

(1) that the 1987 Act establishes a criminal sanction for non-compliance;[33]

(2) that, bearing in mind developments in the law (in particular regarding enfranchisement and the right to manage), the Right of First Refusal is no longer needed and should be abolished;[34]

(3) that the 1987 Act is poorly drafted, giving rise to unclear, inconsistent, and cumbersome outcomes; and

(4) that there are various challenges presented by the 1987 Act, for example:

(a) it can be difficult to prove prior compliance with the Act on subsequent disposals;

(b) establishing what constitutes the premises and the building is sometimes not simple; and

(c) the scheme of notices to comply with the Right of First Refusal provided for in the 1987 Act is problematic, for example, because there are no standard form notices.

2.15 Where an issue with the 1987 Act arises in a block of flats with all residential leases and no commercial leases, then that issue is clearly not within the scope of our current work. So far as the issues mentioned above are concerned – which are general in

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31 See para 1.44 above.

32 See para 2.103 and following below.

33 See the 1987 Act, s 10A.

34 See para 2.8 and following above. We also note that, in January 2026, the Government published a draft Commonhold and Leasehold Reform Bill (https://www.gov.uk/government/publications/draft-commonhold-and-leasehold-reform-bill). The draft Bill would have the effect of banning the use of leasehold for most new flats and facilitate conversion to commonhold for existing leasehold homeowners.

nature and do not have a commercial leasehold focus – we are unable, in this current project, to address them.

THE CURRENT LAW

2.16 We set out below the current law regarding the Right of First Refusal and why, in certain circumstances, it may cause problems in the commercial sphere. However, unlike many of our projects, our exploration of the current law is mostly high-level. That is because this project is not considering the ongoing existence of the Right of First Refusal or, save in one regard, the detail of its operation.[35]

Qualifying criteria

2.17 For the Right of First Refusal to apply, various criteria must be met:

(1) there must be "premises" to which the 1987 Act applies;

(2) there must be enough "qualifying tenants";

(3) there must be a proposed disposal by a "landlord"; and

(4) the proposed disposal must be of a relevant type.

The premises

2.18 Subject to certain exemptions mentioned below, the 1987 Act applies to premises[36] if:

(1) they consist of the whole or part of a building;[37]

(2) they contain two or more flats held by "qualifying tenants"; and

(3) the number of flats held by qualifying tenants exceeds 50% of the total number of flats contained in the premises.[38]

2.19 What is meant by the "building" is not defined in the 1987 Act and the question is left to the case law. What is a "building" is important because the 1987 Act only applies to premises if they consist of the whole or part of a building.[39]

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35 We consider in detail one element of the qualifying criteria that determines whether the Right of First Refusal applies: whether there is a "relevant disposal" of premises. See para 2.35 and following below.

36 In the case of *Dartmouth Court Blackheath Ltd v Berisworth Ltd* [2008] EWHC (Ch) 350 at [46], Warren J explained that:

> The relevant premises are to be ascertained in an objective way disregarding the disposal concerned; many factors may come into play in determining the extent of the relevant premises.

We note that what comprises the premises is beyond the scope of this project as it would impact upon residential leasehold and commercial leasehold.

37 1987 Act, s 1(2)(a).

38 1987 Act, s 1(2)(b) and (c).

39 In addition, there are other provisions which use the term "building". Most notably, s 5(3) states that:

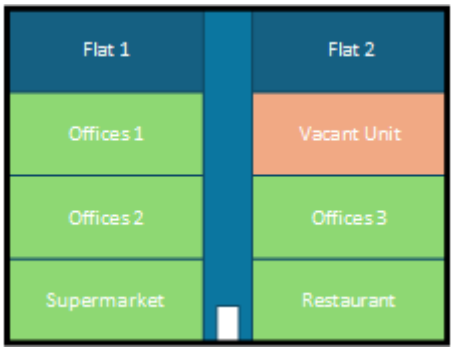
2.20 We note, for example, that the Right of First Refusal can extend beyond the physical structure of the building, to include appurtenant premises.[40] Issues can also arise where an estate comprises a number of different blocks or buildings.[41]

2.21 Whilst the definition of "building" (or lack of it) is something we are aware can cause difficulties, we are not aware that it presents specific challenges that are unique to commercial leasehold transactions. Rather, the challenges that it presents are more general in nature (and therefore affect residential leaseholders and the scope of the Right of First Refusal generally) and are therefore outside of the scope of this project.[42] However, of relevance to this project, we understand that where a building contains flats and commercial premises, in most cases the whole building will constitute the relevant premises.[43]

The 50% Rule

2.22 The 1987 Act does not apply where more than 50% of the internal floor area of the premises is occupied, or intended to be occupied, "otherwise than for residential purposes"[44] (disregarding any common parts).[45] We call this the "50% Rule".

2.23 The 50% Rule can be explained by way of an example:



2.24 In the building above, the combined internal floor area of the premises that is occupied, or intended to be occupied, for non-residential purposes is greater than 50%. That is true regardless of whether the Vacant Unit is let (or intended to be let) as

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[w]here a landlord proposes to effect a transaction involving the disposal of an estate or interest in more than one building (whether or not involving the same estate or interest), he shall … sever the transaction so as to deal with each building separately.

40 See *Dartmouth Court Blackheath Ltd v Berisworth Ltd* [2008] EWHC 350 (Ch) at [53].

41 See *SGL1 Ltd v FSV Freeholders Ltd* [2026] EWCA Civ 267.

42 We note that, similarly, we make no provisional proposal to change what constitutes the "premises" for the purposes of the 1987 Act.

43 E Peters KC, M Rodger KC, N Dowding KC, Sir Paul Morgan, and Lewison LJ, *Woodfall: Landlord and Tenant* (Looseleaf) (which we refer to as "Woodfall: Landlord and Tenant" in this Consultation Paper), para 28.007.

44 The language of using "premises otherwise than for residential purposes" is set out in the 1987 Act, s 1(3). We generally use the shorter phrase "non-residential premises" to refer to such premises in this chapter.

45 1987 Act, s 1(3).

a flat (in other words, for residential purposes) or as office space (in other words, for non-residential purposes).

2.25 The effect of the 50% Rule means that, when the landlord proposes to dispose of the Vacant Unit by granting a lease of it (or, indeed, plans to dispose of any other interest in the building – for example, its freehold interest), the Right of First Refusal will not apply.

The need for flats in the premises

2.26 As explained above, and alongside other criteria, the 1987 Act applies only to premises that contain two or more flats. Section 60(1) of the 1987 Act defines a "flat" as:

> … a separate set of premises, whether or not on the same floor, which-
>
> (a) forms part of a building, and
>
> (b) is divided horizontally from some other part of that building, and
>
> (c) is constructed or adapted for use for the purposes of a dwelling.

2.27 Section 60(1) defines "dwelling" (which is referred to in the definition of "flat" set out above) as:

> … a building or part of a building occupied or intended to be occupied as a separate dwelling ….

Qualifying tenants

2.28 As mentioned above, the Right of First Refusal cannot apply if there are fewer than two flats held by "qualifying tenants". What constitutes a "qualifying tenant" is set out in detail in section 3 of the 1987 Act. Broadly speaking, a person will be a qualifying tenant if:

(1) he or she holds a tenancy of a flat and the tenancy is not one of several excluded types;[46] and

(2) he or she holds fewer than three tenancies in the premises.

2.29 A person cannot be a qualifying tenant if his or her immediate landlord is a qualifying tenant.

The landlord

2.30 The Right of First Refusal applies where a landlord plans to make a disposal; who is the landlord in those circumstances is set out in section 2 of the 1987 Act. In most

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[46] See the 1987 Act, s 3(1). While there is no requirement that the tenancy held by a qualifying tenant is granted for a long period, the excluded types of tenancy include assured tenancies within the meaning of the Housing Act 1988, pt 1 and "a tenancy that is an occupation contract (within the meaning of the Renting Homes (Wales) Act 2016". Those exclusions prevent many tenants with short-term tenancies from being qualifying tenants for the purposes of the 1987 Act.

cases, section 2 of the 1987 Act regards the landlord as being the "immediate landlord of the qualifying tenants of the flats".[47]

2.31 The 1987 Act contains provisions that limit who is a "landlord" for the purposes of the Act; therefore, disposals by them are not subject to the Right of First Refusal. They are:

(1) an "exempt landlord"; and

(2) a "resident landlord".

2.32 There are a large number of landlords who are "exempt landlords" for the purposes of the 1987 Act.[48] They include, for example, registered social landlords, various councils and other public bodies.

2.33 A "resident landlord" is one who occupies a flat at the premises as their only or principal residence and has occupied it for a period of not less than 12 months. This exemption does not apply if the premises are a purpose-built block of flats.[49]

2.34 Section 56 of the 1987 Act makes provision for how parts of the Act, including the Right of First Refusal, operate where there is a Crown interest[50] in the land. In short, the Right of First Refusal will apply where the Crown had an interest in relevant land, but has disposed of it when the right is exercised, and may apply where the Crown retains such an interest.

The meaning of relevant disposal

2.35 Where other qualifying criteria are met, the 1987 Act prevents landlords from making a "relevant disposal" affecting any premises that it owns unless they comply with the requirements of the 1987 Act.[51]

2.36 What constitutes a relevant disposal is set out in section 4(1) of the 1987 Act. Subject to what is said at paragraph 2.37 below, the provision is widely drafted:

> … the disposal by the landlord of any estate or interest (whether legal or equitable) … including the disposal of any such estate or interest in any common parts [of the premises] …[52]

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47 1987 Act, s 2(1)(a). We note that the operation of the 1987 Act, s 2 can be complicated. For example, there are circumstances in which there can be more than one landlord – see the 1987 Act, s 2(2). For the purposes of this Consultation Paper, we do not go into those complications.

48 See the 1987 Act, s 58.

49 See the 1987 Act, s 58(2).

50 A "Crown interest" is defined in the 1987 Act, s 56(4) to mean: an interest comprised in the Crown Estate, an interest belonging to [His Majesty] in right of the Duchy of Lancaster, an interest belonging to the Duchy of Cornwall, and any other interest belonging to a government department or held on behalf of [His Majesty] for the purposes of a government department.

51 1987 Act, s 1(1).

52 The 1987 Act, s 4(1A) extends the Right of First Refusal to disposals made by mortgagees (see n 21 above).

2.37 However, the breadth of disposals that are caught is reduced by other provisions in section 4 of the 1987 Act:

(1) First, section 4(1) excludes from the Right of First Refusal any grant of a tenancy which consists of a single flat (and any appurtenant premises).

(2) Second, while making clear that a "disposal" includes the creation or transfer of an interest in land (including a surrender of a tenancy and the grant of an option or pre-emption), section 4(3) puts in place a general exclusion so that a "disposal" does not include one made under the terms of a will or the law relating to intestacy.

(3) Third, section 4(2) sets out a list of specific exclusions. The exceptions include: a disposal of an "incorporeal hereditament", which would include the grant of an easement (for example, a right of way); a disposal by way of security for a loan (which would include a mortgage); disposals made under various statutory provisions; and disposals made in pursuance of a compulsory purchase order.

2.38 The question of what is a "relevant disposal" is crucial to this project.

Procedure and restrictions on disposal

2.39 Where the qualifying criteria are met and a landlord proposes to make a relevant disposal, the 1987 Act sets out detailed procedures and restrictions on the landlord to give effect to the Right of First Refusal. The following is a high-level summary.

(1) An "offer notice" must be served by the landlord on the "qualifying tenants" of the flats within the premises.[53] The offer notice must comply with various requirements set out in the 1987 Act. The requirements are different depending on the type of disposal – for example, a contract followed by conveyance, or a sale by auction.[54] However, in all cases, the notice must:

(a) contain particulars of the principal terms of the proposed disposal;

(b) state that the notice constitutes an offer to effect the same transaction, which can be accepted by the "requisite majority of qualifying tenants";[55]

(c) indicate a period within which the offer can be accepted (which cannot be less than two months beginning with the date on which the offer notice is served); and

(d) indicate a second period during which the qualifying tenants may nominate a person (the "Nominated Person") to act as the person to

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53 1987 Act, s 5(1).

54 See the 1987 Act, ss 5A to 5D. Also see s 5E which applies whenever a disposal is proposed for which the payment does not consist, in whole or in part, of money.

55 What constitutes the "requisite majority" of qualifying tenants is established by reference to the 1987 Act, s 18A (also see the definition of "requisite majority" in the 1987 Act, s 20(1)).

acquire the interest that the landlord is disposing of; in most circumstances the second period cannot be less than two months.[56]

The time limits mentioned in paragraphs (c) and (d) above can be extended by agreement between the landlord and the requisite majority of qualifying tenants.

(2) Where an offer notice is served, the landlord is restricted from making the disposal that is subject to the Right of First Refusal. That restriction stays in effect until the period of the offer specified in the offer notice has expired.

(3) If the landlord's offer is not accepted, or it is accepted but no nomination is made within the relevant time limit, then the landlord may proceed to dispose of the interest that was offered to the qualifying tenants. Any such disposal to a third party is subject to several restrictions that aim to ensure that the disposal of the interest is made on no less favourable terms than those offered to the tenants.[57] If the landlord does not dispose of the interest within 12 months of him or her having the ability to do so, the ability to do so without again following the requirements of the 1987 Act is lost.

(4) To accept the landlord's offer, a requisite majority of the qualifying tenants must serve an acceptance notice on the landlord within the period given in the offer notice. The qualifying tenants must nominate a person to acquire the interest being disposed of, which they can do at the same time as serving the acceptance notice, or within the period indicated in the offer notice.

(5) Where the requisite majority of qualifying tenants accept the landlord's offer, and a person is nominated to acquire the interest, the 1987 Act sets out a detailed procedure for various different types of disposals that, ultimately, results in the acquisition of the interest by the Nominated Person, or the withdrawal of either party from the acquisition.

(6) If the landlord withdraws from the acquisition, the landlord is not permitted to dispose of the interest for a period of 12 months.[58] If the Nominated Person withdraws from the acquisition then, broadly speaking, the landlord may dispose of the interest to a third party, but on no less favourable terms than those notified to the tenants when complying with the early stages of the Right of First Refusal.[59]

(7) Where either the landlord or the Nominated Person withdraws from the acquisition, they may be required to pay the costs of the other party.[60]

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56 Where the proposed disposal is by way of auction, the period to nominate is no less than 28 days – see the 1987 Act, s 5B(6).

57 The restrictions are set out in the 1987 Act, s 7. However, they are not summarised as they are not relevant to this project.

58 1987 Act, s 9B(2).

59 1987 Act, s 9A(4) and (5).

60 1987 Act, s 9A(6) and (7) and s 9B(3) and (4).

The consequences of a failure to comply

2.40 There are several possible consequences of a failure to comply with the provisions of the 1987 Act.

2.41 First, where a person has failed to comply with an obligation imposed on them by the 1987 Act, an application can be made to the court for an order requiring that person to remedy the default. The application to court can only be made after a notice has been served on the person in default and 14 days have elapsed.[61]

2.42 Second, and subject to what we say in the paragraph below, a landlord commits a criminal offence if they do not comply with the Right of First Refusal. In other words, a landlord commits an offence where they make a relevant disposal of premises to which the 1987 Act applies without following the requirements to serve notices and in contravention of the restrictions set out in the 1987 Act about making such a disposal.[62]

2.43 The landlord will not commit an offence if they have a "reasonable excuse". There appears to be no guidance – either accompanying the 1987 Act or by way of later judicial authority – as to what might be a "reasonable excuse" for failing to comply.[63]

2.44 Finally, tenants are given a group or bundle of rights that enable them to seek to investigate and, potentially, to unravel a disposal. The rights are detailed, but, broadly speaking, they include:

(1) a right to information about the terms of a disposal (including the sale price, any deposit, the date on which a disposal was made and, in certain circumstances, a copy of a relevant contract);[64]

(2) a right to take the benefit of a contract for the disposal of an interest;[65]

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61 1987 Act, s 19.

62 1987 Act, s 10A. We note that a large number of amendments were made to the 1987 Act by the Housing Act 1996. The amendments included the criminal sanction for failure to comply with the 1987 Act. In a case that concerned transactions that preceded a change in the law, *Belvedere Court Management Ltd v Frogmore Developments Ltd* [1997] QB 858, Sir Thomas Bingham MR, at 864, observed that:

> One of the apparently strange features of [the 1987 Act] is that although section 1 lays a clear mandatory duty on a landlord … to follow the statutory procedure, no sanction attaches to violation of this duty whether inadvertent or (as here, it would seem) deliberate.

63 We note that there are other offences that are subject to a "reasonable excuse" exception or defence. By way of examples: the Road Traffic Act 1988, s 7(6) creates an offence of failing to provide a specimen in accordance with that section unless a person has a reasonable excuse for doing so; the Identity Documents Act 2010, s6(1)(a) makes it an offence for a person, without reasonable excuse, to have in their possession or under their control, an identity document that is false. However, whilst there are numerous offences that are avoided where a person has a reasonable excuse, we note that, in *Regina v Unah* [2011] EWCA Crim 1837, the Court of Appeal, at para 8, indicated that:

> It is only with caution that one should seek to draw analogies with other statutory contexts where the concept of reasonable excuse is employed.

64 The 1987 Act, s 11A.

65 The 1987 Act, s 12A.

(3) a right to compel the sale of the premises by the purchaser or a new landlord to a person nominated by the qualifying tenants;[66] and

(4) where the disposal by the landlord consisted of a surrender by the landlord of a tenancy held by him or her, a right to compel the grant of a new tenancy by the superior landlord.[67]

DISCUSSION

2.45 The driver for implementing the Right of First Refusal was to enable residential leaseholders in blocks of flats to "step-in" and take control of the landlord's interest rather than it passing to somebody new, who might, for example, not be a "'traditional' landlord" but one who would "'break-up' … blocks by selling flats wherever possible".[68] The intention, as explained in the recommendation made in the 1985 Report, was for leaseholders:

> … [to] have a right of first refusal where the landlord wishes to dispose of his interest whether freehold or leasehold.[69]

2.46 The Right of First Refusal increased the statutory rights benefiting owners of leasehold flats, and the expansion of those rights continued in the decades that followed.

2.47 In particular, at the time the 1987 Act was passed there was no right for residential tenants of a block of flats to acquire compulsorily the interest of their landlord ("collective enfranchisement"), or to take control compulsorily of the performance of various landlord obligations.[70] Those rights exist today and are, arguably, more direct and effective mechanisms to allow residential flat owners to take ownership and control of the management of their homes and the buildings in which they are situated than the Right of First Refusal.[71]

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66 The 1987 Act, s 12B.

67 The 1987 Act, s 12C.

68 1985 Report, para 2.6.

69 1985 Report, para 7.9.15.

70 For more information about the right to collectively enfranchise, see the Leasehold Advisory Service's summary at https://www.lease-advice.org/fact-sheet/collective-enfranchisement-buying-freehold-building/. For more information about the right to manage, see the Leasehold Advisory Service's summary at https://www.lease-advice.org/advice-guide/right-manage/. Also see n 28 above regarding the Law Commission's work in respect of those regimes.

71 We note that further reform of the law that is relevant to leasehold homeowners is ongoing. As mentioned at n 34 above, in January 2026, the Government published a draft Commonhold and Leasehold Reform Bill (https://www.gov.uk/government/publications/draft-commonhold-and-leasehold-reform-bill). The aim of the Bill, amongst other things, was to "[make] it easier for existing leaseholders to convert to commonhold should they wish to do so, and [ban] the use of leasehold for most new flats". The Bill was, in part, based upon recommendations made by the Law Commission in its work to reinvigorate commonhold (https://lawcom.gov.uk/project/commonhold/). The King's Speech, delivered on 13 May 2026, indicated that a Commonhold and Leasehold Reform Bill would be brought forward (for further details, including the text of the King's Speech, see https://assets.publishing.service.gov.uk/media/6a18713db95db968c8f3bbfd/The_King_s_Speech_2026_-_background_briefing_notes.pdf pp 5 and 45).

2.48 The legal landscape was therefore very different when the 1987 Act was passed. The built environment was also very different – there are now many buildings that are developed for mixed residential and commercial use. As we explain above, we are aware that the Right of First Refusal may not be working appropriately so far as disposals of commercial premises in some mixed-use properties are concerned.

Disposals of commercial premises

2.49 In the discussion that follows we consider two linked questions.

(1) Does the Right of First Refusal apply to disposals of commercial premises in mixed-use properties?

(2) Was a deliberate policy choice made when the 1987 Act was passed regarding disposals of commercial premises?

Does the Right of First Refusal apply to disposals of commercial premises in mixed-use properties?

2.50 The Right of First Refusal does not apply to any disposal of premises where the 50% Rule applies.[72] So, if premises are predominantly comprised of commercial (and other non-residential) space, with a smaller space given over to residential flats, the Right of First Refusal will not apply to any disposal by the landlord.

2.51 What is less clear is what happens in a disposal of premises where the 50% Rule does not apply. In other words, where the premises are predominantly comprised of residential space, with a smaller space occupied by one or more commercial units.[73]

2.52 There has been no case law arising directly in respect of the 1987 Act to determine whether disposals of commercial premises forming part of a mixed-use property are subject to the Right of First Refusal.

2.53 However, in *Dartmouth Court Blackheath Limited v Berisworth Limited*, the point arose in the arguments raised by the parties' legal representatives. In his judgment, Mr Justice Warren highlighted that:

> [The legal advisor to the claimant purchaser of an interest from the landlord]… points out that the [interpretation of the 1987 Act proposed by the legal advisor to the defendant's nominated purchaser] has a rather surprising consequence. Suppose, he says, that a landlord owns a building consisting of retail shops on the ground floor and flats on a number of floors above. On the construction … [proposed], … a disposal of any of the retail premises eg a new letting of a shop which had fallen vacant, would be subject to the provisions of [the Right of First Refusal]. He says that cannot possibly have been intended by Parliament.[74]

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72 See para 2.22 and following above.

73 For the rest of this chapter, it is assumed that the 50% Rule does not apply.

74 [2008] EWHC 350 (Ch) at [44].

Mr Justice Warren later concluded that the interpretation giving rise to the "rather surprising consequence" (that the Right of First Refusal would apply to a disposal of the shop) was "to be preferred".[75]

2.54 It is our understanding that those advising landlords take a cautious view on the question of whether disposals of commercial units in mixed-use premises (which are predominantly residential) are subject to the Right of First Refusal, and advise their clients to work on the basis that such disposals are subject to the right. That is unsurprising, bearing in mind the case law mentioned above[76] and the potential for criminal sanctions where there is noncompliance with the right.[77]

2.55 We consider that the caution exercised by practitioners is well-judged. It is our view that, provided other elements of the Right of First Refusal are met, disposals of premises that are used, or intended to be used, for commercial purposes are extremely likely to be caught by the Right of First Refusal.[78]

2.56 This Consultation Paper is not the place for a detailed discussion of how Acts of Parliament are interpreted by the courts. However, generally speaking, when engaging in statutory interpretation the courts will "[seek] the meaning of the words which Parliament used".[79]

2.57 The modern approach to statutory interpretation requires the court to "ascertain the meaning of the words used, in the light of their context and the purpose of the provision(s)".[80] This "involves an objective assessment of the meaning which a reasonable legislature as a body would be seeking to convey in using the statutory

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75 [2008] EWHC 350 (Ch) at [46].

76 We note that *Dartmouth Court Blackheath Ltd v Berisworth Ltd* [2008] EWHC 350 (Ch) is a first instance decision of the High Court and it did not directly concern commercial premises (the "retail shops" mentioned in the extract from the judgment at para 2.53 above were hypothetical).

77 See paras 2.42 and 2.43 above.

78 As a starting point, it is, in our view, entirely possible for commercial (and other non-residential) parts of a property to form part of the premises. Quite apart from the fact that the 1987 Act – in establishing the 50% Rule – anticipates explicitly the existence of premises that are, in part, non-residential, we note again Warren J's judgment in the *Berisworth* case:

> The relevant premises are to be ascertained in an objective way…

We also note Marder J's comments in *Saga Properties Ltd v Palmeira Square Nos 2-6 Ltd* [1995] 1 EGLR 199, 210, in which the "ordinary meaning" of the word building was used, "being an inclosure of brick or stone covered in by a roof unless the statute imports a different meaning to that word". The language used by Marder J derives from that used by Lord Esher, in *Moir v Williams* [1892] 1 QB 264, 270, where he considered what is "ordinarily called a building", and explained that "[s]uch an ordinary building is an inclosure of brick or stonework covered in by a roof".

79 *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591 at 613 by Lord Reid.

80 *Dairy UK Ltd v Oatly AB* [2026] UKSC 4, para 10. See also the authorities cited in that passage: *X v Lord Advocate* [2025] UKSC 44, para 22; *Darwall v Dartmoor National Park Authority* [2025] UKSC 20, para 15; *R (N3) v Secretary of State for the Home Department* [2025] UKSC 6, para 62; *News Corp UK & Ireland Ltd v Revenue and Customs Comrs* [2023] UKSC 7, para 27; *R (Project for the Registration of Children as British Citizens) v Secretary of State for the Home Department* [2022] UKSC 3, paras 28 to 29.

words which are being considered".[81] To aid statutory interpretation, it is possible, in some cases, to refer to parliamentary material recorded in Hansard.[82]

2.58 We explained at paragraph 2.45 above, that it is the purpose of the Right of First Refusal to enable leaseholders of blocks of flats to "step-in" and take a landlord's interest rather than it passing to somebody new. Therefore it could be argued that it is not the "purpose" of the 1987 Act to stand in the way of disposals of commercial premises.[83]

2.59 However, despite the purpose of the 1987 Act being relatively narrow, the 1987 Act's starting point is to make what constitutes a "relevant disposal" very wide, to cover:

> … the disposal affecting any premises… of any estate or interest (whether legal or equitable) … including the disposal of any such estate or interest in any common parts of any such premises …[84]

2.60 As we explain at paragraph 2.37 above, the broad starting position is then whittled down in section 4 of the 1987 Act with various types of disposal excluded from the Right of First Refusal, including a disposal of a single flat[85] and a long list of specific disposal types in section 4(2); leases of commercial premises are not in that list or otherwise explicitly excluded from being a "relevant disposal".

2.61 As we explained above, the 1987 Act's genesis was concerns with landlords disposing of all of their interests in the reversions of blocks of flats, leaving them poorly managed. That is, on its face, a relatively narrow purpose. Bearing that in mind, the drafters of the 1987 Act could, arguably, have taken a different starting point; a "relevant disposal" could have been defined narrowly. For example, it could have been drafted to cover only disposals of the whole, or substantially the whole of the landlord's interest in the premises.[86] The drafters of the 1987 Act did not take that "narrow" approach.

2.62 We consider that one reason for the drafters taking the approach that they did, rather than drafting a definitive list of disposals that are subject to the Right of First Refusal, might have been a reflection of a concern about avoidance of the right by landlords.

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81 *R (Project for the Registration of Children as British Citizens) v Secretary of State for the Home Departmen*t [2022] UKSC 3 at [31]. For information on the role of external aids to interpretation, we refer the reader to para 30 of that judgment.

82 Where the statute is ambiguous or obscure or its literal meaning leads to an absurdity and the material consists of clear statements by a minister or other promoter of the Bill. See *Pepper v Hart* [1993] AC 593.

83 We note that the authors of a leading textbook in the field of the Right of First Refusal changed their view between editions as to whether commercial premises might be caught by the right based on the court's approach of ascertaining the relevant premises in an objective way, see Radevsky and Clark, *Tenants' Right of First Refusal* (4th ed 2021), para 3.12 and n 78 above. We call this textbook "Radevsky and Clark" in this chapter.

84 See the 1987 Act, s 4(1) and para 2.36 and following above.

85 The 1987 Act, s 4(1)(a).

86 We intend only to suggest that a different starting point for drafting the 1987 Act could have been adopted, not that the text we have used is necessarily acceptable language to include in a statute, or what might have been under consideration.

That concern was expressed in the 1985 Report: "Care will need to be taken in drafting the legislation to prevent its frustration by avoidance devices".[87]

2.63 This is an important gloss on the 1987 Act's purpose; we explained the purpose of the 1987 Act was to enable leaseholders to "step-in" where landlords disposed of their interest. That is a right given to leaseholders and the purpose of a right is for it to be available to be exercised, not avoided.

2.64 We note the judgment of Mr Justice Zacaroli (as he then was) in *York House (Chelsea) Ltd v Thompson.*[88] In that case, the judge considered the judgment of Mr Justice Warren, in the *Berisworth* case:[89]

> The defendants contend that the conclusion reached by Warren J is wrong for the further reason that it leads to an absurd result in the case of mixed residential and commercial premises and the landlord disposes of its reversionary interest in part of the commercial premises …. The point does not arise directly for decision in this case. If it did, such arguments would need to be fully explored. Even assuming in the defendants' favour – putting their submission at its highest – that there is no discernible legislative purpose in qualifying tenants being able to demand the transfer to them of the landlord's reversionary interest of that part of the building used as shop premises, I nevertheless do not consider that would provide a reason for rejecting Warren J's conclusion (in a case where the commercial premises point does not arise for decision) that having regard to the legislative purpose that he did find, a disposal of the landlord's reversionary interest in any part of the building was one to which the Act applied.[90]

2.65 Bearing all of the above in mind, we expect a court would be extremely cautious about concluding that a disposal that is not explicitly excluded from the Right of First Refusal is somehow implicitly excluded, thereby "reading in" an exclusion to the Right of First Refusal that Parliament itself omitted. However, doubt remains and this project is well placed to consider, with the aid of consultation, whether or not the list of excluded disposals is incomplete.

Was a deliberate policy choice made when the 1987 Act was passed regarding disposals of commercial premises?

2.66 While we have concluded that disposals of commercial premises in mixed-use premises (which are predominantly residential) are extremely likely to be caught by the Right of First Refusal, that does not mean the outcome was deliberate. For example, it may have been the case that such disposals were not at the forefront of minds when the 1987 Act was passed.

2.67 As a starting point, there does not appear to be much consideration given in the 1985 Report to the possibility that a landlord might make "smaller" disposals – in other

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87 The 1985 Report, para 7.9.19.

88 [2019] EWHC 2203 (Ch).

89 See para 2.53 and n 78 above.

90 [2019] EWHC 2203 (Ch) at [99].

words, disposals of significantly less than their entire interest in a block of flats – although many such disposals would be caught by the Right of First Refusal.

2.68 What is also clear is that the 1985 Report did not give much consideration to the possibility that a block of flats might be mixed-use, with part of a property being used for residential purposes and part for non-residential purposes. The 1985 Report contains almost no reference to commercial or non-residential use.[91] Instead, the report focussed almost exclusively on the paradigm case of premises comprised entirely of flats.

2.69 We have found no indication that it was the intended purpose of the 1987 Act to regulate the disposal of commercial premises within a building (as opposed to the disposal of the building itself).

2.70 In addition, there is commentary that is critical of the apparent inclusion of commercial premises in the Right of First Refusal. For example, Radevsky and Clark identify several factors that suggest commercial premises were not intended to be caught by the 1987 Act or, perhaps, if they were then the Act is doing a poor job of dealing with them.

2.71 First, the authors question the interaction between rights of first refusal under the 1987 Act and protected tenancies under Part 2 of the Landlord and Tenant Act 1954 (the "1954 Act").[92] After highlighting that there is nothing in the 1987 Act that deals with the renewal of business premises leases under the 1954 Act, the authors observe that:

> It would be extraordinary if a business tenant were to find that he could lose his business tenancy (and his business) to the qualifying tenants of the buildings.[93]

2.72 This is clearly a problematic issue:

(1) on the one hand, there is the 1987 Act, which, on the basis of what we have said above, appears extremely likely to prevent the grant of a lease of commercial premises without first offering the possibility to the leaseholders of flats; and

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91 The definitions in the 1985 Report, para 1.5 are interesting; for example, a "Mixed block" is defined as "a residential block containing renting tenants and long leaseholders. It occurs for example where flats are sold to existing tenants or to new tenants when the existing renting tenants give up their tenancy. It is particularly associated with the 'break up' of blocks of flats (i.e. selling off on long leases flats which were formerly rented) from the 1960s onwards". The distinction in that definition is between a mix of those renting and long leaseholders, rather than between residential and commercial tenants.

92 Broadly speaking, the 1954 Act gives to tenants of business premises a right to be granted a new lease when a previous lease comes to an end. For more details about the security of tenure regime under the 1954 Act, see our work examining that regime (https://lawcom.gov.uk/project/business-tenancies-the-right-to-renew/). Also see Business Tenancies: the right to renew Consultation Paper 1: models of security of tenure (2024) Law Commission Consultation Paper No 266, app 1, para 1.6 and following.

93 Radevsky and Clark, para 3.12.

(2) on the other hand, there is the 1954 Act, which, in certain circumstances, gives a right to an existing tenant to take, and forces a landlord to grant, a renewal lease of commercial premises occupied by the tenant.[94]

2.73 Both the 1987 Act and the 1954 Act were intended to protect tenants by giving them rights, but neither Act makes provision for the other. Unlike in respect of commercial leases generally, it is our view that courts could resolve the tension between the two Acts if it were to be litigated. For example, a court might legitimately conclude that the general Right of First Refusal in respect of disposals by a landlord could be subject to the specific right of a business tenant to a new lease under the 1954 Act.[95]

2.74 Second, the authors highlight inconsistent treatment of, on the one hand, a flat used for business purposes, and, on the other hand, premises specifically designed for business purposes:

> The [1987] Act … excludes as being a 'relevant disposal' 'the grant of any tenancy under which the demised premises consist of a single flat …'. The grant of a single lease of a shop is not excluded. Thus, paradoxically, the landlord can grant a lease of a flat for business purposes (eg for use as a doctor's surgery) without triggering the [Right of First Refusal] but granting a lease of premises specifically designed for business purposes would be caught. This result would be, … if correct, an odd one.[96]

2.75 We note that the authors, in using the words "if correct" in the passage above, highlight uncertainty in the outcome they describe; we share that uncertainty. As explained above,[97] the Right of First Refusal does not apply to disposals of "a single flat".[98] The 1987 Act defines:

(1) "flat" as a "separate set of premises … which … is constructed or adapted for use for the purposes of a dwelling"; and

(2) "dwelling" as "a building or part of a building occupied or intended to be occupied as a separate dwelling…".[99]

In the example above (where a flat is leased for use as a doctor's surgery), it is our view that a court may conclude that, notwithstanding the construction of the flat as a dwelling, the ultimate letting of the unit as a doctor's surgery means it is not "intended to be occupied as a dwelling" and therefore cannot be a "flat" for the purposes of the

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94 See n 92 above.

95 We see this outcome as being in keeping with a principle of statutory interpretation that is expressed by the Latin phrase generalia specialibus non derogant. The Lexis+ UK service explains the principle as follows: "[the] principle of interpretation of statutes and other documents that general provisions do not derogate from specific ones". Our provisional proposal at para 2.121 below would resolve the tension between the two Acts described above without the need for any litigation.

96 Radevsky and Clark, para 3.12.

97 See para 2.37(1) above.

98 1987 Act, s 4(1)(a).

99 See the definitions in the 1987 Act, s 60(1).

exclusion from the Right of First Refusal. However, we recognise the issue identified by the authors as real and the uncertainty within the 1987 Act.

2.76 Finally, the authors highlight the fact that the absence of an exclusion of commercial premises from the Right of First Refusal could make tenants under residential leases better off than they might otherwise be by giving them control over parts of the building meant for commercial purposes.[100]

2.77 We note that Radevsky and Clark set out a counter argument – that commercial premises were within the sight of those developing the policy and the 1987 Act. The authors highlight that section 1(3) of the 1987 Act (which establishes the 50% Rule) anticipates there could be business premises. They highlight that those drafting the Act could have excluded dispositions of business premises from the Right of First Refusal and that the fact they did not points towards the omission being deliberate.[101]

2.78 While we note the above – and have had the same thought – we reiterate that we have not found any evidence that significant consideration was given to mixed-use premises at the time the 1987 Act was passed (and we highlight again that the 1985 Report, on which the 1987 Act was based, contained practically no consideration of commercial premises).

2.79 While an absence of information is not a solid foundation on which to form a conclusion, we consider the following factors tend towards the view that the apparent inclusion of disposals of commercial premises in the Right of First Refusal is unlikely to have been deliberate.

(1) The 1987 Act fails to take into account what are arguably obvious, and problematic, interactions with other regimes (for example, the security of tenure regime for business tenants under the Landlord and Tenant Act 1954).[102]

(2) There was cursory consideration of commercial premises in the 1985 Report.

(3) There was no consideration of commercial premises by Parliament during the passage of the 1987 Act, but there was extensive criticism made of the rushed manner in which the Act was passed.[103]

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100 Radevsky and Clark, para 3.12.

101 Radevsky and Clark, para 3.13.

102 See para 2.71 above.

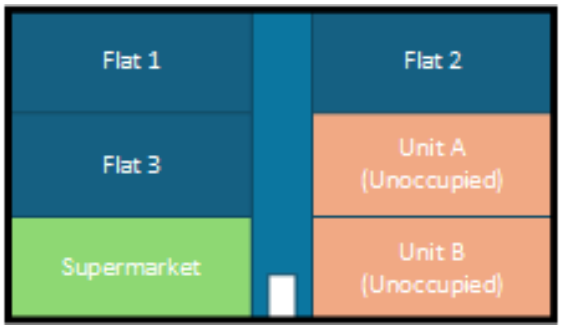
103 The bill leading to the 1987 Act was introduced into the House of Commons on 5 March 1987. Ultimately it had an accelerated passage through Parliament in order to pass prior to dissolution on 18 May 1987. The second and third readings of the 1987 Act in the House of Lords took place on a single day – 13 May 1987. Many of those present expressed significant discontent with that. For example, Lord Denning stated:

> It seems to me very wrong to rush this complicated and legal piece of legislation through without its having progressed through the proper stages in this House. I have read the Bill. It is exceedingly complicated, exceedingly legal and exceedingly obscure. It is the sort of Bill on which this House repeatedly does a first-rate job in revising legislation. It is altogether wrong that it should be rushed through in one day when there is no urgency about it. It ought to be properly considered by the House in its proper stages before it is passed into law [Hansard, (HL) 13 May 1987, vol 487, col 64].

Problems with disposals of commercial units in mixed-use premises

2.80 Bearing in mind the criticism of the 1987 Act in the commentary in Radevsky and Clark, we unsurprisingly have heard concerns that the 1987 Act is standing in the way of commercial transactions where, it is argued, it makes little sense to give leaseholders of flats the Right of First Refusal. We understand the position is particularly acute in situations where a property was designed for mixed-use, with some parts residential and some parts commercial.

2.81 Take the following example:



In this case, a building has been developed to be mixed-use. A landlord owns the freehold to the building, with three flats being owned by qualifying leaseholders (who own their properties on long leases). A supermarket is situated on the ground floor. Two units, A and B, are unoccupied.

2.82 The following table sets out a small number of possible disposals that the landlord might propose, and whether they are subject to the Right of First Refusal.

Proposed disposal	**Subject to the Right of First Refusal?**
A transfer of the freehold to a third party purchaser	Yes
A 999-year lease of Units A and B (together) to a single third party purchaser	Yes
A 999-year lease of Unit A (or B) for it to be used as a flat	No

2.83 The exception mentioned at paragraph 2.37(1) above (and which is reflected in the table) that prevents a tenancy of a single flat from being a "disposal" allows a developer separately to dispose of a multitude of flats to residential homeowners without each one triggering the Right of First Refusal. In other words, the exemption facilitates the purpose for which the residential block of flats was built.

2.84 However, there is no such exemption for areas of the (mixed-use) building that are intended for commercial use.[104] The result is that, on the face of it, the grant of a lease

[104] We note that there is an exemption for the "conferral of a code right" under the Electronic Communications Code (see the 1987 Act, s 4(1)(db)). The Electronic Communications Code governs the rights of telecommunication operators to install and maintain electronic communications apparatus (such as mobile

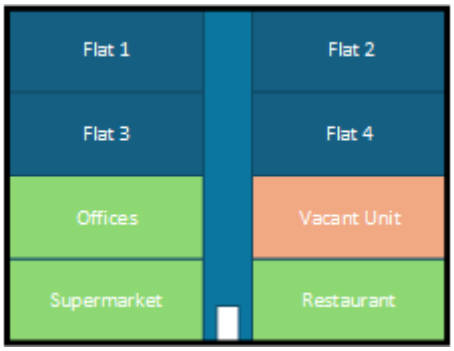
(of any length) of a unit intended for commercial use is caught by the Right of First Refusal. In the scenario described above, and by way of examples, that would appear to catch the following:

(1) a lease for five years of Unit A (or B) for its use as a restaurant;

(2) a lease for ten years of the supermarket premises to the current or a new supermarket tenant; and

(3) a fifty-year lease of Units A and B (together) which allows the tenant to sub-let each unit, but only for commercial purposes.

2.85 The following example highlights the difference:



2.86 In the above building the Offices, Supermarket and Restaurant are, or are intended to be, occupied for non-residential purposes. The flats are let to residential leaseholders. Whether the Right of First Refusal applies to the Vacant Unit will depend on what it is intended to be used for.

2.87 If the Vacant Unit is intended for use as a residential flat, then the landlord granting a lease of it for residential purposes means that the Right of First Refusal will not apply. That is because disposals of a single flat are exempt from the Right of First Refusal.[105] However, if the Vacant Unit is intended for non-residential purposes, so, for example, if the landlord proposes to grant a lease of the Vacant Unit for office space, then the disposal is likely to be subject to the Right of First Refusal. As explained at paragraph 2.84 above, there is no corresponding, explicit exception to the Right of First Refusal for disposals of a non-residential unit.

2.88 Various stakeholders have expressed concern about that position. For example, the Property Litigation Association set out its concerns in a response to the Law Commission's consultation[106] preceding its 14th Programme of Law Reform:[107]

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phone masts, antennae, cables or equipment cabinets) on land owned or occupied by others. While the entry into of a "code right" may be commercial in nature, we do not regard it as an "exemption … for commercial use" for the purposes of the point made in this paragraph.

105 See para 2.37(1) above.

106 See https://webarchive.nationalarchives.gov.uk/ukgwa/20240605042856/https://lawcom.gov.uk/14th-programme/.

107 14th Programme of Law Reform (2025) Law Com No 421.

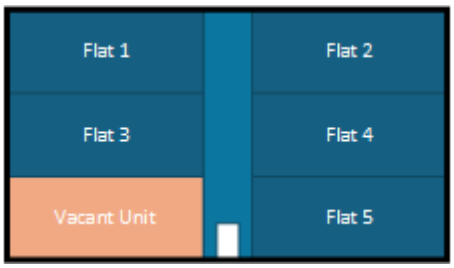
> The consensus view of the [Property Litigation Association] is that in relation to commercial premises within a residential development the section 5 provisions serve no beneficial purpose for either landlords or tenants. Indeed, from a landlord's perspective, they create costly delays which adversely impacts on them and there are no real tangible benefits that are actually exercised by tenants. It ought to be amended so that commercial elements of the premises are excluded from the section 5 process.[108]

2.89 We agree with the Property Litigation Association. It is our provisional view that:

(1) it is unlikely that it was deliberate for the 1987 Act to give tenants a Right of First Refusal on disposals of those parts of mixed-use buildings that are used, or intended to be used, for commercial purposes; and

(2) it is not beneficial that the 1987 Act appears to do so.

2.90 At first sight, it may appear that a change to the law might put tenants in a worse position. However, we explain below why we do not consider that to be the case.



2.91 In this case, the landlord proposes to make a disposal of the Vacant Unit by way of a five-year lease, at a rent of £100,000 each year, for use as a live music venue. It may be thought that the residential leaseholders of the flats – fearful of noise and nuisance (and wishing to prevent them arising) – may benefit from the Right of First Refusal.

2.92 However, the Right of First Refusal is only a right to acquire whatever the landlord proposes to dispose of. If the residential leaseholders of the block were to have the Right of First Refusal, and exercise that right, they would acquire a five-year lease, with a rent of £100,000 each year, which may expressly limit the use of the premises to a live music venue. In those circumstances, the residential leaseholders would need to pay the rent, and perform all of the other obligations under the lease, while struggling to recoup the outgoings because they do not wish to use the premises for the permitted purpose.

2.93 We have no evidence to suggest that residential leaseholders would use the Right of First Refusal in the manner set out above. In addition, there are other regimes that may better achieve the outcome desired by the leaseholders in our example, or at least be designed to take into consideration their views. For example, if the residential leaseholders' fears about noise are realised, the terms of their leases may give them rights enforceable against the landlord, there might be other remedies available if a

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[108] Property Litigation Association, Response to the Law Commission's Consultation on the 14th Programme (2021), p 2 (available at https://www.pla.org.uk/storage/uploads/2022-03/response.pdf).

statutory nuisance[109] or tortious nuisance arises,[110] and, if the use of the premises as a nightclub represents a change of use, it may be that planning permission is required that the leaseholders can object to.

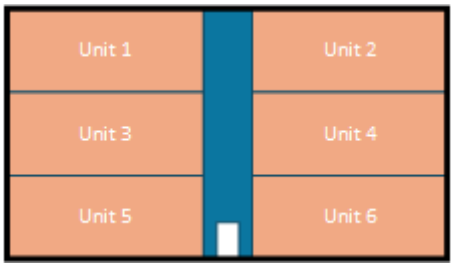
Avoidance of the 1987 Act

2.94 We note below that it is relatively simple for landlords to avoid the provisions of the 1987 Act, preventing the Right of First Refusal arising altogether. We have included this material to highlight two things.

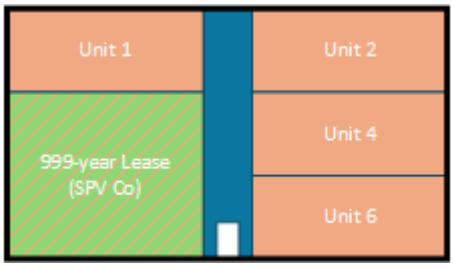
(1) First, that landlords are already able to achieve an outcome that avoids the Right of First Refusal, but only by using "artificial" arrangements that result in unnecessary costs, bureaucracy and risk.

(2) Second, that it has not been suggested to us that the ability of landlords to achieve that outcome in respect of commercial premises should be prevented.

2.95 We explain how workarounds can operate with an example:



2.96 In this case a developer is constructing a building. It is planning for the premises to be mixed-use, with four residential flats (Units 1, 2, 4 and 6) and two commercial units (Units 3 and 5). The developer can avoid the Right of First Refusal applying to disposals of the individual commercial units. Before granting any lease of the flats, it can grant a long lease – say 999-years – to a "special purpose vehicle" ("SPV Co"):[111]



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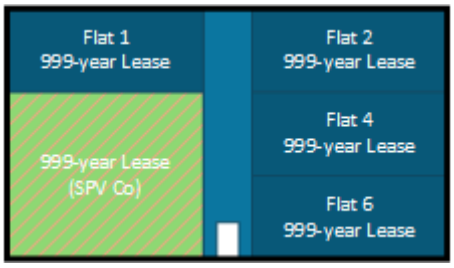
109 See the Environmental Protection Act 1990, s 79(1)(g).

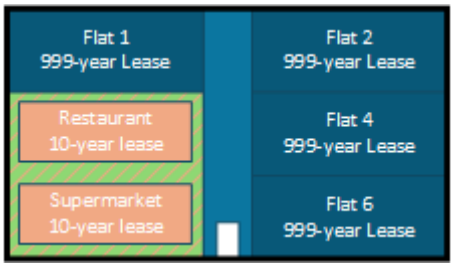
110 See, for example, the case of *Coventry v Lawrence* [2014] UKSC 13, which concerned the law of private nuisance, which is a common law tort (see para 1 of the judgment). The nuisance claimed in the case related to noise.

111 A special purpose vehicle (or SPV) is a separate legal entity which is established for a particular function. For example, a high street retailer with many premises might set up an SPV to hold its property portfolio, or its distribution network. In our case, the SPV will be the tenant of the long lease of Units 3 and 5 – being the future commercial premises.

2.97 In the above scenario, SPV Co holds the 999-year lease of the units that are intended for commercial use. Immediately after the grant of the 999-year lease to SPV Co, the landlord of the block grants leases of the flats (Units 1, 2, 4 and 6) to residential leaseholders, again on 999-year leases.



2.98 SPV Co later grants a 10-year lease to a supermarket operator and a 10-year lease to a restaurant operator.



2.99 These 10-year leases are not granted by the landlord of the block of flats and so the owners of the flats have no Right of First Refusal.

2.100 The introduction of headleases in a way that prevented the 1987 Act applying as it otherwise would have done was considered in the case of *Belvedere Court Management Ltd v Frogmore Developments Ltd*.[112] The facts were complicated and there is no need to recite[113] other than to note the words of Sir Thomas Bingham MR (as he then was), that the case concerned a transaction in which:

> [Party A] did not tell the [residents' association] or the tenants before the [transaction] took place. It would seem that this omission was quite deliberate. But it was a breach of [Party A]'s duty under [the 1987 Act].[114]

2.101 Sir Thomas concluded that:

> It would seem plain that the object of [Party A] was not primarily to deny the tenants a power to manage but to ensure that the profit to be made by selling long leases of the flats in the block was earned by [Party A] or [Party B] and not the tenants. There would seem to be little room for doubt about [Party A]'s motivation.

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112 [1997] QB 858.

113 We note, however, that the headleases that were introduced in the *Belvedere* case were in respect of residential leasehold units, not commercial units; for the avoidance of doubt, our provisional proposal set out at para 2.121 below would not facilitate the form of avoidance that existed in the *Belvedere* case.

114 *Belvedere Court Management Ltd v Frogmore Developments Ltd* [1997] QB 858 at 864.

> I share the [lower court's] view that these arrangements were not a sham. There was no element of pretence…. The parties were not doing one thing and saying another. I would also accept … that [the leases to Party B] were an artificial device intended to circumvent a result the [1987] Act would otherwise have brought about. … I am not … satisfied that in the field of real property [certain principles emerging from two tax law cases] entitle the court simply to ignore or override apparently effective transactions which on their face confer an interest in land on the transferee. Many transactions between group companies may be artificial. That does not entitle the court in ordinary circumstances to treat such transactions as null.[115]

2.102 We note that there are various other ways in which the Right of First Refusal might be avoided. For example:

(1) instead of there being a headlease in respect of the commercial units in the example above, there might instead be a headlease granted in respect of the residential flats. The landlord, for the purposes of the 1987 Act, would then be the owner of the headlease interest and not the owner of the freehold to the block; or

(2) a developer may set up an SPV to own the freehold or a headlease of the block of flats, and then transfer the shares in that freehold or headlease to a purchaser. In that case it is the ownership of the landlord itself that is disposed of and not the ownership of the block of flats, and, accordingly, the Right of First Refusal will not be triggered.[116]

A PROVISIONAL PROPOSAL AND FURTHER QUESTIONS

2.103 The 1987 Act is clear that, where premises are used predominantly for non-residential purposes, so that the requirements of the 50% Rule are met, the Right of First Refusal does not apply. However, it is our view that, in addition, the Right of First Refusal is unlikely to have been deliberately intended to capture disposals of premises that are exclusively occupied, or intended for exclusive occupation, as non-residential premises.

2.104 Even if that is incorrect, we are doubtful that the Right of First Refusal is valuable to residential leaseholders in the sorts of circumstances described in the examples set out in this chapter. We have, for example, explained that the Right of First Refusal may not solve concerns residential leaseholders have about the potential use of commercial units in mixed-use premises.[117]

2.105 The fact that "ordinary" disposals of commercial units in mixed-use premises (for example, leases to tenants to trade from the units) appear to be caught by the Right of First Refusal has been described as a "surprising consequence" of the 1987 Act. This consequence creates uncertainty and problems in practice. The risk, and potential

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115 [1997] QB 858 at 876.

116 We note that this outcome can be achieved at any time. The 1987 Act, s 4(1)(i) means that disposals (for example, the grant of a headlease) to associated companies (eg a wholly owned subsidiary company) are not subject to the Right of First Refusal where the companies have been associated for at least 2 years.

117 See para 2.90 and following above.

criminal liability, of non-compliance with the Right of First Refusal, causes well-represented landlords to employ workarounds.[118] Those workarounds involve legal expense and, potentially, ongoing administrative costs in maintaining in place an artificial structure of leasehold interests. However, the issue may be particularly problematic for smaller developers and landlords who may be unaware of the Right of First Refusal (and the possibility of or need to employ workarounds) and therefore be at a greater risk of criminal sanction.

2.106 We also highlight that the existing uncertainty in the application of the Right of First Refusal to commercial premises may not be resolved through litigation. The criminal sanction means that developers will generally go to significant lengths to avoid any risk of breaching the right.

2.107 We therefore provisionally propose that disposals of parts of premises that are, or are intended to be, used for non-residential purposes should be excluded from the Right of First Refusal. These disposals would be excluded from the definition of "relevant disposal".[119] We consider that reforming the law in this way would bring clarity and reduce unnecessary costs and risks (including risks of potential criminal sanction). It will also bring the practical effect of the legislation in line with, what we consider to be, its original intended purpose. For the avoidance of any doubt, we make no proposal to remove or otherwise alter the 50% rule.[120]

2.108 In making the provisional proposal, we are mindful of the risk of unintended consequences and unacceptably undermining a right that exists for the protection of residential leaseholders. We note the unusual circumstances in cases such as *Belvedere Court Management Ltd v Frogmore Developments Ltd*,[121] in which complex leasehold structures were put in place with the intention of preventing an outcome that the 1987 Act would otherwise enable.

2.109 We also note again the committee's warning in the 1985 Report that, in drafting the legislation creating the Right of First Refusal, "[c]are [would] need to be taken … to prevent its intention being frustrated by avoidance devices".[122]

2.110 Whether or not that outcome has been achieved, we agree with the sentiment; we must be careful in any reform to do only what is necessary and we must be vigilant to avoid unintentionally doing damage to the Right of First Refusal.

2.111 With that in mind we limit our provisional proposal to exclude only:

(1) disposals that are by way of the grant of a lease; and

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118 See para 2.94 and following above.

119 See the current list of excluded disposals at s 4(1) and (2) of the 1987 Act.

120 See para 2.22 and following above.

121 See para 2.100 and following above.

122 1985 Report, para 7.9.19; also see para 2.62 and following above.

(2) those disposals of parts of the premises that are used, or intended to be used, for non-residential purposes, but only in so far as those premises are, or are intended to be, exclusively occupied or used for such purposes.

2.112 We consider that this approach is sufficiently focussed to ensure that the protections afforded to residential leaseholders by the 1987 Act are not frustrated or undermined. In particular, we note two things about the test.

(1) First, we have limited our provisional proposal to disposals by way of the grant of a lease. We have done that to limit a possible risk that the reversionary interest of the landlord (that the Right of First Refusal was originally intended to cover) might be fragmented and disposed of piecemeal.

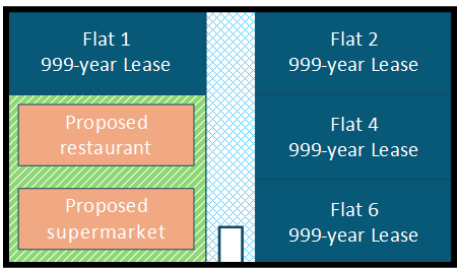
(2) Second, we have incorporated into the test a need for exclusivity of non-residential use. This has been done with a view to ensuring the Right of First Refusal applies where residential leaseholders of a building share, or have a right to share, the use of any part of the premises that is non-residential in nature, but where the sharing (or right to share) those premises is ancillary to their own residential use of the premises.

We considered a qualified test – for example, one that was based on whether premises were predominantly non-residential. However, we have discounted that possibility because, as explained previously, a key aim is to avoid eroding the protections afforded to residential leaseholders. We are concerned that any relaxation of the requirement (that the premises be exclusively occupied or used or intended to be exclusively occupied or used for non-residential purposes) would risk doing so.

2.113 In responding to the provisional proposal at paragraph 2.121 below, we are keen to hear whether we have correctly balanced the interests of landlords and tenants (whether those tenants are residential or commercial). Our aim in this work is to free landlords and commercial tenants from needless bureaucracy, cost and risk, without doing damage to the underlying Right of First Refusal and the intentions that underpinned its creation. We want to hear views on whether our provisional proposal achieves that.

2.114 To assist in understanding the provisional proposal, and to help to consider the points mentioned in the paragraph above concerning the balancing of interests, we set out an example of how our provisional proposal might work. In doing so, we highlight some similarities and differences with existing exceptions from the Right of First Refusal.

2.115 Consider the following building, which a developer has constructed:



2.116 There are four flats, each let to different people on 999-year leases. The developer has reserved part of the building, shown with green diagonal lines, for commercial use. The developer proposes to dispose of that part of the building by way of two separate leases: a ten-year lease of the first-floor unit to a restaurant operator and a ten-year lease of the ground-floor unit to a supermarket operator. Access to the commercial premises and the residential premises is by way of a central lobby, which is shown cross-hatched blue. There is no access to the residential premises directly from the commercial units, save via the central lobby.

2.117 Each of the ten-year leases would be a disposal of part of the premises that is intended exclusively for non-residential use. Therefore, under our provisional proposal, the grant of each lease would be excluded from the Right of First Refusal. In this way, our provisional proposal operates in a similar way to the existing exclusion of the grant of a tenancy of a single flat.[123]

2.118 However, our provisional proposal goes further. It would allow the grant of a headlease of the whole of that part of the premises that is to be used exclusively for non-residential use (being the area shown with green diagonal lines in the diagram above). That might be done before the separate ten-year leases of the restaurant and supermarket are granted (by the head-lessee), or after (slotting in the headlease between the ten-year leases of the restaurant and the supermarket).

2.119 We acknowledge that, in this respect, our provisional proposal is wider than the exception relating to residential premises (which only excludes the grant of a tenancy of a single flat). We consider that it is, however, important for landlords to be able pragmatically to structure, and dispose of, the commercial elements of the building (but not dispose of the entire building itself).

2.120 We now note some disposals that our provisional proposal would not exclude from the Right of First Refusal.

(1) The landlord could not dispose of the freehold of any part of the premises (because the provisional proposal excludes only disposals by way of the grant of a lease).

(2) The landlord could not grant:

(a) a lease of the whole or any part of the central lobby (because the lobby is used to access both commercial premises and residential premises, and the tenants have a right to use the lobby for that purpose);

(b) a headlease of Flats 1, 2, 4 and 6 (because the headlease would not be of premises that are exclusively used (or intended to be exclusively used) for non-residential purposes); or

(c) a lease or headlease in respect of the commercial units together with the flats and/or lobby (because, again, the headlease would not be exclusively of premises that are used for non-residential purposes).

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[123] See para 2.37(1) above.

Consultation Question 5.

2.121 We provisionally propose that:

(1) a disposal by way of the grant of a lease by a landlord of a part of the premises that is:

(a) exclusively occupied or used, or

(b) intended to be exclusively occupied or used;

for non-residential purposes should not trigger the Right of First Refusal; and

(2) where one or more residential tenants of the premises share, or have a right to share, the use of parts of the premises (the "Shared Premises"), and the sharing of those Shared Premises is ancillary to their own residential use of part of the premises (that is, their flat), then a disposal of the whole or part of the Shared Premises shall in no circumstances satisfy the test in (1) above.

Do consultees agree? Please explain why.

2.122 We note the existing uncertainty and lack of coordination between the 1954 Act and the 1987 Act that was discussed above. In short, there is nothing in either Act to indicate whether a tenant's right to be granted a new lease of commercial premises when their existing lease expires (under the 1954 Act) or the Right of First Refusal (under the 1987 Act) takes precedence.[124]

2.123 While we anticipate the courts may be able to solve this problem without statutory intervention,[125] we nevertheless consider the uncertainty to be unhelpful. The provisional proposal we make above would resolve this uncertainty (whether under the 1954 Act or under the 1987 Act), because disposals of commercial premises would no longer be caught by the Right of First Refusal.

"Dwellings" and "non-residential" property

2.124 Having set out our provisional proposal, we consider the use in it of the phrase "non-residential purposes". As we have indicated above, it will be obvious that we see the use of premises for "non-residential purposes" to include their use for commercial purposes (or at least those commercial purposes that are common in mixed-use buildings). However, the phrase is obviously wider than that. It would, for example, cover the central lobby in the example at paragraph 2.115 above, a bin store, or the ducts used for cabling. We have limited a landlord's power to dispose of non-residential premises, so that it cannot dispose of anything that is enjoyed (in some way) by residential premises. We explained that, in the example above, the central lobby would not benefit from the provisional proposal. In the same way, we

[124] See para 2.71 and following above.

[125] See para 2.73 above.

would expect a duct that carries cables to both commercial and residential premises would not benefit from our provisional proposal.

2.125 The phrase "non-residential purposes" is not used in the 1987 Act. However, a similar phrase, "otherwise than for residential purposes", is used in the context of the 50% Rule. While the 50% Rule is not of particular importance to the conclusions we reach in this Consultation Paper, it is nevertheless useful to note here for that reason.

2.126 Assuming we proceed with our provisional proposal we believe it may be possible usefully (and consistently) to employ the phrase "otherwise than for residential purposes" in our draft Bill.

2.127 In concluding the above, and framing the provisional proposal, we are conscious of the suggestion that the distinction between residential and non-residential premises (and what constitutes an intention to use premises for one or other of those purposes)[126] may cause difficulties in practice.

2.128 We have indicated that the 1987 Act employs the phrase "otherwise than for residential purposes". There is, however, no definition, or other use, of the word "residential" in the 1987 Act (other than in that one context). As explained at paragraph 2.27 above, there is a (somewhat circular) definition of "dwelling" in section 60(1): "a building or part of a building intended to be occupied as a separate dwelling".

2.129 The distinction between non-residential and residential premises (or "dwellings") is important. That is true not only for the 50% Rule (as discussed at paragraph 2.22 and following above), but also because what constitutes the "premises",[127] who is a "qualifying tenant",[128] and key exceptions[129] to the Right of First Refusal are linked to the concept of a "flat", and a "flat" must, amongst other requirements, be "constructed or adapted for the purposes of a dwelling".[130]

2.130 Radevsky and Clark identify various issues that might arise in practice regarding this distinction. For example, the authors highlight that:

> It is considered that the fact that a flat is used for residential purposes does not preclude it from being used for business purposes as well.[131]

The authors go on to acknowledge that what is residential and non-residential may be problematic in some cases.

2.131 We agree with the authors' conclusion, although we consider that, in most cases, it will be clear whether a part of the premises is intended to be used for residential

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126 An intention to use premises for a particular purpose is relevant in several places in the 1987 Act: see the definition of "dwelling" at para 2.27 above and our discussion of the 50% Rule at para 2.22 above. We also incorporate a test of intention in the provisional proposal we make at para 2.121 above.

127 See para 2.18 and following above.

128 See para 2.28 and following above.

129 See para 2.37 above.

130 See the definition of "flat" in the 1987 Act, s 60(1).

131 Radevsky and Clark, para 2.31.

purposes or otherwise. However, even if we are wrong, we are not persuaded that things would be improved significantly by statutory intervention (or, at least, in this project focussing on commercial leasehold). In particular, we would expect any new test would need to be open-textured, giving latitude to the court to determine, in an almost infinite variety of circumstances, whether something was “residential” or “non-residential”. We consider that a change to the law would invite fresh uncertainty and litigation.

2.132 Accordingly, we make no provisional proposal statutorily to define the distinction between what are residential and non-residential premises.

Chapter 3: The background to the Landlord and Tenant (Covenants) Act 1995 and the current law

INTRODUCTION

3.1 In this chapter we explore the background to the Landlord and Tenant (Covenants) Act 1995 (the "1995 Act") and its purpose, two fundamental doctrines that the 1995 Act replaced in the landlord and tenant context, and the regime that exists now under that Act.

3.2 This chapter outlines what the 1995 Act does, why it was introduced, and the earlier law that it replaced. This background context may assist the reader when considering the issues in the current law discussed in later chapters. If readers wish to focus upon the issues and already understand sufficiently the current law, then we suggest they start reading from the start of Chapter 4 below.

BACKGROUND TO THE 1995 ACT

3.3 The 1995 Act arose out of work undertaken by the Law Commission. In 1988 we published our report: "Landlord and Tenant Law – Privity of Contract and Estate"[132] (the "1988 Report"), which included a draft bill.

3.4 The 1988 Report arose from a concern about the co-existence of two doctrines governing the question of against whom landlord and tenant covenants in leases could be enforced: privity of contract and privity of estate. We explored those doctrines in detail in our 1988 Report and explain them below.[133] In our 1988 Report we indicated:

> In the law of landlord and tenant privity of contract means that the original landlord and the original tenant normally remain liable to perform their respective obligations for the whole of the period for which the lease was granted, even if they have parted with all interest in the property. Privity of estate means that the landlord and the tenant for the time being automatically assume responsibility for the lease obligations which relate directly to the property for the period during which they own an interest in it, but they are not necessarily bound to comply with all the terms of the lease.[134]

3.5 The problems with the law prior to the 1995 Act coming into force were succinctly explained by Peter Thurnham MP during the second reading of the Landlord and Tenant (Covenants) Bill in the House of Commons:[135]

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132 Landlord and Tenant Law: Privity of Contract and Estate (1988) Law Com No 174.

133 See para 3.10 and following below.

134 1988 Report, para 1.1.

135 The Bill that became the 1995 Act was introduced by Peter Thurnham MP as a Private Member's Bill under the Ten Minute Rule (for information about Ten Minute Rule bills see

> The smooth working of the commercial property market requires good relations between landlords, who provide their capital, and tenants, who trade on their skills. I am sure that most landlords dislike enforcing that unjust law, which has caused distress and genuine hardship to many thousands of former tenants caught in its obscure and iniquitous trap.
>
> Long after retirement, a shopkeeper—or even, after his death, his family—can be confronted with exorbitant demands for arrears of rent owing to the failure of a subsequent tenant. The original tenant can be pursued 20 or more years after assigning a lease, perhaps three or four tenants later. The landlord is under no obligation to mitigate the losses, so confronting former tenants with potential financial ruin.[136]

3.6 The concern at the time the 1995 Act was passed was therefore predominantly about the effect of the doctrine of privity of contract and its impact on tenants.

3.7 However, in addition to the concerns of tenants, landlords will legitimately want to have confidence that the rent under leases is likely to be paid and that other tenant obligations are performed. A landlord is therefore likely to be interested in the "covenant strength"[137] of a tenant to whom a lease is granted, and will also be interested in the covenant strength of any successor tenant to whom the lease is assigned.[138]

3.8 Ultimately, the 1995 Act made amendments to the Landlord and Tenant Act 1927 in a way that increased the degree of control available to landlords over a tenant's ability to assign a lease. In response to concerns expressed by landlords, the Act allowed landlords to stipulate in leases the circumstances in which consent to an assignment might be withheld, or conditions that must be satisfied before consent would be granted.[139]

3.9 Accordingly, although the 1995 Act addressed a significant problem faced by historic tenants of premises, it ensured that the balance was not tipped in a one-sided direction. In other words, "[i]nasmuch as the landlord has lost the unfair historic advantage of privity, the landlord will be compensated by a greater supervisory role in

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https://www.parliament.uk/about/how/laws/bills/private-members/ and https://commonslibrary.parliament.uk/research-briefings/sn04568/).

136 Hansard (HC), 14 February 1995, vol 254, col 799.

137 A tenant's "covenant strength" is a shorthand way of saying "a tenant's ability to comply with the tenant covenants in the lease". A tenant's financial situation (including its financial history and anything that might be gleaned about its future) would be a (likely significant) factor in assessing its covenant strength.

138 The Law Commission recognised this point in the 1988 Report, see para 5.1(2). The recommendation made in that paragraph relied upon the Landlord and Tenant Act 1988, s 1 to ensure that, where a landlord's consent to an assignment was required (rather than an absolute bar on assignments) it would only be possible to insist on a guarantee by the outgoing tenant where doing so was reasonable – see the 1988 Report, para 4.11 and following and the explanatory notes to clause 2 of the draft bill attached to the 1988 Report (p 41). The concerns of landlords were also recognised in the speech made by Peter Thurnham MP that is referred to at para 3.5 above, see Hansard (HC), 14 February 1995, vol 254, col 800.

139 See the Landlord and Tenant Act 1927, ss 19(1A) to (1E) and the 1995 Act, s 22 which amended the 1927 Act by inserting those sub-sections.

respect of assignment mechanisms...".[140] The resulting statutory regime therefore recognises a need for balance between the concerns of landlords and the concerns of tenants.

THE DOCTRINES OF PRIVITY OF CONTRACT AND PRIVITY OF ESTATE

3.10 The two doctrines of privity of contract and privity of estate were, until the 1995 Act came into force, the foundations of the law governing who may be liable under the landlord and tenant covenants in a lease.

3.11 It is useful to understand those doctrines, and the issues arising from them, in order to understand the change in the law brought about by the 1995 Act and its importance. However, it is also important to understand that the relevance of the two doctrines has diminished significantly since the coming into force of the 1995 Act. That is because the 1995 Act establishes a statutory system setting out who is bound by, and who has the benefit of, the covenants in leases.

Privity of contract

3.12 Privity of contract is a principle of contract law that only the parties to a contract can enforce its terms, or have the terms enforced against them.[141]

3.13 Privity of contract is relevant in landlord and tenant law because, as well as creating a leasehold estate in land, a lease is a type of contract and creates contractual obligations between the landlord and tenant. The relevance of this has been significantly curtailed due to the 1995 Act.

Privity of estate

3.14 Privity of estate is the relationship that exists between the current tenant and its current landlord.

3.15 We explain the concept by way of an example below, but, in doing so, **we ignore the effect of the 1995 Act**.

(1) On 1 January, L grants a lease of a property to T1. In the lease, T1 covenants with L to pay £1,000 rent on the first day of each month.

(2) On 15 January, T1 assigns its interest in the lease to T2.

(3) On 1 February, T2 pays nothing to L.

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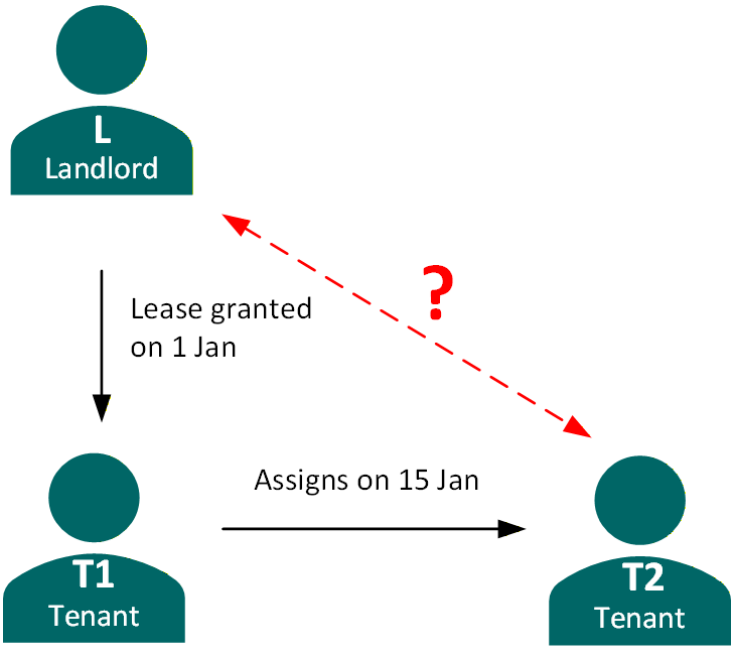
[140] See Hansard (HC) 21 April 1995, vol 258, cols 489-91.

[141] Since the 1995 Act came into force, the Contracts (Rights of Third Parties) Act 1999 has been implemented. That Act also affects how privity of contract operates, but it is not relevant to this project and we consider it no further. The explanatory notes available from https://www.legislation.gov.uk/ukpga/1999/31/notes/contents contain brief details of the 1999 Act's effect.



3.16 In this example, L has never been a party to any agreement with T2 (in other words, there has never been any contractual relationship between them).

3.17 However, following T1's assignment of its interest in the lease to T2 on 15 January, there is a relationship between L and T2 as landlord and tenant. The doctrine of privity of estate means that the law recognises that relationship and L can enforce the obligation to pay rent directly against T2.

3.18 Privity of estate is relevant only where covenants in leases can be said to "touch and concern the land". This is a common, but somewhat vague, principle in property law. In a formulation of it that is set out in statute, it means that a covenant "has reference to the subject-matter of the lease".[142]

3.19 While the concept of "touching and concerning land" is important in property law – and in limiting the sorts of obligations that might be enforceable between people who have interests in land but where there is no contractual relationship – we do not need to consider it further in this Consultation Paper.

The interaction between contractual obligations, privity of contract and privity of estate in leasehold law

3.20 The interaction between contractual obligations, privity of contract and privity of estate is critical to this project, and to understanding why the 1995 Act was implemented.

3.21 To help explain the interaction, we return to the example at paragraph 3.15 above (and later develop it into a more complex example). Again, in the examples and explanation below, **we ignore the effect of the 1995 Act**.

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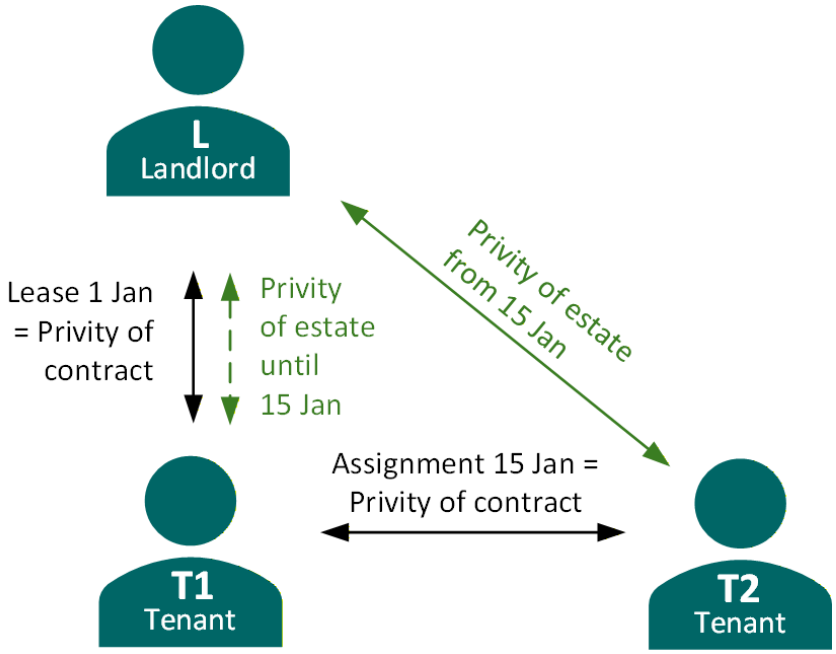
[142] Law of Property Act 1925, ss 141 and 142. Also see *Megarry & Wade: The Law of Real Property* (10th ed 2024), para 19-033.

3.22 In the example at paragraph 3.15 above, there are multiple transactions and relationships. The nature of each is explained below.

(1) On 1 January, the lease created contractual obligations between L and T1 – that is because the lease is a type of contract.

(2) On 1 January, the lease also created a leasehold estate in land with L as the landlord and T1 as the tenant. As we explained at paragraph 3.17 above, there is privity of estate between L and T2 after T1's interest under the lease is assigned to T2 on 15 January. However, there was also privity of estate between L and T1 from the creation of the lease until T1 assigned his or her interest to T2.

(3) The assignment of T1's interest under the lease to T2 on 15 January is also a type of contract.



3.23 The relationship of privity of estate (which "moves" with the assignment of T1's interest in the lease to T2) is separate and distinct from those relationships that arise by virtue of the two contracts (the lease and the assignment). That fact is irrelevant (to the discussion of the current law and this paper) during the time before T1 assigned his or her interest to T2. However, once the assignment has taken place, the two relationships become very important.

3.24 When T2 fails to pay the rent on 1 February, L can enforce the obligation to pay rent contained in the lease against T2 under the principle of privity of estate.[143]

3.25 However, depending on the terms of the lease entered into with T1, that may not be L's only option. L could separately choose to enforce the obligation to pay rent against T1, relying on the fact that the lease is a contract to which L and T1 were the

[143] The requirements for the relationship of privity of estate are satisfied because T2 is the current tenant under the lease and L is their immediate and current landlord – see para 3.14 above.

parties.[144] That is despite T1 no longer being the tenant under the lease and having parted with possession of the leased property.

3.26 The above outcome can be described as "original covenantor liability" and its unfairness was a key reason for implementing the 1995 Act.[145]

3.27 If the assignment between T1 and T2 was well-drafted, it would contain a promise from T2 to T1 to pay the rent always on time (and observe all of the other provisions of the lease). If that were the case, then, if L pursued T1 for the rent, T1 could then pursue T2. However, that does not help T1 if T2 cannot be found or has become insolvent. Indeed, those possibilities may have caused T2 to miss paying the rent in the first place and for L to pursue T1.

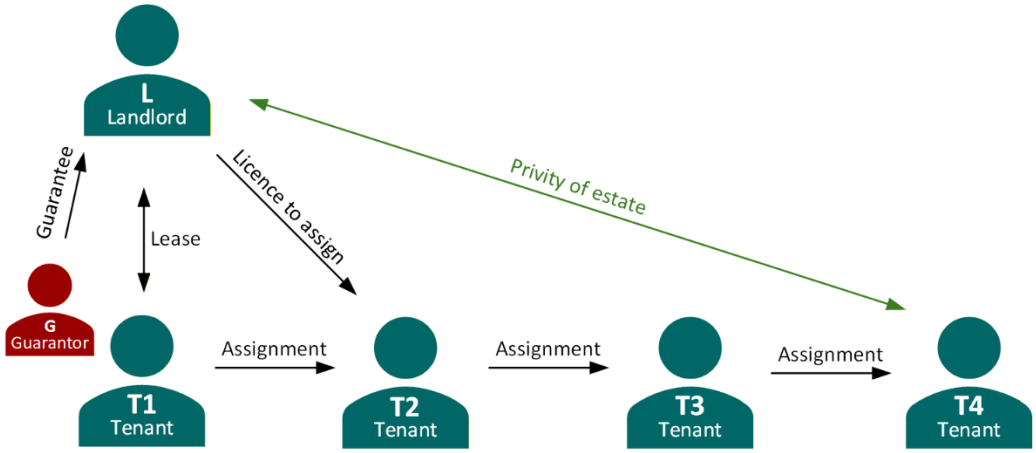
3.28 The above is a simple example. However, leasehold structures and arrangements can be, or become, very complex. For example:

(1) the landlord and tenant interests in a lease may be assigned many times during the lifetime of a lease;

(2) there may be other parties involved, for example, the tenant(s) may have guarantor(s) who promised the landlord that the tenant would abide by the terms of the lease and to cover the tenant's liabilities if it did not; and/or

(3) the various documents – including leases, assignments (and any licences given by landlords permitting those assignments), and guarantees – may contain complex provisions (including provisions that seek to limit the potential liability of a party after an interest in a property has been assigned).

3.29 The following is a visual example of the sort of complexity that might arise from the grant of a single lease where the parties' interests are assigned multiple times, and where guarantors and licences to assign are required under the provisions of a lease. As before, **we ignore the effect of the 1995 Act**.



144 In the language used above, there remains privity of contract between L and T1.

145 The issues explained here are recognisable in the concerns expressed by Peter Thurnham MP when the Landlord and Tenant (Covenants) Bill was passing through Parliament, see Hansard (HC), 14 February 1995, vol 254, col 799.

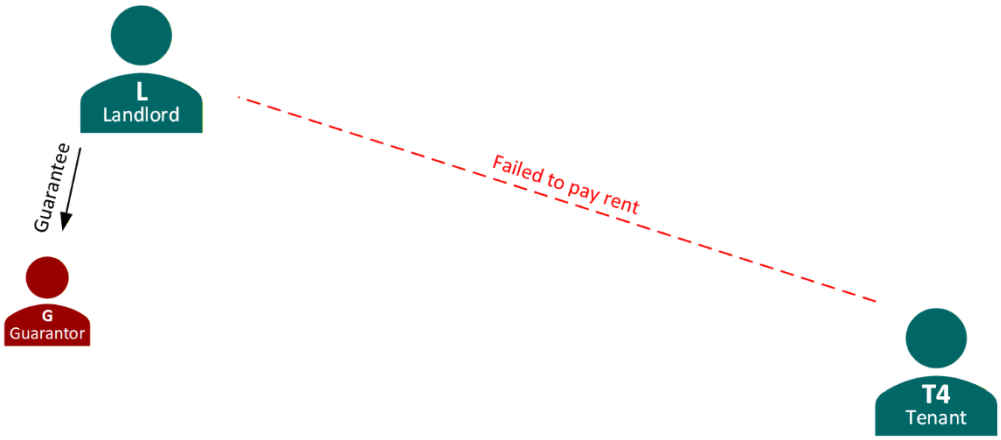
3.30 The lease, and each assignment, is a contract and the licence, depending upon its terms, may be a contract. Depending on the facts of a case, the potential web of liabilities and enforcement possibilities could become complex.

THE NEED FOR THE 1995 ACT

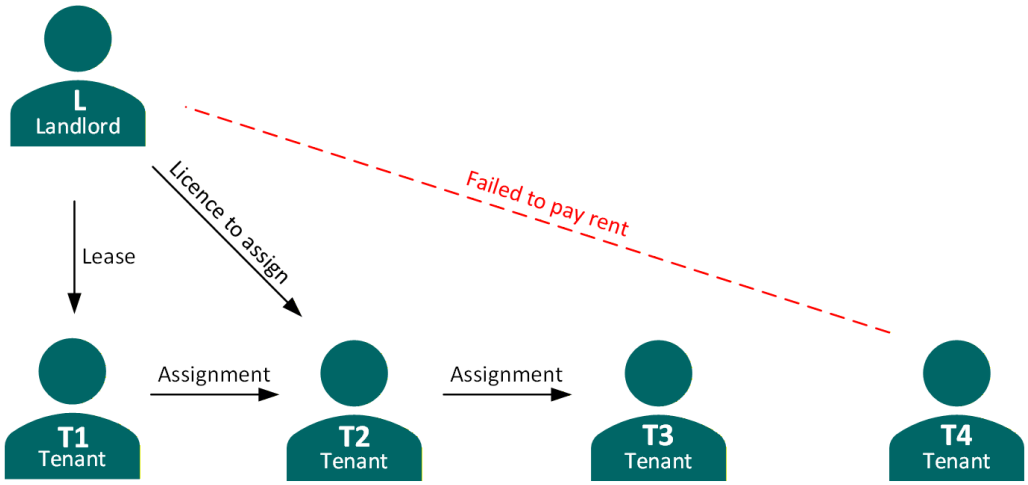
3.31 The complex web of relationships in the example above could result in unfair outcomes.

3.32 If, in the example above, T4 failed to pay L the rent at any point, and depending on the terms of the various assignments, guarantees, licences and other documents, the following outcomes (among others) are possible:

(1) T1's guarantor (G) may have to cover the missed rent. That would involve L pursuing G under the terms of the guarantee provided to L at the time of the original lease.



(2) T3 may ultimately have to cover the missed rent. There is no privity of contract between L and T3, so that outcome might arise where: L pursues T1, T1 pursues T2, and T2 pursues T3. It may also be possible that L can pursue T2 directly (omitting T1 entirely), depending on the terms of the licence to assign.



3.33 In the above examples, neither the guarantor of T1 (G), or the former tenant, T3, would be happy to cover the missed rent.

(1) First, they may not be able to recover from anybody else (for example T1 or T4), because there is no contractual chain leading to those parties, or there is a break in it (which may arise at any point). For example, a party in the chain may have died (with the estate long since distributed), become insolvent, or simply be impossible to find.

(2) Second, L's claim may be made many years after the eventual assignment to T4. During that time, T1's guarantor (and any other party in the contractual chain) is unlikely to have made provision for future liabilities on a lease that T1 owned in the past. Indeed, the various previous tenant(s) and guarantor(s) may have forgotten about the lease entirely. Being pursued for breaches of the terms of a lease that were not any of their faults, and seen as historic by those parties who have long since parted with a property, is likely to generate stress, confusion and cost.

3.34 Where the tenants and any guarantors in the examples above were represented, their advisors are likely to have sought to limit the sort of "distant" liabilities that might otherwise emerge. For example, T1's guarantor (G) may have sought to limit its liability under the guarantee by including a limitation that the guarantee is effective only while T1 is the tenant. Similarly, T1 may have sought to limit its (and future tenants') liabilities under the lease only to breaches of the terms of the lease that arise in the period prior to its interest in the lease being assigned.

3.35 However, such negotiations could have taken time and may have increased costs, and the extent to which potential liabilities following an assignment might be mitigated could depend on the negotiating strength of the parties. Those who were unrepresented may not have appreciated what risks were being taken on and may have made no attempt to mitigate them.

3.36 Before moving on to consider the effect of the 1995 Act and the current law, we make two final points.

(1) First, the examples above concern problems arising when a tenant assigns its interest and a later assignee fails to perform the tenant covenants under the lease. However, the issues caused by original covenantor liability may affect landlords or tenants. There are reasons why tenants are more likely to be affected adversely and the 1995 Act was introduced owing to concerns about tenants, not landlords, remaining liable after an assignment of their interest in a lease.[146]

(2) Second, there may arguably be legitimate reasons for a landlord and/or a tenant to be concerned about the other party being released from their contractual obligations on an assignment of the other party's interest. For example, if a wealthy landlord assigns its interest to a newly created company with no assets, a tenant may be legitimately concerned about the ability of the

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[146] See para 3.5 above. See also the 1988 Report, para 2.1, which reads:

> Although the privity of contract principle applies equally to landlords and tenants, examples of tenants being made liable are more common. The main reason for this is probably that in the majority of leases the tenant undertakes many more obligations than does the landlord.

assignee company to perform the landlord obligations in the lease if the original landlord is released from them.

THE EFFECT OF THE 1995 ACT AND THE CURRENT LAW

3.37 The 1995 Act fundamentally changed how, in particular, contractual liabilities operate on an assignment of a landlord's or tenant's interest in a lease and whether they can exist at all.

3.38 The effect of the 1995 Act was to replace the doctrines of privity of contract and privity of estate with a statutory regime setting out when a landlord and tenant (and former landlord and tenant) have the benefit of tenant and landlord covenants in a lease, and when they are bound and/or released from them.

3.39 We explain how that effect was achieved (in other words, the current law) in the remainder of this chapter. However, we do not attempt to explain every nuance of the 1995 Act; rather we focus on its main effects and provisions.

Application of the 1995 Act

3.40 The 1995 Act's purpose is to establish who has the benefit, and who can enforce the burden, of the landlord and tenant covenants in leases after an assignment of a party's interest. With a small number of exclusions,[147] the Act applies widely, with all landlord and tenant covenants falling within its scope whether or not they have "reference to the subject matter of the tenancy"[148] and whether they are expressly set out in the tenancy, implied, or imposed by law.[149]

3.41 The 1995 Act applies to almost all leases, including those of commercial and residential premises.[150] However, the effect of the 1995 Act is very different depending on the date a lease was granted.[151]

3.42 If a lease was granted on or after 1 January 1996, the 1995 Act considers the leasehold interest created to be a "new tenancy".[152] (We use the terms "New Lease", "New Leases", "New Tenancy", or "New Tenancies" in this chapter as a reference to

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147 See the 1995 Act, s 2(2).

148 Note that this is the statutory formulation of the touch and concern requirement that was set out at para 3.18 above.

149 In a well-drafted lease, all of its terms are likely to be set out expressly. It is, however, possible for terms of a lease to be implied. The law relating to the implication of terms into a lease is complicated and is not considered further in this Consultation Paper. An example of a term imposed by statute can be found in the Landlord and Tenant Act 1988, s 1, which provides that, where a tenancy contains a tenant covenant not to, for example, assign the lease without the consent of the landlord, there is implied (by that section) a qualification that the consent by the landlord is not to be unreasonably withheld.

150 1995 Act, s 1 and the definition of "tenancy" in the 1995 Act, s 28(1). There is a limited exclusion which means that the Act does not apply to "occupation contracts" under the Renting Homes (Wales) Act 2016, s 7. See the 1995 Act, s 1(8).

151 For the sake of completeness, the effect of the of the 1995 Act is different depending on the date a lease was granted, or, if earlier, the date an agreement or court order to grant a lease was entered into or made. We do not consider the latter possibilities further in this Consultation Paper.

152 See para 1.47 for an explanation of the interchangeable nature of various words used in this paragraph.

such tenancies).[153] As the date of enactment of the 1995 Act moves further into the past, the relevance of the distinction between "new" and all other tenancies, unsurprisingly, diminishes.

PROVISIONS OF THE 1995 ACT THAT ARE ONLY RELEVANT TO NEW TENANCIES

A statutory replacement for privity of contract and privity of estate for leases

3.43 Sections 3 to 16 and 21 of the 1995 Act set out a self-contained statutory regime for the transmission of the benefit and burden of landlord and tenant covenants on assignment of the landlord or tenant interests created under a tenancy.[154] They also set out in what circumstances those who were bound by the covenants prior to an assignment are released. The statutory regime applies only to New Tenancies.

3.44 The regime established in those sections is, essentially, a statutory abolition of privity of contract in the landlord and tenant context and a statutory replacement of privity of estate.

The passing of the benefit and burden of leasehold covenants on assignment

3.45 Section 3 of the 1995 Act sets out the rules for when the person to whom a landlord or tenant interest in a New Tenancy is assigned (the "Assignee") is bound by the landlord or tenant (as applicable) covenants in it, and when they benefit from those owed by the tenant or landlord.

3.46 Broadly speaking,[155] for both landlords and tenants,[156] immediately upon an assignment:

(1) the Assignee is bound by the landlord or tenant (as applicable) covenants in the New Tenancy, except for any that:

(a) did not bind the outgoing tenant (or landlord) (the "Assignor") immediately before the assignment;

(b) relate to premises that are not part of the assignment; or

(c) are expressed to be personal to the Assignor;[157] and

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153 1995 Act, s 1(3).

154 The sections mentioned also contain provisions ancillary to the regime that are aimed at ensuring it operates as intended.

155 There are some additional complexities to the 1995 Act, s 3. For example, s 3(6)(b) makes it clear that the section does not operate to make enforceable a covenant which would be unenforceable by reason of it not having been registered under the Land Registration Act 2002 or the Land Charges Act 1972. We have set out broad principles in the summary of the law in this chapter and do not go into this level of detail. Also see para 3.39 above.

156 See the 1995 Act, ss 3(2) and 3(3).

157 1995 Act, s 3(6)(a).

(2) the Assignee is entitled to the benefit of the tenant or landlord (as applicable) covenants, except to the extent that any relate to premises that are not part of the assignment.[158]

3.47 Section 3 of the 1995 Act is, to a large extent, a reflection of the effect of the privity of estate rule.[159]

Release of an Assignor from leasehold covenants

3.48 The most significant departure from the doctrine of privity of contract arises in sections 5 to 7 of the 1995 Act. These sections have the effect of preventing one party from enforcing leasehold covenants against another party who was a former landlord or tenant (in other words one who assigned their interest in the lease at some point in the past) by relying on the fact the lease is a type of contract.[160] Subject to what is said below, it is these sections that address the problems of original covenantor liability.[161]

3.49 The provisions releasing the Assignor from liability under the covenants in a lease operate differently depending on whether the Assignor is a landlord or a tenant. We consider how the provisions work for landlords and tenants below. We also consider how the release of a tenant affects the position of a guarantor, who may have guaranteed that a tenant will perform its obligations under a lease.

The release of a tenant Assignor from leasehold covenants

3.50 Where a tenant assigns their interest under a lease, section 5 of the 1995 Act releases them from the tenant covenants in the lease and provides that the tenant is no longer entitled to the benefit of any landlord covenants. The release under section 5 does not affect any liability of the tenant that arises from a breach of covenant occurring before the release.[162]

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158 The 1995 Act, s 23(1) provides that where, as a result of an assignment, a person is bound by, or has the benefit of, a covenant under a lease, he or she does not have any liability or right under the covenant that arose before the assignment. However, it may still be possible for the parties to the assignment to expressly assign the benefit of a right (see s 23(2)). There is a different, and specific, rule where the right in question is a right of re-entry (see s 23(3)).

Conversely, the 1995 Act, s 24 ensures that any release of a person from a covenant does not affect any liability that person had that arose from a breach of the covenant arising before the release. The section has another effect that is important to the issues we consider in this Consultation Paper, which we consider at para 3.54 below.

159 See para 3.14 and following above.

160 See para 3.12 and following above.

161 See para 3.31 and following above.

162 See the 1995 Act, s 24(1). We note that the 1995 Act, s 5 is, by s 5(5), subject to the Communications Act 2003, sch 3A, para 16(4). The summary given of paragraph 16(4) in section 5(5) of the 1995 Act is as follows: "[sub-paragraph 16(4)] places conditions on the release of an operator from liability under an agreement granting code rights under the electronic communications code". As mentioned at n 104 above, the Electronic Communications Code governs the rights of telecommunication operators to install and maintain electronic communications apparatus (such as mobile phone masts, antennae, cables or equipment cabinets) on land owned or occupied by others.

We believe the reference to sub-paragraph 16(4) may be incorrect, and the intention may have been to refer to sub-paragraph 16(5) (or para 16 generally). Sub-paragraph 16(5) limits the release of an assignor of an

3.51 If the tenant assigns part of the premises under the lease, the tenant is released from the tenant covenants, and no longer entitled to the benefit of any landlord covenants, in so far as those covenants fall to be complied with in respect of that part.

3.52 However, despite the rules releasing an assignor tenant from the tenant covenants it is permissible under the 1995 Act for them to guarantee the performance of the tenant obligations under a lease by an incoming tenant under what is called an "authorised guarantee agreement". This provision is of particular importance to this project. We consider authorised guarantee agreements in greater detail in Chapter 4.

The release of a tenant's guarantor

3.53 Where a person wishes to take a lease, or (depending on the terms of the lease) an assignment of a lease, the landlord may require a guarantor. The guarantor is there to guarantee that the tenant complies with the tenant's covenants in the lease. We explained the concept of a guarantor in the leasehold context at paragraph 3.28(2) above.

3.54 Section 24(2) of the 1995 Act is relevant to guarantors. It provides that:

(1) where a tenant is released from the tenant covenants of a tenancy by virtue of the 1995 Act; and

(2) immediately before the tenant's release another person is bound by a covenant of the tenancy imposing any liability or penalty in the event of a failure to comply with the tenant covenants;

then the other person is released to the same extent that the tenant is released.

3.55 Section 24(2) of the 1995 Act is most relevant in the common situation where a tenant has its performance of obligations under the lease guaranteed by another person. The effect of the section is relatively simple and can be explained by an example.

3.56 A well-established and profitable company "Top Company plc" has started a new business venture. The new business venture is being run out of a newly incorporated, wholly-owned subsidiary company, "Sub Company Ltd". Sub Company Ltd needs premises from which to operate to launch the new business venture and finds a building to rent at £500,000 per year. The landlord of the premises (L) is happy to let the premises to Sub Company Ltd for five years, but is concerned that Sub Company Ltd has no trading history and no assets.

3.57 L refuses to grant the lease to Sub Company Ltd unless Top Company plc guarantees that Sub Company Ltd will perform the tenant obligations in the lease, including the

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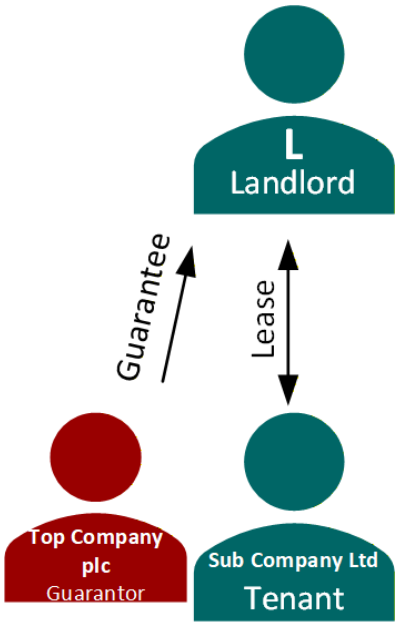
agreement made under the electronic communications code (in respect of breaches that occur post-assignment) to circumstances in which certain information was provided to the other party to the agreement.

The way in which the Electronic Communications Code operates (and the specific rules it establishes regarding the release of an assignor) are outside of the scope of this project.

payment of rent.[163] Top Company plc agrees to do so. Once granted the lease and guarantee structure looks as follows:



3.58 There are advantages to all parties in this example.

(1) The advantage to L is that, if the business venture fails and Sub Company Ltd fails to pay the rent (and/or is liquidated), L can pursue Top Company plc (and has confidence Top Company plc would have the assets to pay).

(2) The advantage to Sub Company Ltd is that, without the guarantee from Top Company plc, L would have refused to let the property and Sub Company Ltd would have no premises in which to set up the new business venture.

(3) The advantage to Top Company plc is that the new business venture – being delivered via Sub Company Ltd – can be achieved (because, as the owner of Sub Company Ltd, an advantage to Sub Company Ltd is an advantage to Top Company plc).[164]

3.59 The effect of section 24(2) of the 1995 Act in the above example is that, if Sub Company Ltd assigns its interest in the lease (and is then automatically released from the tenant covenants in the lease under section 5 of the 1995 Act), then Top Company plc is released also.[165]

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163 At para 1.35(1) above, we introduced a specific type of guarantee that is permitted by the 1995 Act – the "authorised guarantee agreement". For the avoidance of doubt, the type of guarantee provided by Top Company plc in this example is not an authorised guarantee agreement.

164 The point we are making here is that the guarantee relationship can be mutually beneficial. We do not suggest that guarantors are always content to enter into guarantee arrangements, or that a landlord's insistence upon one in every situation is reasonable or necessary.

165 See para 3.53 and following above.

The release of a landlord assignor from leasehold covenants

3.60 The position for a landlord when they assign their interest in a lease is similar to the position of a tenant who assigns their interest that is explained above, but with an important difference: while the tenant is automatically released from the tenant covenants in a lease on an assignment of their interest, the landlord must apply to be released from the landlord covenants.

3.61 If the landlord assigns their interest under a lease then, under section 6 of the 1995 Act, the landlord may apply to be released from the landlord covenants. If the application is successful, then they are released from the landlord covenants, and no longer entitled to the benefit of the tenant covenants, as from the date of the assignment. A release under section 6 does not affect any liability of the landlord that arises from a breach occurring before the release.[166]

3.62 If the landlord assigns part of the premises, then they may apply to be released from the landlord covenants in respect of that part. If the application is successful then the landlord is released, and no longer entitled, in so far as the landlord and tenant covenants fall to be complied with in respect of that part.

3.63 Section 8 of the 1995 Act sets out the procedure to be followed when a landlord seeks release from the landlord covenants. Briefly, the process involves serving a notice in a prescribed form[167] on the tenant before, or within four weeks of, the assignment, informing the tenant of the assignment and requesting to be released.[168]

3.64 The landlord is released from the landlord covenants (and ceases to be entitled to the tenant covenants) if the tenant:

(1) does not serve a notice in a prescribed form on the landlord objecting to the release within four weeks of being served with the landlord's notice;

(2) does serve a notice objecting to the release, but the court (on the application of the landlord) makes a declaration that it is reasonable for the covenant to be released; or

(3) serves on the landlord a notice consenting to the release (and withdrawing any prior objection, if one has already been served).[169]

3.65 If the landlord is successfully released from the landlord covenants (and no longer entitled to the benefit of the tenant covenants), the release (and loss of entitlement) is treated as having happened on the assignment, which may be in the past.[170]

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166 See the 1995 Act, s 24(1) and n 158 above.

167 See the 1995 Act, s 27 and the schedule to the Landlord and Tenant (Covenants) Act 1995 (Notices) Regulations 1995, SI 1995 No 2964.

168 See the 1995 Act, s 8(1).

169 1995 Act, s 8(2).

170 1995 Act, s 8(3).

3.66 From the above, it will be apparent that there are circumstances in which the landlord might not be released when they assign their interest. The 1995 Act allows a landlord in that position to make further applications to be released from its covenants on later assignments in the way explained in paragraphs 3.63 and 3.64 above.[171]

Assignments in breach of covenant or that arise by operation of law

3.67 The 1995 Act makes special provision about the passing of the benefit and burden of leasehold covenants to an assignor, and the release of the former landlord or tenant, for assignments that are made in breach of a covenant of the lease or that arise by operation of law (each an "Excluded Assignment").[172] An example of each is given below.

(1) **Assignment in breach of covenant**: a lease provides that a tenant is not to assign their interest without first obtaining the landlord's consent, such consent not to be unreasonably withheld or delayed. Where the tenant does not seek the landlord's consent before assigning their interest, the tenant's assignment is in breach of covenant.

(2) **Assignment by operation of law**: where a tenant becomes bankrupt. The effect of the law of bankruptcy is that the tenant's interest in the lease is automatically assigned to the trustee in bankruptcy without any other formality.

3.68 In both of those cases, the former tenant is not immediately released on the assignment, and the former landlord cannot apply for release from their covenants under the lease. Instead, they are released (or can apply for release) on the next assignment (if any) of the interest that is not itself an Excluded Assignment.[173]

PROVISIONS OF THE 1995 ACT THAT ARE RELEVANT TO ALL TENANCIES

Restrictions on the liability of former tenants

3.69 As explained above, where a tenancy is a New Tenancy,[174] the tenant is, in most cases, automatically released from the tenant covenants in the tenancy on its assignment. However, an outgoing tenant can, in limited circumstances, remain liable in respect of the covenants,[175] or be required to enter into an authorised guarantee agreement which guarantees that the assignee will perform the tenant covenants.[176] Where a tenancy is not a New Tenancy, the tenant might remain liable for the performance of tenant covenants due to the doctrine of privity of contract.

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171 See the 1995 Act, s 7.

172 See the 1995 Act, s 11.

173 See the 1995 Act, ss 11(2) and (3).

174 See para 3.42 above.

175 See para 3.67 above.

176 Authorised guarantee agreements are considered in detail in ch 4 below.

3.70 The 1995 Act contains two provisions which restrict the liability of former tenants, whether the liability arises under an authorised guarantee agreement or otherwise. They are considered briefly below.

Restriction on the liability of a former tenant or their guarantor for the payment of fixed charges

3.71 A lease may include a tenant covenant for the payment of a "fixed charge". A fixed charge is defined in the 1995 Act as: rent, any service charge,[177] and any amount payable under a tenant covenant which provides for the payment of a liquidated sum[178] in the event of failure to comply with such a covenant.[179]

3.72 The 1995 Act provides that the former tenant (or the former tenant's guarantor) is not liable under the authorised guarantee agreement or the covenant (as applicable) unless the landlord serves a notice in a prescribed form. The notice must be served within six months of the charge becoming due.[180] A similar provision applies if the landlord is seeking to recover a sum from a guarantor of the former tenant.[181]

3.73 If a former tenant or the former tenant's guarantor makes a payment, they are entitled to have the landlord grant them an overriding lease.[182]

Restriction on the liability of a former tenant or their guarantor where a tenancy is subsequently varied

3.74 It is possible for a landlord and tenant to vary the terms of a lease. The 1995 Act provides that the former tenant is not liable under an authorised guarantee agreement or a covenant (as applicable) to the extent that the amount claimed arises from a relevant variation of the tenant covenants of the tenancy effected after the assignment.[183] A relevant variation is one which the landlord has, or would have had if the former tenant had sought the variation immediately prior to the assignment, an absolute right to refuse.[184]

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177 "Service charge" is defined in the 1995 Act by reference to the Landlord and Tenant Act 1985, s 18 (but omitting the words "of a dwelling" from that section). That means, for the purposes of the 1995 Act, a service charge is an amount payable by a tenant as part of, or in addition to, the rent, which is payable, directly or indirectly, for services, repairs, maintenance, improvements or insurance or the landlord's costs of management, the whole or part of which varies or may vary according to the costs, or estimated costs, incurred by or on behalf of the landlord or a superior landlord.

178 A "liquidated sum" in the context of a lease is a sum that is included in the lease as a pre-determined estimate of the loss or damage arising from breach of a covenant. An example might be a pre-defined sum payable for each day after the tenant fails to leave the property after the lease has terminated.

179 See the 1995 Act, s 17(6).

180 See the 1995 Act, s 27 and the schedule to the Landlord and Tenant (Covenants) Act 1995 (Notices) Regulations 1995.

181 See the 1995 Act, s 17(3).

182 The 1995 Act contains detailed provisions regarding the overriding lease: see the 1995 Act, ss 19 and 20. Confusingly, there are other sorts of leases (not entered into pursuant to the 1995 Act) that can also be called overriding leases. We consider those leases at para 5.27 and following below.

183 See the 1995 Act, s 18(2).

184 See the 1995 Act, s 18(3).

Chapter 4: The 1995 Act – problems caused by the interaction of the release of tenants and guarantors from covenants, authorised guarantee agreements and the anti-avoidance provision

INTRODUCTION

4.1 In this chapter we focus on two aspects of the Landlord and Tenant (Covenants) Act 1995[185] that we are aware cause problems in practice:

(1) authorised guarantee agreements; and

(2) the anti-avoidance provision.

4.2 Whilst the above are the elements of the 1995 Act that have caused issues in practice, they do so because of two other foundational aspects of the 1995 Act:

(1) the automatic release of tenants from the tenant covenants under leases where the assignment is not made in breach of any covenant; and

(2) the automatic release of those who guarantee the performance of a tenant's covenants to the same extent.

4.3 In particular, it is our understanding that the way in which the anti-avoidance provision operates means that landlords, tenants and their guarantors are limited in their ability to negotiate or implement commercially sensible arrangements, creating uncertainty, risk, additional cost and problematic outcomes. These challenges are particularly apparent in transactions involving group companies and partnerships. By way of a brief example and to place our discussion of the current law later in this chapter in context:

(1) A tenant (T1), whose performance of the tenant covenants in a lease is guaranteed by G, assigns its interest to another tenant (T2). T1, T2 and G are all group companies.

(2) Under the 1995 Act, G cannot provide a guarantee to the landlord of T2's obligations. This is the case even though all parties (the landlord, T1, T2 and G) are all happy for the transaction to proceed in this way. Similarly, T cannot assign its lease to G.

We explain the legal principles and the reasons for these outcomes in detail in this chapter.

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185 We call the Landlord and Tenant (Covenants) Act 1995 the "1995 Act" in this chapter.

4.4 Before exploring the current law, we note, as we did in the previous chapter,[186] that the 1995 Act operates differently if a lease was granted (or an agreement or court order to grant the lease was entered into or made) on or after 1 January 1996. Those leases are considered by the 1995 Act to be "new tenancies".

4.5 In the previous chapter, it was necessary to specify when we were referring to new tenancies. In this chapter, however, the issues under consideration arise only in relation to new tenancies. We therefore no longer use the phrase "new tenancy" (etc), we simply refer to "tenancies" and "leases".

THE CURRENT LAW

The automatic release of tenants and others

4.6 We explained the following principles in the previous chapter,[187] but go into more detail here. They are essential to an understanding of the issues that have arisen in practice.

The automatic release of tenants (and exceptions to that rule)

4.7 Section 5(2) of the 1995 Act provides that:

> If the tenant assigns the whole of the premises …, [the tenant] … is released from the tenant covenants of the tenancy … as from the assignment.[188]

4.8 The release of the tenant is automatic and there are few exceptions to it. There is, however, one important exception for the purposes of this chapter that is set out in section 11 of the 1995 Act.

4.9 Section 11(1) and (2) provide that:

> In the case of an [assignment in breach of a tenant covenant] … section [5(2)] … shall not have the effect mentioned in that subsection in relation to the tenant as from that assignment, but … shall have that effect as from the next assignment … which is not an excluded assignment.

4.10 So, if a tenant assigns its interest in a tenancy to somebody in breach of a covenant in the tenancy against doing so, the outgoing tenant is not automatically released from the tenant covenants.

4.11 An example of the above is as follows. Suppose a tenant (T1) is granted a lease by a landlord (L). The lease contains an obligation on the tenant not to assign the lease

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186 See paras 3.41 and 3.42 above.

187 See para 3.50 and following and para 3.67 and following above.

188 The 1995 Act, s 5 also sets out what happens where there is an assignment of part. We do not consider that here for the sake of clarity.

without the consent of the landlord.[189] T1 plans to assign their interest in the lease to T2.

4.12 In **scenario 1**, T1 seeks and obtains their landlord's consent to the assignment to T2 and proceeds with the assignment. In this scenario the assignment is in accordance with the tenant's covenant relating to assignment. In this scenario, section 5 of the 1995 Act causes T1 to be automatically and immediately released from the tenant covenants in the lease on the assignment to T2.[190]

4.13 In **scenario 2**, T1 does not seek their landlord's consent to the assignment to T2, but nevertheless proceeds with the assignment. In this scenario, the assignment is not in accordance with the tenant's covenant relating to assignment. In this scenario, because the assignment is made in breach of a tenant's covenant, T1 continues to be bound by the tenant covenants in the lease and is not automatically released from them on the assignment to T2. That is because section 11 of the 1995 Act applies and prevents section 5 from operating.

4.14 In **both scenarios**, following the assignment to T2, T2 decides to assign their interest in the lease to T3. T2 seeks and obtains their landlord's consent to the assignment to T3 and proceeds with the assignment.

4.15 We now look separately at the two assignments in both scenarios.

(1) **The assignment from T2 to T3**: as in scenario 1, section 11 of the 1995 Act does not apply (because the assignment from T2 to T3 was made in accordance with the tenant covenants in the lease). That means section 5 operates and causes T2 to be automatically and immediately released from the tenant covenants in the lease on the assignment to T3.

(2) **The assignment from T1 to T2**:

(a) **Scenario 1**: it will be recalled that, in scenario 1, T1 was released from the tenant covenants in the lease immediately upon the assignment from T1 to T2. The assignment from T2 to T3 is therefore of no relevance to T1.

(b) **Scenario 2**: it will be recalled that, in scenario 2, T1 was not released from the tenant covenants in the lease on the assignment to T2. On T2's assignment of the lease to T3, section 11 of the 1995 Act is relevant to T1. That is because the section only prevents the automatic release of a tenant from the tenant covenants in a lease (in other words, the effect of section 5) operating until the next assignment that does not fall foul of section 11. Because T2's assignment to T3 is not in breach of any

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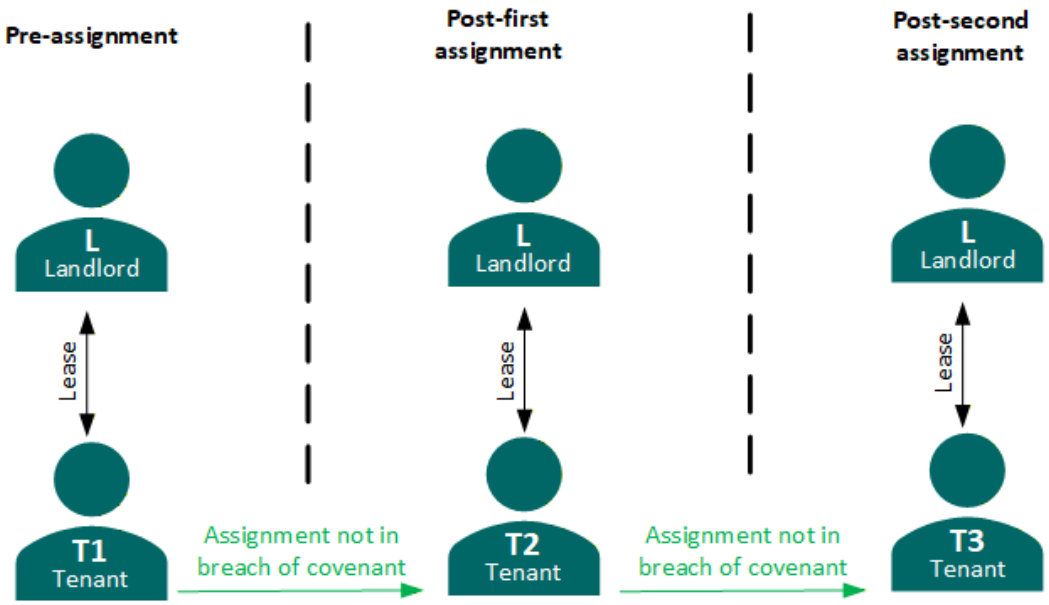
189 The requirement for a tenant to obtain their landlord's consent before undertaking an assignment is a very common feature of commercial leases. The inclusion of a clause of that type is also a pre-condition to whether an authorised guarantee agreement is permissible (see the 1995 Act, s 16(3)(a)).

190 For the avoidance of doubt, the 1995 Act, s 11 does not apply in scenario 1 because the assignment by T1 to T2 was not in breach of a tenant's covenant.

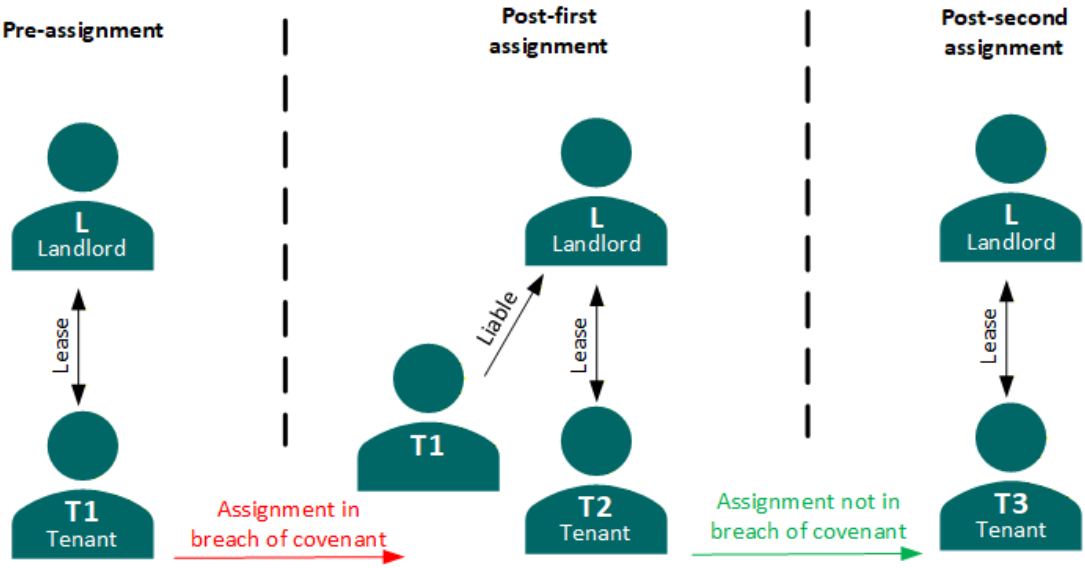
covenant it has the effect of releasing T2 and T1 from the tenant covenants in the lease at the same moment.

4.16 The scenarios above, and the outcomes, can be visualised as follows:

4.17 **Scenario 1**: assignment from T1 to T2 is not in breach of any covenant; assignment from T2 to T3 is not in breach of any covenant.



4.18 **Scenario 2**: assignment from T1 to T2 is in breach of covenant; assignment from T2 to T3 is not in breach of covenant.



The automatic release of guarantors

4.19 Having explained when tenants are automatically released from the tenant covenants under a lease, we explain the statutory provisions that are of particular importance for those who guarantee to a landlord that a tenant will comply with the tenant covenants (we call these people “guarantors”).

4.20 Section 24(2) of the 1995 Act provides that:

> Where–
>
> (a) by virtue of this Act a tenant is released from a tenant covenant of a tenancy, and
>
> (b) immediately before the release another person is bound by a covenant of the tenancy imposing any liability or penalty in the event of a failure to comply with that tenant covenant,
>
> then, as from the release of the tenant, that other person is released from the covenant … to the same extent as the tenant ….

4.21 The effect of section 24(2) can be best understood by expanding the example we used at paragraph 4.11 above.

4.22 In this expanded example, the position of the tenants is the same as in the previous example: a tenant (T1) is granted a lease by a landlord (L). The lease contains an obligation on the tenant not to assign the lease without the consent of the landlord. T1 assigns their interest in the lease to T2. T2 later assigns their interest in the lease to T3. However, at the time T1 was granted the lease, its parent company "G" guaranteed to the landlord that T1 would comply with the tenant's covenants.

4.23 There are the same two scenarios in this expanded example. In scenario 1 both the assignment by T1 to T2 and the assignment by T2 to T3 are not in breach of any covenant. In scenario 2 only the assignment by T2 to T3 is not in breach of any covenant.

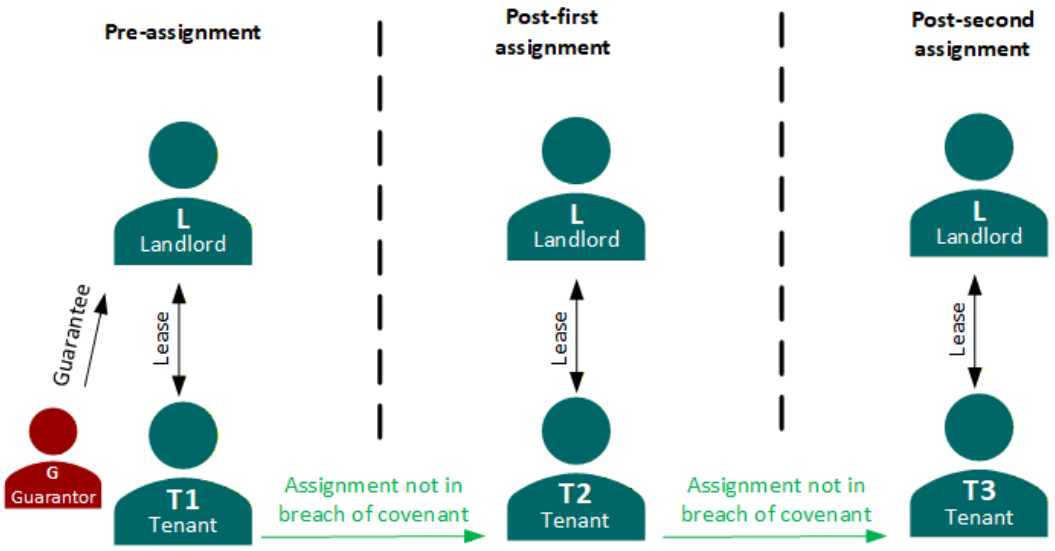
4.24 The effect of section 24(2) can be explained simply: if T1 is released from the tenant obligations under the lease, then so is G. This has the following effect in the two scenarios:

(1) **Scenario 1**: T1 is released immediately on the assignment to T2. The effect of section 24(2) is that G is released to the same extent as T1 (in other words, entirely).

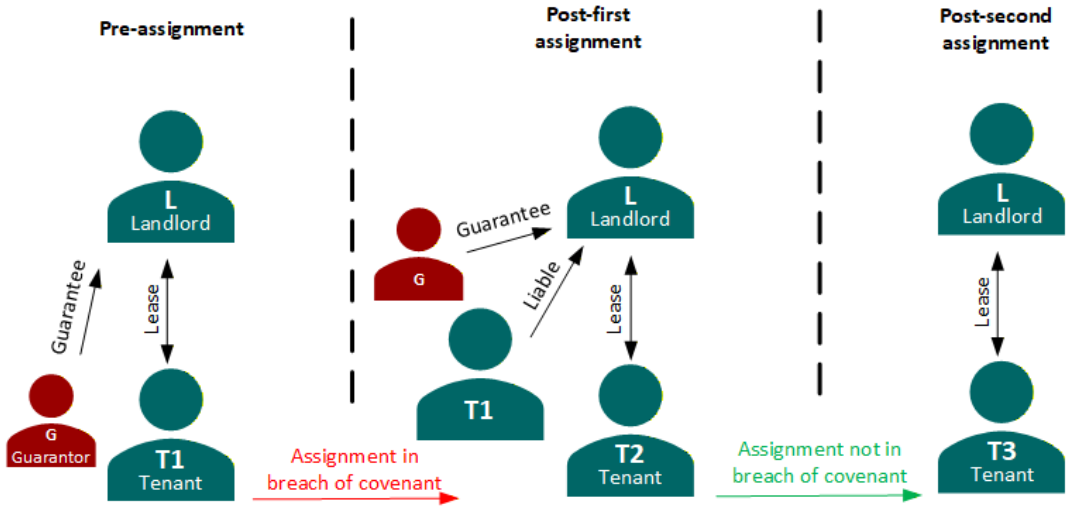
(2) **Scenario 2**: T1 is only released from the tenant obligations on the assignment to T3. Section 24(2) releases G at the same time as T1 and to the same extent.

Once again, we show this expanded example diagrammatically below.

4.25 **Scenario 1**: assignment from T1 to T2 is not in breach of any covenant; assignment from T2 to T3 is not in breach of any covenant.



4.26 **Scenario 2**: assignment from T1 to T2 is in breach of covenant; assignment from T2 to T3 is not in breach of covenant.



Authorised guarantee agreements

4.27 As explained previously,[191] in most circumstances a tenant is automatically released from the tenant covenants of a lease immediately upon assigning their interest in the lease to another person. This outcome was a foundation of the 1995 Act.

4.28 However, at paragraph 3.52 above, we explain an important caveat to that rule: a tenant, who is assigning their interest in a lease to another person, can enter into an agreement that guarantees the incoming tenant will perform the tenant covenants in the lease. These agreements are specifically permitted under the 1995 Act. The agreements are called authorised guarantee agreements (which we call "AGAs").

[191] See para 4.6 and following above.

4.29 It will be clear from the above that AGAs can result in a tenant – after they have assigned their interest in a lease and left the premises – being pursued for breaches of the lease committed by the incoming tenant.

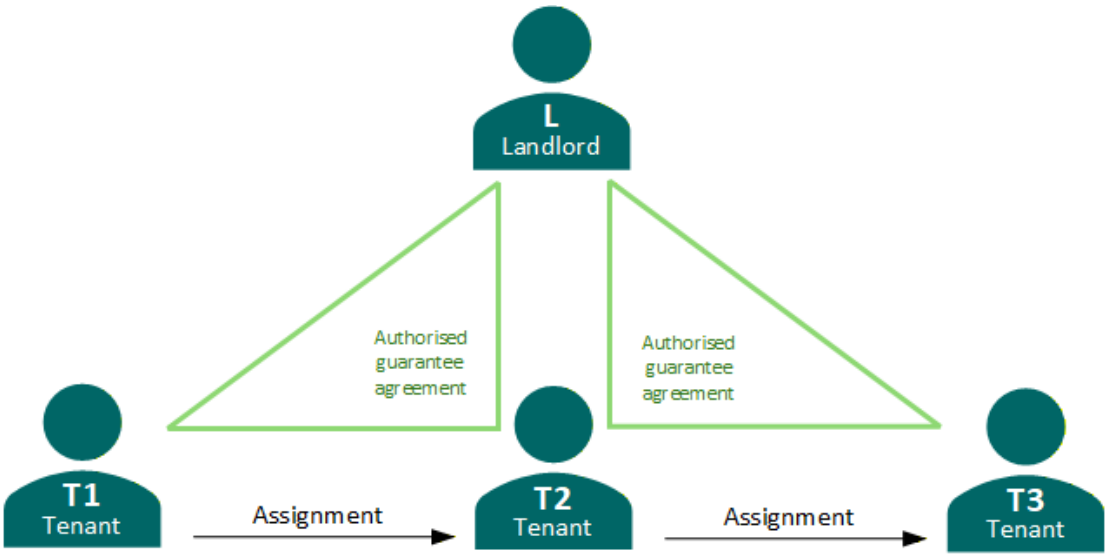
4.30 This was one of the main concerns that the 1995 Act was seeking to address. Accordingly, in order to strike an appropriate balance between the interests of landlords and tenants, AGAs are subject to important limitations, of particular note: a tenant (T1) can only guarantee the performance of obligations by their own assignee (T2); and it is not possible for an AGA to result in T1 guaranteeing the performance of obligations by any future assignee (for example, when T2 assigns their interest in the lease to T3, T1 cannot guarantee the performance of the tenant obligations by T3 under an AGA).

4.31 This can be explained in an example. A tenant, T1, is granted a lease; the lease prevents the tenant assigning the lease without the consent of the landlord, L.

4.32 T1 later seeks consent to assign their interest in the lease to T2. L gives consent, subject to a condition that T1 enters into an AGA. T1 assigns their interest in the lease to T2 and, at the same time, enters into an AGA with L. The AGA sets out that T1 guarantees the performance by T2 of the tenant covenants in the lease. If T2 breaches those covenants, T1 can be pursued by L under the AGA.

4.33 Later still, T2 seeks consent to assign their interest in the lease to T3. L, again, gives consent subject to a condition that T2 enters into an AGA. T2 assigns their interest to T3 and, at the same time, enters into an AGA with L. The AGA sets out that T2 guarantees the performance by T3 of the tenant covenants in the lease. If T3 breaches those covenants, T2 can be pursued by L under the AGA. Upon this assignment, the AGA that T1 entered into falls away, because T1 can only guarantee the performance of the tenant obligations by an immediate assignee (in other words T2 in our example) under an AGA.

4.34 This can be shown diagrammatically as follows:



4.35 We highlight here that both of the AGAs mentioned in the paragraphs above are permitted under the 1995 Act.

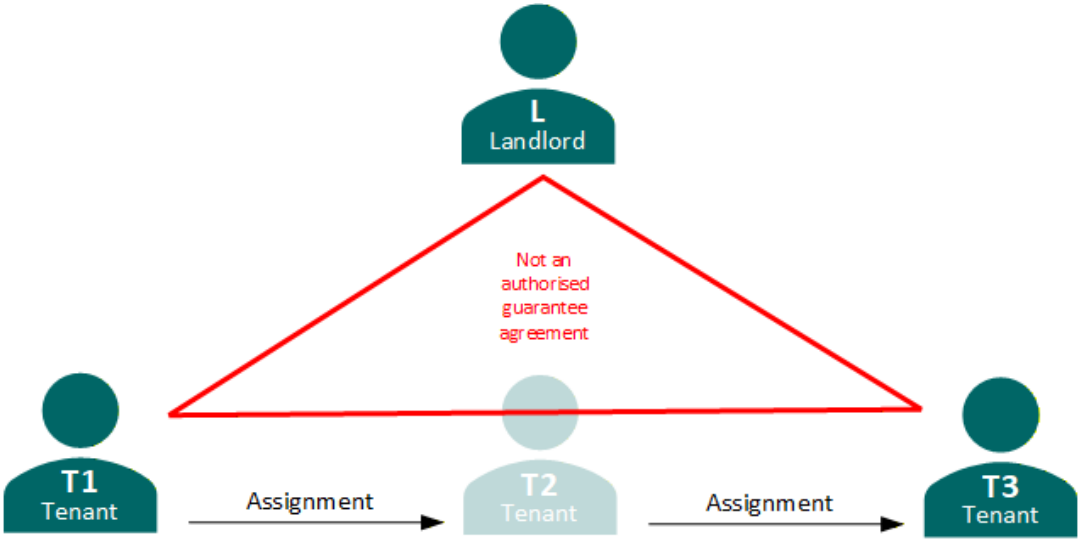
4.36 We contrast the above example with a second example.

4.37 In this case, T1 is granted a lease which prevents the tenant assigning it without the consent of the landlord, L.

4.38 T1 later seeks consent to assign their interest in the lease to T2. L gives consent, but this time the consent is subject to T1 entering into an agreement that provides for T1 to guarantee the performance of the tenant obligations in the lease by T2 and by any future assignee. T1 assigns their interest in the lease to T2 and, at the same time, enters into the agreement with L in the form that L has requested.

4.39 Later still, T2 assigns their interest in the lease to T3. T3 is a "future assignee" as anticipated under the agreement mentioned in the paragraph above. However, T3 is not the immediate assignee of the lease from T1. The 1995 Act does not permit T1 to guarantee T3's obligations and the agreement is not an AGA. We explain why below, but, if T3 breaches the tenant covenants of the lease, T1 cannot be pursued by L under the agreement.[192]

4.40 The above can be shown diagrammatically as follows:



4.41 Looking more closely at the 1995 Act, AGAs are permitted by section 16. Section 16 provides that an AGA is valid if:

(1) the tenant guarantees the performance of one or more of the tenant covenants by the assignee;[193]

(2) it is entered into in the following circumstances:

(a) due to a tenant covenant in the lease, the assignment cannot be effected without the consent of the landlord or some other person;

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192 See para 4.47 and following below.

193 See the 1995 Act, s 16(2)(a).

(b) any such consent is given subject to a (lawful) condition that the tenant is to enter into an AGA; and

(c) the AGA is entered into by the tenant in order to meet that condition;[194]

(3) Section 16 prevents an agreement being an AGA to the extent that it attempts to impose on the tenant:

(a) a requirement to guarantee the performance of one or more tenant covenants by anybody other than the assignee; or

(b) any liability, restriction or other requirement in relation to any time after the assignee is released from the covenant under the 1995 Act.[195]

4.42 We mentioned in the example at paragraph 4.31 and following above that, if an incoming tenant breaches the tenant covenants in a lease, the outgoing tenant "can be pursued" under an AGA; section 16 of the 1995 Act explains what is permissible in that regard.

4.43 An AGA can make the outgoing tenant the "sole or principal debtor" in relation to any obligation owed by the assignee under one or more tenant covenants. However, it cannot impose on the outgoing tenant any liability that is more onerous than they would have been subject to if they were liable as sole or principal debtor in respect of any obligation owed by the assignee under the guaranteed covenant(s).[196]

4.44 In summary, this means that an AGA can make the outgoing tenant (T1) liable in a way that the landlord can pursue T1 for the full extent of the liability that has arisen due to the incoming tenant's (T2's) breach of the tenant covenants in the lease without first, or also, pursuing T2 for that breach. However, it cannot impose on T1 any greater liability than T2 would have.

4.45 An AGA can include a provision requiring T1 to enter into a new tenancy of the premises if the tenancy is disclaimed whilst T2 is the tenant. Disclaimer of a lease results in the termination of the lease and can occur where T2 becomes insolvent.[197] The new lease must expire no later than the end of the term of the tenancy that was assigned and contain tenant covenants that are no more onerous than that tenancy.[198]

4.46 If an assignment of a lease by T1 to T2 was made in breach of a covenant in that lease, or an assignment arose by operation of law, then T1 is not immediately released on the assignment, but may be released on a later assignment.[199] If a later

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194 See the 1995 Act, s 16(3).

195 See the 1995 Act, s 16(4).

196 See the 1995 Act, s 16(5)(a) and (b).

197 See the Insolvency Act 1986, ss 178 to 182 for provisions relating to companies and the Insolvency Act 1986, ss 315 to 321 for individuals.

198 See the 1995 Act, s 16(5).

199 See para 3.67 and following above.

assignment happens, and T2 enters into an AGA, then T1 can be required to enter into an AGA also.[200]

Anti-avoidance of the effect of the 1995 Act

4.47 An anti-avoidance provision in legislation is a measure, usually widely drafted, that is intended to prevent people circumventing the intended effect of an Act.

4.48 Section 25 of the 1995 Act – the title of which is "Agreement void if it restricts operation of the Act" – puts in place such an anti-avoidance mechanism (which we call the "Anti-Avoidance Provision" in this chapter). The Anti-Avoidance Provision provides that:

> (1) Any agreement relating to a tenancy is void to the extent that—
>
> (a) it would … have effect to exclude, modify or otherwise frustrate the operation of any provision of [the 1995] Act, or
>
> (b) it provides for—
>
> (i) the termination or surrender of the tenancy, or
>
> (ii) the imposition on the tenant of any penalty, disability or liability,
>
> in the event of the operation of any provision of [the 1995] Act, or
>
> (c) it provides for any of the matters referred to in paragraph (b)(i) or (ii) and does so (whether expressly or otherwise) in connection with, or in consequence of, the operation of any provision of [the 1995] Act.

4.49 Section 25 of the 1995 Act contains exceptions to the Anti-Avoidance Provision.

> (1) First, the Anti-Avoidance Provision does not catch covenants against assignment, or parting with possession of the premises. So, if a lease does not permit a tenant to assign its interest in the lease at all, or (for example) permits an assignment only with the landlord's permission, then that will not fall foul of the Anti-Avoidance Provision.[201]
>
> (2) Second, the Anti-Avoidance Provision does not catch any agreement that is a (lawful) AGA.[202]

4.50 The example at paragraph 4.36 is instructive here. In that example, we explained that the original tenant of a lease, T1, could not be pursued for breaches of the tenant covenants in a lease by a distant assignee, T3.

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200 See the 1995 Act, s 16(6).

201 The 1995 Act, s 25(2).

202 The 1995 Act, s 25(3).

4.51 In that example, it is a combination of the fact that the agreement entered into by T1 and L was not a (lawful) AGA and the Anti-Avoidance Provision that causes that outcome.

Examples of the operation of the Anti-Avoidance Provision

4.52 We set out four examples of the operation of the Anti-Avoidance Provision below.

4.53 **Example 1**: A lease contains a provision stating that:

> Section 5 of the Landlord and Tenant (Covenants) Act 1995 ("Tenant released from covenants on assignment of tenancy") does not apply to the tenant's covenants in this lease. The tenant shall, therefore, not be released from its obligations in this lease and/or any liability arising from any breach thereof, on an assignment of the lease.

Even without the Anti-Avoidance Provision, this type of clause in a lease would almost certainly be ineffective. Section 5 of the 1995 Act is not drafted in a way that suggests the parties can agree to exclude its effect if they wish to do so.[203] However, if, for any reason, that were in doubt, the Anti-Avoidance Provision makes clear that any attempt to "exclude … the operation of any provision of [the] Act" will fail.[204]

4.54 **Example 2**: A separate agreement (i.e. one that is ancillary to the lease itself) between the parties who are landlord and tenant under a lease contains a provision stating that:

> The [person who is the tenant] covenants, on behalf of itself *and all future assignees*, to observe and perform the tenant covenants in the lease and to indemnify the landlord against all losses arising from its, *or any future assignee's*, failure to do so.

The fact that the provision is in an agreement ancillary to the lease is irrelevant.[205] The italicised text goes beyond what would be permitted by an AGA and would have the effect of frustrating the operation of section 5 of the 1995 Act, which releases a tenant from the tenant covenants in a lease on an assignment. The provision is therefore void to that extent.[206]

4.55 **Example 3**: An "agreement for surrender" is entered into between the parties who are the landlord and tenant of a lease. The agreement contains a provision stating that:

> The tenant shall, by completing a deed of surrender in the form annexed to this agreement, surrender to the landlord all estate, right and interest it has arising from the lease in the event that the guarantor of a predecessor in title to the tenant is

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203 Contrast, for example, the ability of a landlord and tenant to exclude, or contract-out from, the security of tenure for business tenants under pt 2 of the Landlord and Tenant Act 1954. For further details of that regime, see our work examining it: https://lawcom.gov.uk/project/business-tenancies-the-right-to-renew/.

204 See para 4.48 above.

205 See the 1995 Act, s 25(4).

206 See para 4.48 above.

released from its obligations as a consequence of the effect of any provision in the 1995 Act.

Again, the fact that the provision is in an agreement ancillary to the lease itself is irrelevant.[207] The provision itself is void. It "provides for the … surrender of the tenancy … in the event of the operation of [a] provision of the [1995] Act".[208]

4.56 **Example 4**: A lease contains a provision stating that:

> Prior to any assignment, the tenant shall pay £10,000 to the landlord, such sum to be forfeited in the event that it, or any future assignee of the lease, successfully argues in court that it is not bound by the tenant covenants of the lease due to the operation of the 1995 Act.

That provision would be void. It provides for the "imposition of a penalty … or liability, in the event of the operation of [a] provision of the [1995] Act".[209]

Key cases

4.57 The examples given in the paragraphs above are egregious. They are clearly intended to frustrate the effect of the 1995 Act (or penalise a tenant due to the operation of the 1995 Act).

4.58 In the years that followed the 1995 Act coming into force, several key cases arose that brought to light the combined effect of the limited types of agreement that could be AGAs and the Anti-Avoidance Provision. The provisions in agreements that the courts had to consider were often not egregious, or, necessarily, intended to avoid provisions in the 1995 Act. However, the Anti-Avoidance Provision is not concerned with the intention of the parties when entering into an agreement, rather it is concerned with an agreement's effect.[210]

4.59 We consider below the following cases:

(1) *Good Harvest Partnership LLP v Centaur Service Ltd*[211] (which we call the "*Good Harvest Case*");

(2) *K/S Victoria Street v House of Fraser (Stores Management) Ltd*[212] (which we call the "*House of Fraser Case*");

(3) *UK Leasing Brighton Ltd v Topland Neptune Ltd; Zinc Cobham 1 Ltd v Adda Hotels*[213] (which we call the "*UK Leasing Case*"); and

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207 See the 1995 Act, s 25(4).

208 See para 4.48 above.

209 See para 4.48 above.

210 See para 4.48 above.

211 [2010] EWHC 330 (Ch).

212 [2011] EWCA Civ 904.

213 [2015] EWHC 53 (Ch).

(4) *EMI Group Ltd v O & H Q Ltd*[214] (which we call the "*EMI Case*").

The *Good Harvest Case*

4.60 In the *Good Harvest Case*, a tenant (T) held a lease of a property (the "Headlease"). T granted an underlease to a sub-tenant (ST1) (this meant that T was the landlord of ST1). ST1's performance of the covenants under the underlease was guaranteed by G1.[215] The underlease contained various provisions, including the following:

(1) a restriction on the tenant assigning its interest in the lease without the consent of the landlord, such consent not to be unreasonably withheld or delayed;[216]

(2) an entitlement for the landlord to "impose any or all of certain conditions on giving any licence for an assignment of the whole premises";[217]

(3) the "certain conditions" referred to above included:[218]

(a) "upon or before any assignment … the Tenant making the application for licence to assign and its guarantor (if any but not someone who has already given an [AGA]) shall enter into an [AGA] in a form permitted by Law and agreed between the parties";

(b) "the Tenant to procure that any … security for the Tenant's obligations under this Lease which the Landlord holds immediately before the assignment is continued or renewed in each case on terms as the Landlord may reasonably require … under the [AGA] …"; and

(c) "the prospective assignee to provide a guarantor … approved by the Landlord … where … it is reasonable for the Landlord to require [the incoming tenant's] obligations under this Lease to be guaranteed".

4.61 The obligation in the underlease therefore envisaged the following position arising in a situation where ST1 assigned its interest in the lease to ST2.

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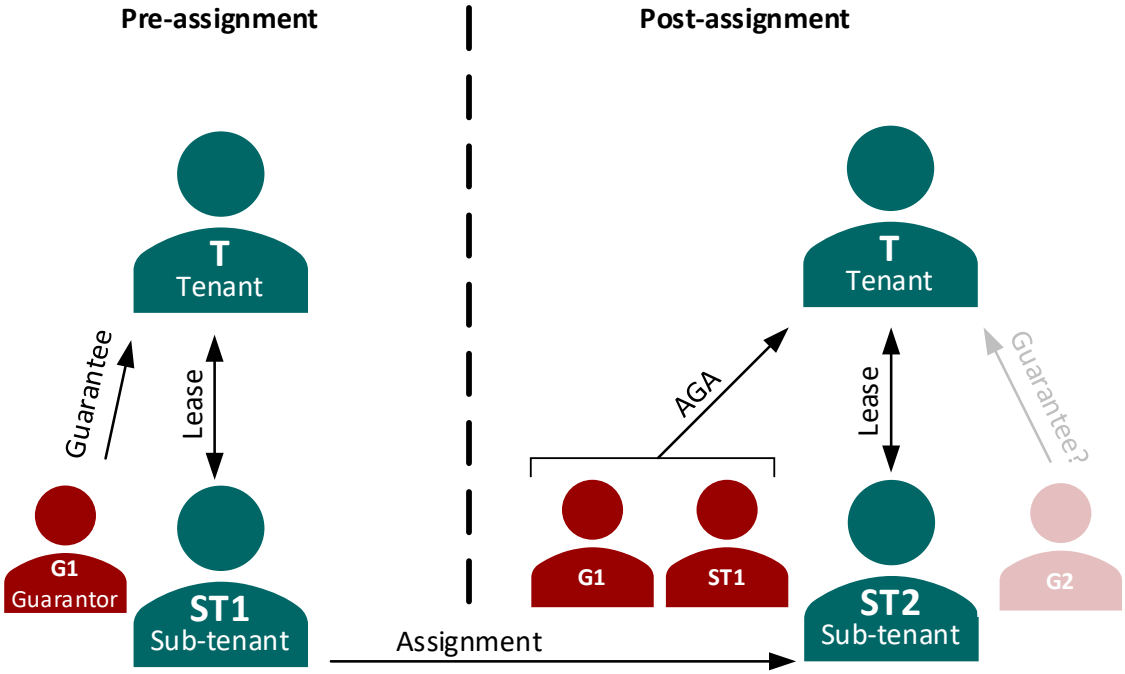
214 [2016] EWHC 529 (Ch).

215 For the avoidance of doubt, we note that G1's guarantee of ST1's performance of the covenants in the lease was not an AGA. It is entirely possible for a tenant to have its performance of obligations under a lease to be guaranteed by a guarantor without the provisions of the 1995 Act being relevant because there has been no assignment. See also the example at para 3.56 and following above.

216 *Good Harvest Case* [2010] EWHC 330 (Ch) at [4][i].

217 *Good Harvest Case* [2010] EWHC 330 (Ch) at [4][ii].

218 *Good Harvest Case* [2010] EWHC 330 (Ch) at [4][ii].



4.62 ST1 assigned its interest in the lease to ST2. Under the terms of the lease, T could have potentially requested ST2 to provide its own guarantor (G2 in the diagram above), quite apart from an AGA.[219] However, it is not apparent that this was requested and it is considered no further.

4.63 ST1, G1 and T entered into (what the parties treated as and which we call in the text that follows) an AGA. For the purposes of this Consultation Paper, the AGA had two important features:

(1) it recited that T agreed to grant ST1 a licence to assign the tenancy to ST2 subject to G1 and ST1 entering into the AGA; and

(2) it provided that ST1 (the assignor) and G1 (ST1's guarantor) each guaranteed that ST2 would pay rent, and otherwise perform the lessee covenants until the next assignment of the lease which is not in breach of covenant.[220]

4.64 The Headlease was surrendered and Good Harvest Partnership LLP ("GHP") purchased the freehold; GHP consequently became the landlord of ST2. ST2 failed to pay the rent and GHP attempted to recover it from G1 under the terms of the AGA.

4.65 The question arose in front of the court whether the AGA was enforceable against G1. Mr Justice Newey (as he then was), sitting in the High Court, concluded it was not. In his judgment, he explained as follows:

> Had Parliament intended a tenant's guarantor to be able to guarantee obligations of an assignee, it could have been expected to say so explicitly …

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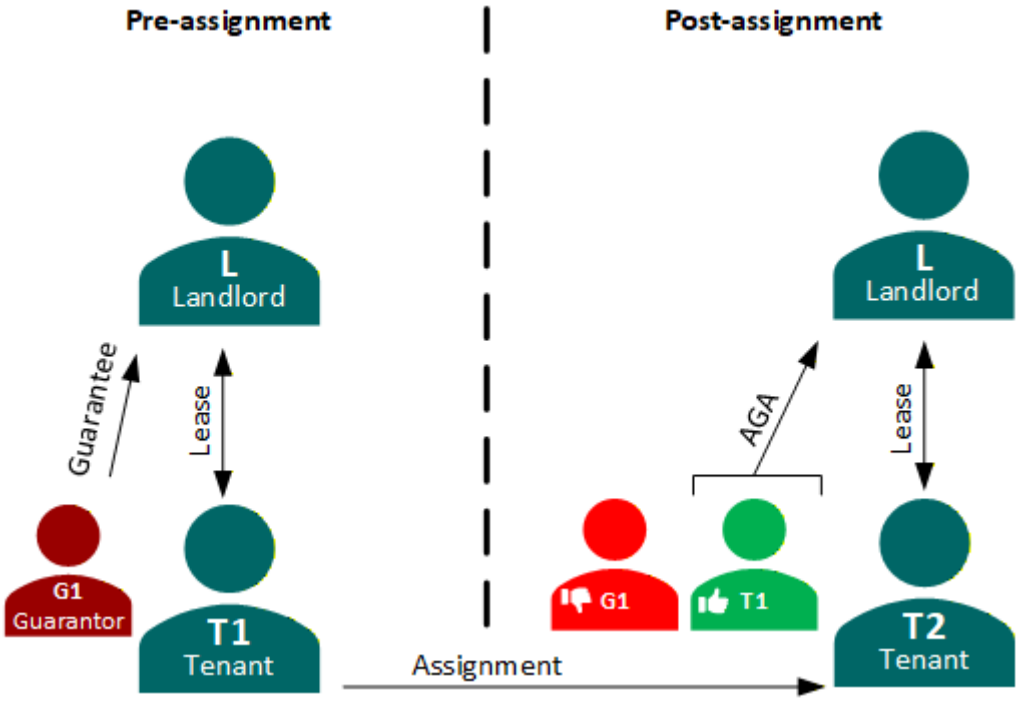
219 See para 4.60(3)(c) above.

220 See the *Good Harvest Case* [2010] EWHC 330 (Ch) at [5].

> [The section that enables AGAs] addresses the circumstances in which a tenant can give a guarantee for an assignee, but there is no equivalent provision dealing with guarantors. Nor does [that section] … contain any reference to guarantors. There is no indication … that an AGA can include a guarantee from anyone other than the tenant….[221]

4.66 The court held that the guarantee given by G1 under the AGA was void under the Anti-Avoidance Provision.[222]

4.67 The *Good Harvest Case* leads to the following outcome:



4.68 Whilst the *Good Harvest Case* focussed on the enforceability of the provisions of the AGA itself, it appears certain that the following obligation, contained in the lease, would also have been found to be void (at least in so far as it purported to oblige the assignee's guarantor to enter into an AGA):

> … upon or before any assignment ... the Tenant making the application for licence to assign and its guarantor (if any but not someone who has already given an authorised guarantee agreement) shall enter into an authorised guarantee agreement in a form permitted by Law and agreed between the parties ...[223]

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221 *Good Harvest Case* [2010] EWHC 330 (Ch) at [22].

222 The language used in the judgment was that:

> the Guarantee Agreement is invalidated by section 25 of the Act *in so far as it purports to impose liability on [G1]* (emphasis added)

See the *Good Harvest Case* [2010] EWHC 330 (Ch) at [22][xi]. It is useful to note the emphasised text, which indicates it was not the entirety of the guarantee that was invalidated, only that aspect that purported to impose liability on G1.

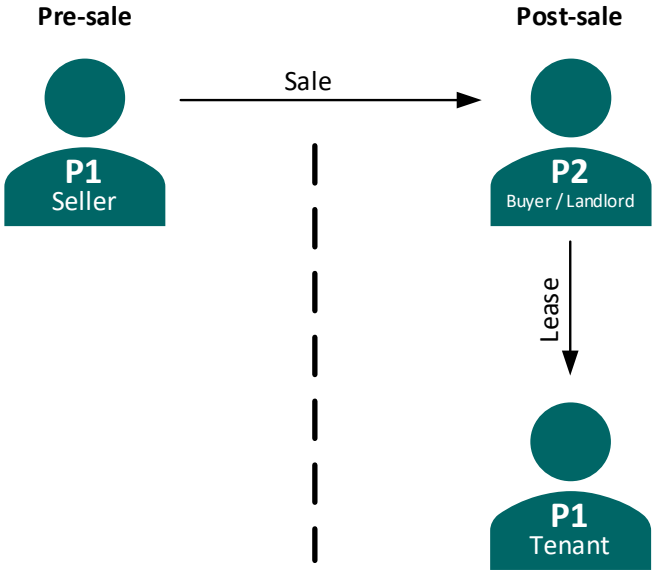
223 *Good Harvest Case* [2010] EWHC 330 (Ch) at [4].

4.69 That point – whether an obligation to enter into an AGA in the future could be void – was considered in the *House of Fraser Case*.

The *House of Fraser Case*

4.70 Before explaining the result of the *House of Fraser Case*, we explain some of the background facts. We have chosen to provide this detail because it is useful to understand that deals involving commercial leasehold property can involve significant sums of money, and that the transactions and the parties to the transactions (particularly where those parties form a group of companies) can be complex. In such cases, the parties are likely to have access to comprehensive legal advice. We believe this to be useful context when considering reform of the 1995 Act.

4.71 The *House of Fraser Case* concerned a common commercial transaction – a sale and leaseback. In a sale and leaseback, one party (P1) transfers their interest in a property (often a freehold interest) to another party (P2) subject to an obligation on P2 immediately to lease the property back to P1. The transaction looks as follows:



4.72 In the *House of Fraser Case*, House of Fraser (Stores Management) Limited ("HoF(SM)") was a subsidiary of House of Fraser Limited ("HoF"). HoF(SM) owned the freehold of a property, having acquired it from another subsidiary of HoF, James Beattie Ltd ("Beatties").

4.73 In an agreement made in January 2006 (the "Agreement"), HoF(SM) agreed to sell the property to K/S Victoria Street ("Victoria") for £46 million, subject to Victoria granting a 35-year lease back to HoF(SM) at an initial rent of £2.25 million each year. The judgment in the case explains that:

> HoF had selected HoF(SM) from among its subsidiaries, to be the seller [of the property to Victoria] and the initial tenant under the [lease], for tax reasons.

4.74 However, Victoria was unhappy with HoF(SM)'s being the tenant for a long period of time due to its financial situation. The Agreement therefore further provided that, within three months, the lease would be assigned to another company in the HoF

group that had the same, or greater, "covenant strength" [224] as Beatties. The Agreement provided a fallback position where the lease would be assigned to a named subsidiary within the group: House of Fraser (Stores) Ltd ("HoF(Stores)").[225]

4.75 The Agreement further provided that:

> [HoF] agrees to enter into a deed of guarantee of [the group company to whom the lease is assigned as explained above's] liabilities as surety in [a specified form] ….[226]

4.76 The lease was granted by Victoria to HoF(SM) and HoF acted as HoF(SM)'s guarantor. The lease contained various provisions relating to assignment, including various restrictions. The restrictions included that:

(1) the tenant would not assign the lease unless either:

(a) the tenant demonstrated that the profits of the assignee met certain criteria set out in the lease; or

(b) the tenant entered into an AGA with the landlord "in such form as the landlord may lawfully require and any surety of the [tenant] guarantees in such form as the [landlord] reasonably requires the Tenant's obligations under such [AGA]";[227] and

(2) the tenant would not assign the lease unless it procured that "such sureties as the Landlord reasonably requires covenant by deed directly with the Landlord as principal debtors or covenantors in such form as the Landlord reasonably requires to pay to the Landlord all losses, costs and expenses arising out of or incidental to any failure by such assignee to comply with its obligations to the Landlord from time to time";[228] and

(3) where the tenant under the lease was HoF(SM) or another group company of [HoF] consent shall not be required to an assignment of the whole to another group company provided [HoF] acts as surety to the assignee Group Company.[229]

4.77 The lease was not assigned by HoF(SM) within three months. Victoria therefore contended that the lease should be assigned to HoF(Stores) with HoF giving a guarantee, as set out at paragraph 4.75 above. HoF(SM) and HoF argued that the

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224 See n 137 above.

225 See the *House of Fraser Case* [2011] EWCA Civ 904 at [7].

226 See the *House of Fraser Case* [2011] EWCA Civ 904 at [7].

227 See the *House of Fraser Case* [2011] EWCA Civ 904 at [9].

228 See the *House of Fraser Case* [2011] EWCA Civ 904 at [9].

229 See the *House of Fraser Case* [2011] EWCA Civ 904 at [9].

obligation to give a guarantee was unenforceable due to the Anti-Avoidance Provision and refused to effect the assignment to HoF(Stores).[230]

4.78 The judge at first instance concluded that the obligation to give a guarantee was void, but that the other provisions in the Agreement concerning assigning the lease to a HoF group company were enforceable.[231]

4.79 The Court of Appeal case was heard by the Master of the Rolls, Lord Neuberger, with the other two members of the court being Lord Justice Thomas and Lord Justice Etherton (as they both then were). The Master of the Rolls delivered the judgment of the court. The judgment recited the argument raised by the various House of Fraser group companies:

> On the assignment of the Lease by [HoF(SM)] to [HoF(Stores)] in accordance with [the Lease], [HoF(SM)] will be released from all further liability under the Lease, by virtue of [section] 5(1) [of the 1995 Act], so [section] 24(2)(a) is satisfied; and, as HoF is "another person" who is "bound by [the] covenant[s] of the [Lease]", [section] 24(2)(b) also applies. Accordingly, it is the effect and intention of [section] 24(2) that, "as from the release of [HoF(SM)]", i.e. on the assignment to [HoF(Stores)], HoF should be released from its liabilities as guarantor under the Lease. Any provision such as [that in the Lease], which stipulates in advance that HoF must re-assume precisely that liability as a term of the assignment, would therefore "frustrate" the operation of section 24(2)(b), and it is therefore rendered void by [the Anti-Avoidance Provision].[232]

(We explained above how sections 5 and 24 of the 1995 Act work.)[233]

4.80 The Court of Appeal concluded that "this argument is correct".[234] In other words, the court confirmed that any agreement that requires the tenant's guarantor to guarantee now, or in the future, the obligations of an assignee of the lease will be void under the Anti-Avoidance Provision.

4.81 We note that, having reached its conclusion, the court had some sympathy with Victoria:

> [Counsel for Victoria] pointed out that neither party to the Agreement had any intention of evading the provisions of the 1995 Act, and that clause 3.5 was included as part of an arrangement intended to benefit the [HoF companies] ….
>
> We have considerable sympathy with that argument, given that clause 3.5 was a perfectly sensible quid pro quo from the [HoF companies] in return for Victoria's

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230 See the *House of Fraser Case* [2011] EWCA Civ 904 at [10].

231 See the *House of Fraser Case* [2011] EWCA Civ 904 at [11].

232 *House of Fraser Case* [2011] EWCA Civ 904 at [20].

233 See paras 4.6 and following and 4.19 and following above.

234 *House of Fraser Case* [2011] EWCA Civ 904 at [21].

agreement to accept HoF(SM) as the initial tenant under the Lease for a short period to assist the HoF group's tax affairs.[235]

4.82 However, despite that sympathy, the court went on to explain that:

> … it seems to us that it would be wrong to accede to [Victoria's] argument, both as a matter of principle and as a matter of practice. … it is the objective effect of a particular provision [in a document], and not the subjective reasons for its existence, which determine its validity for the purpose of [the Anti-Avoidance Provision].[236]

4.83 The Court of Appeal decided to go further in the judgment by considering the *Good Harvest* decision in some detail. We do not go into that discussion, but the court gave its view[237] regarding the state of the law. In particular, the court explained the argument:

> … that the assignor's guarantor can be required to guarantee the liability of the assignor under an AGA appears to comply with commercial sense …. It is also consistent with the purpose of an AGA. Take the facts of the present case: Victoria granted the lease to [HoF(SM)], an impecunious subsidiary of a substantial company, HoF, taking HoF as a guarantor. On an assignment to another company outside the HoF group, it would be of very little value to Victoria to have the right to ask for an AGA from [HoF(SM)], unless it could require HoF to guarantee [HoF(SM)]'s liability under the AGA. It would therefore be positively surprising if [the provision in the 1995 Act that permits AGAs] extended to an assignor but not to the assignor's guarantor.

4.84 The court's comments in the *House of Fraser Case* helped to cement the view that, where an assigning tenant (T1) was to enter into an AGA, T1's guarantor under the lease could themselves enter into the AGA to guarantee T1's obligations under the AGA. This is known as a sub-guarantee (and is sometimes, informally, called a "GAGA").[238] It can be visualised as follows:

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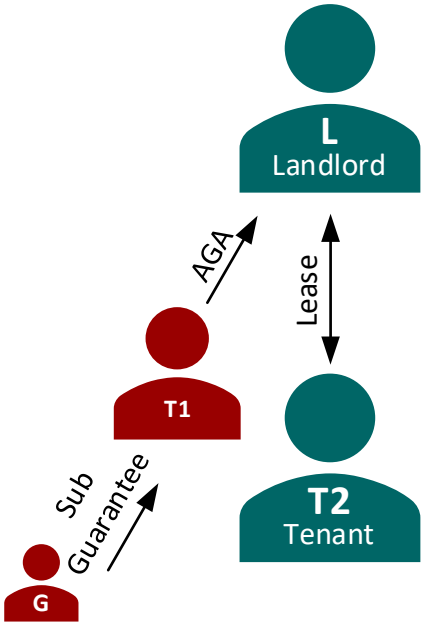
235 *House of Fraser Case* [2011] EWCA Civ 904 at [53].

236 *House of Fraser Case* [2011] EWCA Civ 904 at [29].

237 We use the word "view" here because some of what the Court of Appeal explained was not essential to the judgment in the *House of Fraser* case and, therefore, not a binding statement of the law for future cases.

238 T Fancourt, *Enforceability of Landlord and Tenant Covenants* (3rd ed 2014), at para 23-13, explains that:

> … it was generally thought that, in the absence of any provision in the [1995] Act for sureties of former tenants to remain liable, there was real doubt about the validity of a sub-guarantee, even though the commercial case for allowing it was strong. That doubt has now been largely dispelled by [the] decision of the Court of Appeal [citing the *House of Fraser Case*], though its consideration of the issue was strictly obiter.

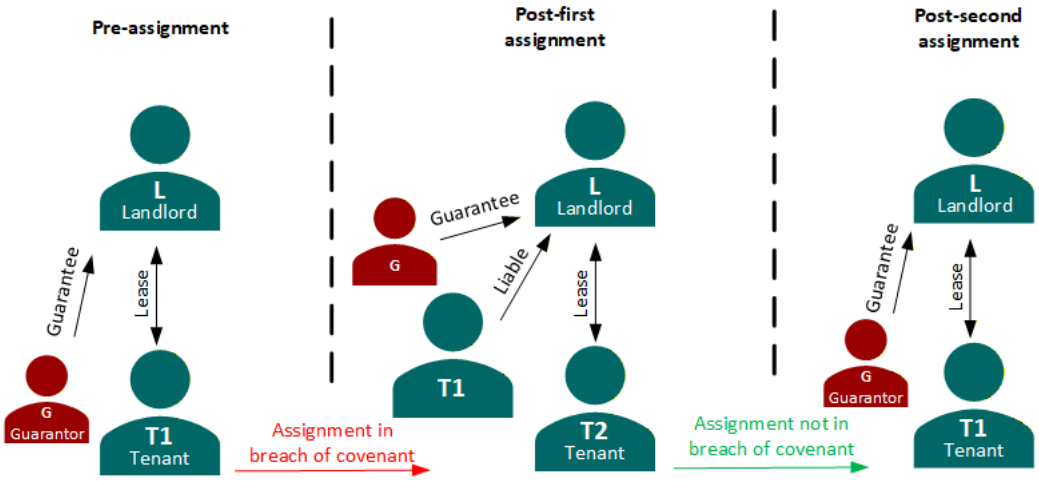


The *UK Leasing Case*

4.85 In the *UK Leasing Case*, a lease was granted to T1. T1's obligations were guaranteed by G. T1 assigned its interest in the lease to T2. While the assignment had the effect of assigning the lease to T2, such that T2 became liable to perform the tenant covenants, it was made in breach of a covenant in the lease. That meant T1 and G were not released from their liabilities by virtue of the 1995 Act.[239]

4.86 The parties wanted to rectify the position so that T1 was, again, the tenant under the lease and G guaranteed T1's performance of the tenant covenants.

4.87 The landlord favoured T2 assigning the lease to T1 with G giving a fresh guarantee. We call this "Possibility 1". If Possibility 1 were adopted, the transactions would look as follows:



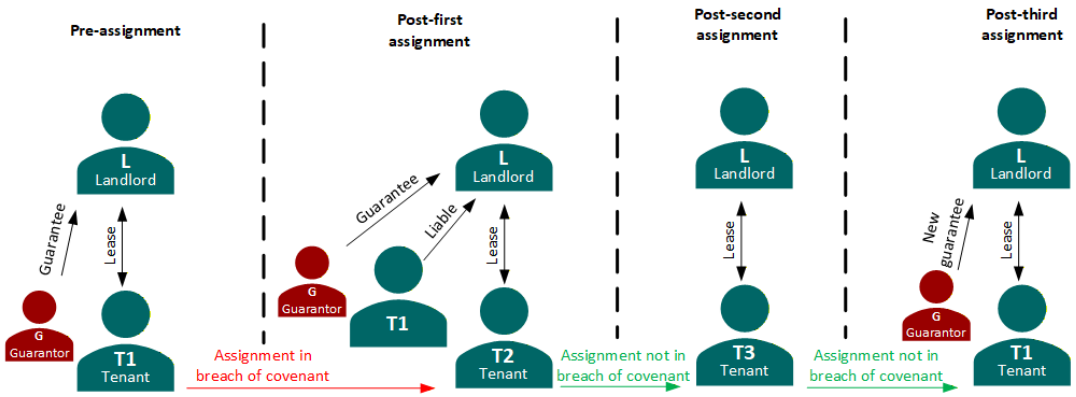
239 See para 4.9 and following above.

4.88 The tenants were, however, concerned that Possibility 1 would mean the guarantee by G would be void as a result of the Anti-Avoidance Provision. They favoured a more convoluted approach with the following steps:

(1) T2 assigns the lease to an associated company, T3. G, at this point, would drop out of the picture.

(2) T3 assigns the lease to T1, at which point G gives a new guarantee.

We call this "Possibility 2". If Possibility 2 were adopted, the transactions would look as follows.



4.89 While the landlord appeared to agree that Possibility 2 would not necessarily fall foul of the Anti-Avoidance Provision, it was, however, concerned that the tenants might not carry through all of the steps. It is worth noting why the landlord was concerned. At the "Post-first assignment" stage in the diagram above, the landlord benefits from T2's covenant together with T1's and G's covenants, with neither T1 nor G having been released by section 5 of the 1995 Act because the assignment from T1 to T2 was in breach of covenant.

4.90 However, at the "Post-second assignment" stage, the lease is assigned to T3 (which was to be a new company) and the assignment is not in breach of any covenant. Upon the assignment to T3, the effect of the 1995 Act would have been that T1 and T2 would each be released from the tenant covenants, and G would be released from its guarantee of T1's obligations.[240] If, at the "Post-second assignment" stage, T3 then failed to assign the lease to T1, or T1 failed to take the assignment, or G failed to give the new guarantee, then the landlord would be in a worse position than it was before the first assignment (which was in breach of covenant).

4.91 A possible solution to the landlord's concern was for the parties to enter into an agreement to undertake the various transactions before T2 assigned the lease to T3. The agreement would oblige each party to undertake each of the steps described in paragraph 4.88 above. However, entering into such an agreement gave rise to a concern that it (or parts of it) would be void due to the Anti-Avoidance Provision.

[240] See paras 4.9 and following and 4.20 and following above.

4.92 A declaration was sought from the court about the validity of Possibility 1 and Possibility 2 for the purposes of the 1995 Act.[241]

4.93 The court first considered Possibility 1. Mr Justice Morgan first explained the effect of the 1995 Act when T2 assigns the lease back to T1 (and that assignment is not in breach of any covenant):

> (1) T2 will be released from the tenant covenants: section 5(2)(a) [of the 1995 Act];
>
> (2) T1 will be released from the tenant covenants entered into at the time the lease was granted to T1 [but that it was not released from on the first assignment which was in breach of covenant]: section 11(2)(b) [of the 1995 Act];
>
> (3) G will be released from the earlier guarantee which it gave [at the time the lease was granted to T1]: section 24(2) [of the 1995 Act];
>
> (4) On the re-assignment to T1, T1 again becomes bound by the tenant covenants: section 3(2)(a) [of the 1995 Act].[242]

4.94 A possible problem lies at (3) in the paragraph above and the effect of the *House of Fraser Case*. Mr Justice Morgan explained the problem as follows:

> The concern is that the decision in [the *House of Fraser Case*] would produce the result that the re-imposition of such a liability on G would frustrate the operation of a provision of the 1995 Act (i.e. section 24(2)) and would therefore be invalid.[243]

4.95 Mr Justice Morgan went on to examine closely what the Court of Appeal found in the *House of Fraser Case*. He referred to the (acceptable) position where a tenant (T1) has its performance of the covenants under a lease guaranteed by a guarantor (G): when T1 assigns its interest in a lease to another person (T2), and enters into an AGA, then G can provide a sub-guarantee (or GAGA) that guarantees T1's performance of the obligations under the AGA.[244]

4.96 The judge "after some hesitation" concluded that the above qualification on the effect of the Anti-Avoidance Provision could be applied in respect of Possibility 1 (meaning that Possibility 1 would work). He explained that:

> On my analysis … when the lease is assigned by T2 to T1, T1 is released from its original obligations [that it took on when the lease was granted] … but becomes bound [again] by the tenant covenants …. If G is released from its original obligations under [the guarantee it gave when T1 was granted the lease], but enters

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241 Multiple other possibilities had been considered by the parties, see the *UK Leasing Case* [2015] EWHC 53 (Ch) at [7].

242 *UK Leasing Case* [2015] EWHC 53 (Ch) at [21].

243 *UK Leasing Case* [2015] EWHC 53 (Ch) at [22].

244 See para 4.84 above.

into a fresh guarantee in relation to the tenant covenants, then G is released to the same extent as T1 is released.[245]

4.97 The court moved on to consider Possibility 2. Mr Justice Morgan analysed the effect of the 1995 Act on the series of transactions envisaged as follows:

(1) on the assignment to [T3], T2 is released under section 5(2)(a) [of the 1995 Act];

(2) on the assignment to [T3], T1 is released under section 11(2)(b) [of the 1995 Act];

(3) on the assignment to [T3], G is released under section 24(2) [of the 1995 Act];

(4) on the assignment to [T3], [T3] becomes bound by the tenant covenants under section 3(2)(a) [of the 1995 Act];

(5) on the assignment to T1, [T3] is released under section 5(2)(a) [of the 1995 Act];

(6) on the assignment to T1, T1 becomes bound by the tenant covenants under section 3(2)(a) [of the 1995 Act].

4.98 The court then considered what would be the effect of G entering into a fresh guarantee on the final assignment to T1. Mr Justice Morgan, relying on the *House of Fraser Case*, concluded that:

> G is effectively released on the assignment to [T3]. G may thereafter, on the subsequent assignment by [T3] to T1 (just like any other assignee), enter into a guarantee in relation to that assignee.[246]

4.99 However, the judge went on to point out that the above was not a complete answer. In the case being considered, the landlord had indicated it would not be willing to consent to an assignment by T2 to T3 unless they were certain the later steps (namely T3's assignment to T1 and a fresh guarantee given by G) were undertaken. The landlord wanted a binding commitment that would happen. The court therefore went on to consider whether such an agreement could be binding on G; the judge concluded it could not:

> The problem arises because, before G is released on the assignment to T3, it is being required to agree that it will commit itself again as a guarantor, admittedly not immediately on the assignment to T3 but shortly thereafter on the assignment by T3 to T1, which T3 and T1 will contract to effect. In view of the meaning given in [the *House of Fraser Case*] to the phrase "otherwise frustrate the operation of any provision of this Act", I consider that the suggested agreement would frustrate the operation of section 24(2) of the 1995 Act.

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245 *UK Leasing Case* [2015] EWHC 53 (Ch) at [32].

246 *UK Leasing Case* [2015] EWHC 53 (Ch) at [36].

The *EMI Case*

4.100 Finally, we consider the *EMI Case*.

4.101 In the *EMI Case*, a lease of around 25 years was granted to HMV UK Ltd ("T1") by the landlord. On the day the lease was granted, a guarantee was entered into by EMI Group plc ("G"). The guarantee provided that, in consideration of the landlord granting a lease to the tenant, G covenanted that "until [T1] is released from liability by section 5 of the [1995 Act]" T1 would (in essence) perform the tenant obligations under the lease.[247]

4.102 Some years later, in 2013, T1 went into administration. In 2014, a licence to assign was entered into. The licence appeared to permit T1 to assign the lease to G. Evidence was given, that was not challenged, that it was G itself which suggested to the landlord that the assignment should take place with the intention that G's "obligations … as Guarantor should, by virtue of the assignment …, be replaced by the tenant obligations under the Lease, at the same time as [T1] was released from [those] obligations by operation of the [1995] Act".[248]

4.103 In the licence to assign, G (as assignee) covenanted with the landlord to pay the rents … and … observe and perform all the covenants … on the [tenant's] part contained in the Lease".[249] The lease was assigned to G. An underlease was then granted by G to HMV Retail Ltd (a new company). Less than one month after the licence to assign and assignment to G were completed, and relying on the *House of Fraser Case*, G's solicitors wrote to the landlord's solicitors stating that "although the assignment of the Lease and the grant of the Underlease were valid, the tenant's covenants in the Lease could not be enforced against G.[250] G applied to court for a declaration that, essentially, its view of the position expressed in the letter to the landlord's solicitors was correct.

4.104 Having considered the law, the judge, Miss Amanda Tipples QC (as she then was), set out a sentence from the *House of Fraser Case* where Lord Neuberger had indicated that "It would … appear … that the lease could not be assigned to the guarantor, even where both tenant and guarantor wanted it".[251] The question in the *EMI Case* was, therefore, whether the statement in the *House of Fraser Case* was correct.

4.105 In reaching her conclusion, the judge explained that:

> The "whole thrust of the [1995] Act" is that there should be no re-assumption or renewal of liabilities, whether on the tenant or the guarantor. … if a tenant and the … guarantor are each liable for the same or essentially the same liabilities as a result of the tenant's covenants of the tenancy, the guarantor cannot as a result of assignment by the tenant to it of the tenancy re-assume those very same …

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247 See the *EMI Case* [2016] EWHC 529 (Ch) at [8] and [9].

248 See the *EMI Case* [2016] EWHC 529 (Ch) at [13].

249 See the *EMI Case* [2016] EWHC 529 (Ch) at [14].

250 See the *EMI Case* [2016] EWHC 529 (Ch) at [16].

251 *EMI Case* [2016] EWHC 529 (Ch) at [48] (see also the *House of Fraser Case* [2011] EWCA Civ 904 at [37]).

liabilities as the tenant. Or, using the terminology used in some of the cases, G1 cannot on an assignment by T1, become T2.[252]

4.106 The judge further explained that:

> The objective effect of the assignment [in the *EMI Case*] is that G1 re-assumes precisely the same liability in respect of the tenant covenants as a result of becoming T2 pursuant to the assignment. It is that consequence which "frustrates" the operation of [the 1995 Act] and the assignment is rendered void by [the Anti-Avoidance Provision]….The guarantor is therefore absolutely precluded from becoming the assignee, on an assignment by the tenant whose tenant covenants he is guaranteeing.[253]

4.107 Having reached her conclusion, the judge considered the effect of it. The "obvious consequence" was that the assignment by T1 to G was void.[254]

4.108 Finally, we note a comment made by the judge towards the end of her judgment:

> As is clear from [the *House of Fraser Case*] the fact … a conclusion [that a guarantor is precluded from becoming the assignee in the circumstances of the case] is unattractively limiting and commercially unrealistic is neither here nor there.[255]

Key principles that can be derived from the cases

4.109 Drawing together the cases above, we consider that several key principles can be stated.[256]

(1) Where a tenant's guarantor enters into (or is required to enter into as a condition of a consent to assign) an AGA which guarantees directly the obligations of an assignee under the lease, that provision is void (see the *Good Harvest Case*).

(2) The principle that the tenant's guarantor cannot guarantee the obligations of an assignee is true both where the guarantee is provided immediately on the assignment, or at some later time (see the *House of Fraser Case*).

(3) Whilst a tenant's guarantor cannot directly guarantee the performance of an assignee on a first assignment:

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252 *EMI Case* [2016] EWHC 529 (Ch) at [78].

253 *EMI Case* [2016] EWHC 529 (Ch) at [79].

254 *EMI Case* [2016] EWHC 529 (Ch) at [89].

255 *EMI Case* [2016] EWHC 529 (Ch) at [86].

256 Some of the principles expressed are, strictly, obiter dictum. That is they are based on a judge's comment (in a judgment) which is not essential to their decision and which is consequently not binding on the same court or inferior courts in future cases. That said, we anticipate that any such comments would be likely to be followed in subsequent cases.

(a) if there is a second assignment, that guarantor can guarantee the performance of the subsequent assignee (see the *House of Fraser Case* and the *UK Leasing Case*);

(b) the guarantor can guarantee the performance of the outgoing tenant's own obligations under an AGA, otherwise known as a sub-guarantee (see the *House of Fraser Case*).

(4) A former tenant who remains bound by the tenant covenants under a lease (for instance, where an initial assignment by the tenant was in breach of covenant) can be re-assigned that lease; and a guarantor of the former tenant who remains bound by the tenant covenants under a lease can guarantee the former tenant's performance on a re-assignment of that lease (see the *UK Leasing Case*).

(5) A tenant may not assign its lease to its guarantor (see the *EMI Case*).

The extent of invalidity of contractual provisions due to section 25 of the 1995 Act

4.110 Before moving on to our discussion and provisional proposal, we highlight, for reasons of clarity, what might be rendered void by the Anti-Avoidance Provision. As a reminder, section 25 of the 1995 Act provides that (emphasis added):

> Any agreement relating to a tenancy is void *to the extent that*—
>
> (a) it would apart from this section have effect to exclude, modify or otherwise frustrate the operation of any provision of this Act, or
>
> (b) it provides for—
>
> (i)the termination or surrender of the tenancy, or
>
> (ii)the imposition on the tenant of any penalty, disability or liability, in the event of the operation of any provision of this Act, or
>
> (c) it provides for any of the matters referred to in paragraph (b)(i) or (ii) and does so (whether expressly or otherwise) in connection with, or in consequence of, the operation of any provision of this Act.

4.111 The inclusion of the words "to the extent that" in section 25 of the 1995 Act indicates that it is not an entire agreement that is rendered void by section 25 (or, at least, that it is not necessarily an entire agreement that is rendered void), rather it is only the part that infringes that section.

4.112 The Court of Appeal considered this point in the case of *Tindall Cobham 1 Ltd v Adda Hotels (an unlimited company)*[257] (which we call the "*Tindall Cobham Case*"). The case is associated with the *UK Leasing Case* (in other words they both arose from the same set of underlying issues).

[257] [2014] EWCA Civ 1215.

4.113 The issue of the extent to which section 25 of the 1995 Act might render void elements of an agreement is not directly relevant to our work. However, we highlight Lord Justice Patten's words regarding that provision here:

> Although the words "void to the extent that" indicate that Parliament did not intend to invalidate more of the relevant agreement than was necessary to safeguard the objectives of the [1995] Act in the context of the particular assignment under consideration, those words do not in my view preclude the Court from taking a balanced approach to invalidation which, whilst neutralising the offending parts of the contract, does not leave it emasculated and unworkable.[258]

The judge went on to say that:

> The [common law] rules of severance are not … of much assistance … to a determination of how much of the contract the Court is required to treat as invalid or unenforceable for the purpose of [section] 25 [of the 1995 Act]. But in carrying out that exercise I can see nothing in [section] 25(1) which prevents the Court from looking at the structure of the agreement in an objective and common sense way.

4.114 In other words, and at the risk of simplifying both the approach taken in, and the circumstances of, the *Tindall Cobham Case*, a court will take a common-sense and balanced approach to determining the extent to which an agreement is impacted by section 25.

DISCUSSION

4.115 We have been told of serious concerns about how provisions are working in the 1995 Act that govern the release of tenants and their guarantors, AGAs, and the Anti-Avoidance Provision. For example:

(1) The Property Litigation Association ("PLA") has described the line of cases starting with the *Good Harvest Case* as "highly unsatisfactory" and as exposing the "commercial absurdity of the operation of the [1995 Act]." In a submission to the Law Commission, the PLA made four proposals for reform, which we summarise below:

(a) To clarify that a guarantor (G) of a tenant's (T1's) covenants under an AGA may do so by way of a sub-guarantee (which was confirmed, albeit in a comment that was not essential to the decision, in the *House of Fraser Case*).

(b) To enable G to stand again as guarantor of T2, provided that it is certified by G, T1, and T2 that T1 and T2 are part of the same group (including LLPs) or partnership.

(c) To clarify that T1 may assign a lease to G.

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258 *Tindall Cobham Case* [2014] EWCA Civ 1215 at [46].

(d) To clarify that where T1 or G is comprised of two or more people, one or more of them may act in a way which, had they acted jointly, would be void under the 1995 Act.

(2) The British Property Federation ("BPF") explained that:

> It is generally believed that reform of the [1995] Act is long overdue. … the Court of Appeal's decision in the [*House of Fraser Case* has] created … confusion for both tenants and landlords around the issues of repeat guarantees.

It continued by saying:

> The BPF is keen to ensure that commercial real estate transactions remain as fair and open as possible. The [1995] Act … does not support this spirit of openness but rather creates too many grey areas.

(3) The City of London Law Society explained that:

> [the] Act is an impediment to what should be day-to-day transactions such as a guarantor guaranteeing an assignee of a lease or becoming the assignee. This … can interfere with intra-group restructuring or transfers between business partners and can be more detrimental to the tenant and its guarantor than the landlord.

(4) The Chancery Bar Association (the "CBA") indicated that:

> … there are serious problems with the 1995 Act which merit consideration in depth. One example is [the *EMI Case* where] it was held that a lessee cannot assign the lease to its guarantor notwithstanding that they might both have powerful commercial reasons for wishing to do this….

The CBA also indicated that provisions of the 1995 Act relating to guarantees are "not fit for purpose if they hinder, rather than reflect, the way in which the commercial world operates".

4.116 We share the concern that the 1995 Act has caused considerable problems in commercial leasehold arrangements (including for the courts when deciding whether transactions are or are not enforceable).

4.117 While, in some cases, the courts have gone further than strictly necessary in order to seek to provide clarity about the law, and to help steer the law to pragmatic conclusions, that has not always been the case. That is unsurprising because there is a limit to what can be accomplished by the courts in the face of a statute with an anti-avoidance provision that is to be "interpreted generously, so as to ensure the operation of the [1995] Act is not frustrated".[259] It follows that some of the outcomes of

[259] See *London Diocesan Fund v Avonridge Property Company Limited* [2005] UKHL 70 at [14] and [18] by Lord Nicholls.

the decisions (and remaining uncertainty arising from those decisions) create issues that need statutory intervention to address.

4.118 It is our view that the primary aims of the 1995 Act (in particular the general protection provided to assigning tenants so that they do not remain "on the hook" for covenants long after they have parted with possession of the premises) can, and must, be preserved, whilst also permitting arrangements that are sensible and appropriate.

4.119 Bearing in mind what we say above, we make a provisional proposal to reform the 1995 Act below.

Our starting point for reform

4.120 The foundation of the 1995 Act, at least so far as new tenancies are concerned, is the automatic release of tenants on an assignment of a lease. We explain this principle at paragraph 4.6 and following. It is this principle that prevents the problem of original covenantor liability that was caused by privity of contract and a key reason for the passing of the 1995 Act.

4.121 Our starting point for reform is that the foundation mentioned above is eminently sensible. It marked a sea change in the way in which landlord and tenant law operated and corrected considerable unfairness. We see no reason to change or undermine this foundation.

4.122 The default release of others – notably guarantors – at the same time and to the same extent as the tenant is also necessary. That is because the alternative risks a "shadow" privity of contract issue (where a third-party guarantor of a tenant remains liable on the tenant covenants even though the tenant itself is released). If that were not the case then it takes little imagination to envisage scenarios where landlords would demand – as a matter of course – a guarantor enter into a lease, not simply to guarantee the performance of the tenant covenants while a particular tenant is in possession, but to, essentially, guarantee the performance of those covenants by all future tenants as well.

4.123 We call the above the "Foundation Rules" in the remainder of this chapter.

4.124 We propose no change to the Foundation Rules; to do so would unravel the 1995 Act and unleash, once again, the possibility of original covenantor liability.

4.125 Following that conclusion, we must consider how to resolve the issues that we have identified. There are two possibilities.

(1) First, we could consider amending the exceptions to the Foundation Rules. Only limited exceptions currently exist.

(a) Section 11 of the 1995 Act provides for a small number of "excluded assignments": assignments where a tenant – and therefore also any guarantor – is not released. The principal exception is where an assignment is in breach of covenant.

(b) AGAs: agreements that comply with section 16 of the 1995 Act.

(2) Second, we could consider amending the Anti-Avoidance Provision. However, we repeat a paragraph from our 1988 Report:

> Clearly, there are many ways in which the parties could seek to circumvent the rules we are proposing. Agreements for this purpose might be made outside the lease or agreement to assign, and might be made with third parties. We cannot foresee all the ways in which it could be done, and we do not consider that it would be satisfactory for statute to try to identify and nullify each individually. We recommend a general provision aimed at invalidating all contracts to the extent that they have the effect of subverting the rules we propose.[260]

The above was the explanation we gave in 1988 of the need for an anti-avoidance provision. While the Anti-Avoidance Provision (implemented in section 25 of the 1995 Act) is not identical to that which we proposed, we maintain that the 1995 Act must include a provision designed to avoid its circumvention.

4.126 An eventual solution – which we will consider in our final report – may involve a combination of the possibilities set out above.

4.127 In approaching any reform, we have firmly in mind that the 1995 Act applies not only to leases that are negotiated extensively by well-represented parties (as was, or was likely to have been, the position in the cases considered above),[261] but also to leases – in both the commercial and residential sphere – where tenants are not represented. Absent the 1995 Act, the problem of original covenantor liability could have been eliminated through "tenant-focussed" drafting in leases. While that was likely done in some cases, it was not done in all and the 1995 Act was (and is) therefore necessary.

4.128 It follows that the reform we are considering is targeted, with a tight focus on addressing the concerns that have arisen in the commercial sphere.

Facilitating transactions involving closely connected parties

4.129 The issues that we have been aware of in advance of this Consultation Paper revolve around transactions where all of the parties – the current tenant, the incoming tenant and their guarantors – are, in some way, closely connected in a business sense. That might be because:

(1) they are all companies that exist within the same group of companies;

(2) they are partners in the same business; or

(3) there is some other substantial business relationship tying them together, for example there is a franchise arrangement (such as where the franchisor is a co-tenant with the franchisee under a lease).

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260 1988 Report, para 4.58.

261 See para 4.57 and following above.

4.130 In the text that follows we consider the above relationships, in each case with a view to enabling business arrangements and transactions that the parties consider to be beneficial, but that might be void under the Anti-Avoidance Provision.

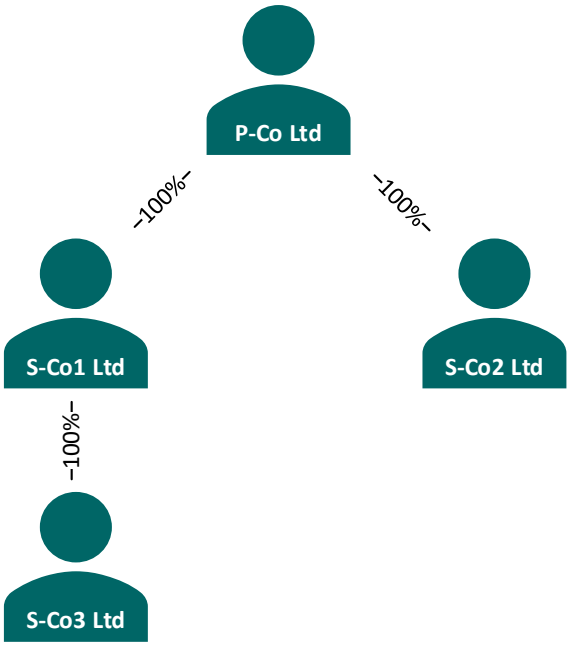
4.131 However, before doing that we note that, in this Consultation Paper, we are focussing upon outcomes. We explain what we believe the 1995 Act should permit (or, rather, what it should not render void). Exactly how that is achieved – in other words, precisely what amendments to the 1995 Act might be needed to achieve these outcomes – is a question for our final report.

Facilitating transactions involving group companies

4.132 It will be apparent from the cases considered above that many of the issues that have been considered by the courts have arisen in the context of transactions involving groups of companies. A significant proportion of the concerns we have told by stakeholders also arise from such transactions.

4.133 A group of companies can be complex, but, briefly, it is a concept that looks to relationships of ownership and/or control between corporate bodies.

4.134 One example of a "group" of companies is set out below.



4.135 In the example, P-Co Ltd owns 100% of the shares in both S-Co1 Ltd and S-Co2 Ltd. P-Co Ltd is the "parent company" or "holding company" of both companies, and both S-Co1 and S-Co2 are "subsidiaries" of P-Co Ltd. Similarly, S-Co1 Ltd owns 100% of the shares in S-Co3 Ltd; S-Co1 Ltd is the "parent company" or "holding company", and S-Co3 Ltd is the "subsidiary".

4.136 As a general rule, we consider that transactions involving group companies should not be rendered void by the 1995 Act. The problems that the 1995 Act were intended to address were not to do with assignments between group companies (and related guarantees), rather they were to do with (for example) one shopkeeper assigning their interest in a lease to a another, unrelated, shopkeeper.

4.137 Where there is a corporate group relationship between G, T1 and T2 it is likely that the group and its members are sophisticated and have access to legal advice. It is our view that a new exclusion to the Foundation Rules along the lines of that described would solve significantly more problems than it creates, and facilitate ordinary, and advantageous (to G, T1 and T2) corporate transactions.

4.138 With this in mind, where:

(1) a tenant (T1), whose performance of the tenant covenants in the lease is guaranteed by G, assigns its interest to another tenant (T2); and

(2) T1, T2 and G are group companies;

we consider the following should be permissible (we note some of these are already possible, or likely to be possible under the current law):

(3) T1 should be able to guarantee T2's performance of the tenant's obligations in the lease in an AGA (this is permitted under the current law);

(4) G should be able to guarantee T1's covenants in the AGA by way of a sub-guarantee (this is permitted under the current law);

(5) G should be able to guarantee T2's covenants by way of co-guarantee with T1 in the AGA (this is not permitted under the current law);

(6) G should be able to be the only guarantor under the AGA (allowing T1 to drop out) (this is not permitted under the current law);

(7) T1 and/or G should be able to provide a direct guarantee to the landlord of T2's obligations (meaning there is no AGA) (this is not permitted under the current law); and

(8) T1 should be able to assign the lease to G (this is not permitted under the current law).[262]

4.139 It is our view that both the transactions themselves (namely, the assignment and/or the giving of a guarantee), and any agreement to enter into such transactions (including allowing for it to be made a condition of a landlord giving licence to assign), should be valid.

4.140 However, it is also our view that the test of whether the relevant parties are within the same group would need to be met at both the time any agreement is entered into and also when the transaction is ultimately completed.

4.141 Bearing in mind all that we say above, we believe a new exception to the Foundation Rules would be necessary to permit (and the Anti-Avoidance Provisions should not

[262] So far as the assignment of the lease to the guarantor is concerned, we have made a provisional proposal at para 4.210 to enable the assignment of a lease to a guarantor in all circumstances, not just those where the parties are in the same group.

therefore catch) transactions where all of the assignor tenant(s), assignee tenant(s) and their guarantor(s) (if any) are group companies.

Consultation Question 6.

4.142 We provisionally propose that the 1995 Act should clearly facilitate assignments and guarantees between members of the same group of companies as set out in the Consultation Paper at paragraphs 4.132 to 4.141.

Do consultees agree? Please explain why.

Consultation Question 7.

4.143 We provisionally propose that the rule proposed in Consultation Question 6 should apply to both the assignment itself and any agreement to enter into the assignment (including allowing for it to be made a condition of a landlord giving consent to assign). However, where there is an agreement to enter into the assignment and a later assignment, the relevant parties to both should be – at the time each is entered into (or consent to an assignment is given) – members of the same group of companies.

Do consultees agree? Please explain why.

4.144 If our provisional proposals are taken forward we will need to define a "group of companies".

4.145 There are various existing definitions on the statute book for what constitutes a group of companies. One example is set out in section 42 of the Landlord and Tenant Act 1954. Section 42 establishes that:

> … two bodies corporate shall be taken to be members of a group if … one is a subsidiary of the other or both are subsidiaries of a third body corporate or the same person has a controlling interest in both.

"Subsidiary", in the above, is defined in section 46(2) of the 1954 Act by reference to section 1159 of the Companies Act 2006, which sets out that:

> A company is a "subsidiary" of another company, its "holding company", if that other company -
>
> (a) holds a majority of the voting rights in it, or
>
> (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or

(c) is a member of it and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it,

or if it is a subsidiary of a company that is itself a subsidiary of that other company.

4.146 We note that the definition of "company" in section 1159 of the Companies Act 2006 "includes any body corporate".[263] "Body corporate" is defined in section 1173 of the Companies Act 2006 to "include a body incorporated outside the United Kingdom, but [does] not include–

(a) a corporation sole, or

(b) a partnership that, whether or not a legal person, is not regarded as a body corporate under the law by which it is governed.

4.147 The definition of "company" set out above is wide and Limited Liability Partnerships (commonly called LLPs) would be capable of forming part of the group of companies for the purpose of our provisional proposals.[264] However, while this is simple where the LLP is a parent company and a company is a subsidiary (a parent LLP can hold shares in a company in the same way that a parent company can), it is less obvious how it might work where the LLP is a subsidiary. In particular, it is not certain how the following tests for when a body corporate is a subsidiary of another should (or could) apply to LLPs:

A [body corporate] is a "subsidiary" of another [body corporate] … if that other [body corporate]:

(a) holds a majority of the voting rights in it, or

(b) is a member of it and has the right to appoint or remove a majority of its board of directors.[265]

4.148 The issue above is more easily understood by examining how parties to an agreement might handle the uncertainty from a contractual drafting point of view. The following provision is from an agreement that was relevant in a case involving a debt: *Alphier Capital LLP v Blyvoor Gold Capital (Pty) Ltd*.[266] Despite the difference in subject matter, it is nevertheless useful. In that case, the court examined provisions in documents, including the following (emphasis added):

Group means a party's holding companies and subsidiaries, from time to time. The terms "holding companies" and "subsidiaries" will be construed in accordance with section 1159 of the Companies Act 2006. *In the case of a limited liability partnership which is a subsidiary of a company or another limited liability partnership, section 1159 of the Companies Act 2006 will be amended so that: (I) references in sub*

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263 See the Companies Act 2006, s 1159(4).

264 A Limited Liability Partnership is expressly a type of body corporate, see the Limited Liability Partnerships Act 2000, s 1(2).

265 See para 4.145 above.

266 [2024] EWHC 2649 (Ch).

sections 1159(1)(a) and (c) to voting rights are to the members' rights to vote on all or substantially all matters which are decided by a vote of the members of the limited liability partnership: and (ii) the reference in sub section 1159(1)(b) to the right to appoint or remove a majority of its board of directors is the right to appoint or remove members holding a majority of the voting rights.[267]

4.149 The above highlights how, for the purposes of contractual agreements, parties are able to clarify how the definition of subsidiary might apply to LLPs. However, without an amendment to the Companies Act (or case law), the way in which section 1159 of the Companies Act 2006 operates in a situation where a company (or LLP) seeks to argue an LLP is its subsidiary is unclear.

4.150 It is our preliminary view that what constitutes a group company for the purposes of creating added flexibility in the 1995 Act should be familiar to those engaged in landlord and tenant matters, and we are therefore attracted to using the definition set out in the Landlord and Tenant Act 1954.

4.151 We recognise that there is some difficulty in the definition relating to how it may operate with respect to putative LLP subsidiaries. This as an issue that impacts areas beyond landlord and tenant law. A general amendment to the Companies Act 2006 is out of scope of this project for that reason. Furthermore, we do not regard a limited amendment (to clarify whether and how LLPs can be subsidiaries within a corporate group structure for the purposes of the 1995 Act) to be appropriate.

Consultation Question 8.

4.152 We provisionally propose that what constitutes a group of companies for the purpose of facilitating more transactions involving them to be valid for the purposes of the 1995 Act should be based on section 42 of the Landlord and Tenant Act 1954. Do consultees agree? Please explain why.

4.153 In particular, we invite views from consultees on the possibility of using the definition in section 42 of the Landlord and Tenant Act 1954 and whether there is a more appropriate definition that might be employed.

Facilitating transactions involving partnerships

4.154 Much of our discussion in this chapter has focussed on the challenges, and problems, that arise from transactions involving group companies. We have also considered Limited Liability Partnerships (LLPs) which are a type of body corporate.

4.155 In the paragraphs below, we consider issues that arise in relation to a different type of business arrangement – partnerships.

4.156 It is our understanding that there are similar issues for partnerships as those we consider above for groups of companies (and LLPs) and that the 1995 Act is standing

[267] *Alphier Capital LLP v Blyvoor Gold Capital (Pty) Ltd* [2024] EWHC 2649 (Ch) at [48].

in the way of business arrangements and transactions that the parties consider to be beneficial.

4.157 In considering the issues, we rely on the following example:

(1) A is a sole-trader who operates a business providing cleaning services for homes;

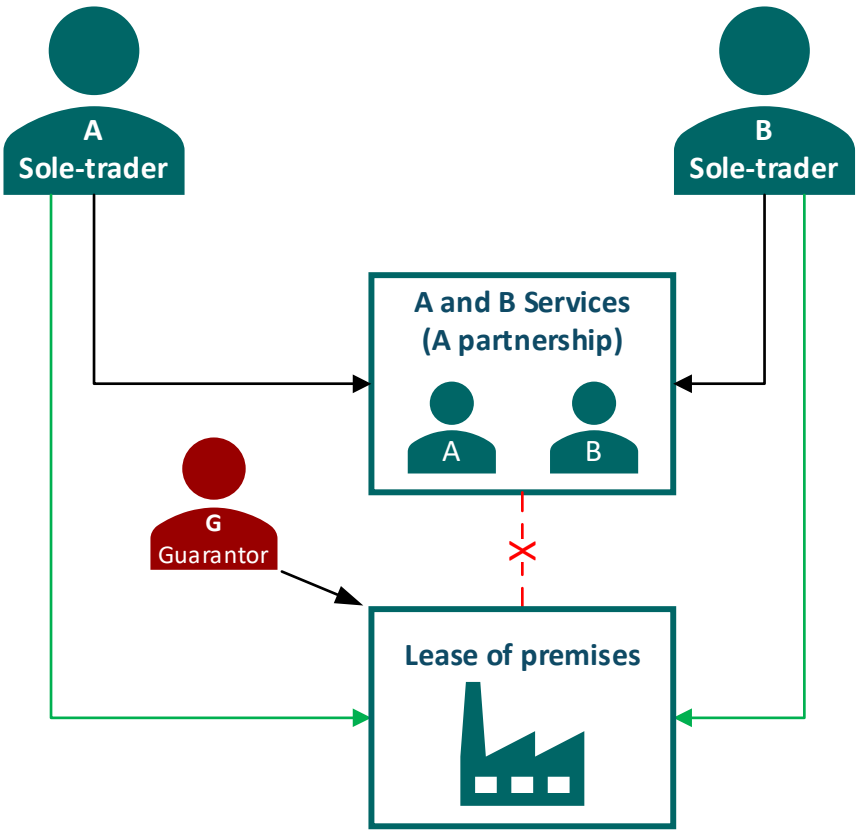
(2) B is a sole-trader who operates a business providing gardening services for homes;

(3) A and B believe their businesses would work well together, they establish a partnership, and trade as "A and B Services".

(4) A and B wish to take a lease of a property from which they will conduct clerical functions relating to the business. In this case, A and B Services cannot be the tenant because it has no legal personality. Instead, both A and B enter into the lease together as the "tenant". A and B are jointly and severally responsible for performing the tenant covenants under the lease.

(5) The landlord requires that a guarantor be appointed to guarantee performance of the tenant obligations in the lease by A and B. G, a third-party, agrees to be the guarantor and the lease is granted by the landlord to A and B, with G a party as guarantor, on that basis.

4.158 The diagram below illustrates the example.



4.159 Later, B wishes to sell their interest in the partnership to C and A agrees. At the same time, B also wishes to cease to have any obligations under the lease. A, B and C agree that the lease should be assigned. To assign the lease, A and B (together) would be the assignor, and A and C would be the assignee. G remains happy to be the guarantor under the lease.

4.160 In this situation, we consider it to be certain that the repeat guarantee by G would be void under the Anti-Avoidance Provision.[268] However, it is not clear what other effect(s) the 1995 Act (and the Anti-Avoidance Provision) might have. For example, a leading textbook on partnership law explains two issues as follows:

> In a case where the lease is merely vested in four partners' names, it will seemingly not be possible to assign the lease into the names of a new group of partners if that group comprises one or more of the original tenant partners. … where all the partners are joined merely as guarantors, this prohibition would mean that an assignment to a new group of partners would not be possible, whatever its makeup.[269]

4.161 The reason given for this conclusion that it is not possible to assign the lease in those circumstances is because it "would frustrate the effectiveness of the release of *all* the existing tenant partners under the [1995 Act]…".[270]

4.162 An article considering the same point raises a similar concern, but the conclusion is more tentative. The author indicates that an assignment of a lease from "A, B, C, and D … to B, C, D, and E, thereby releasing A … may not be possible". In the article, the author further indicates that:

> The courts have interpreted [the Anti-Avoidance Provision] broadly in [the *House of Fraser Case* and the *EMI Case*]. These decisions confirmed that a guarantor cannot guarantee an immediate assignee or take an assignment as … [the Anti-Avoidance Provision] prevents a person who has liability under a lease and whose liability would be released under … the Act from taking on liability either as assignee or guarantor. The effect of these decisions is to make invalid an assignment to a person who was a guarantor of the assignor. The cases concerned guarantees and not assignments between partners, so it remains possible that the courts might distinguish the situation in which the assignment was to some of the assigning tenants plus others. However, the reasoning … in the … cases would seem as applicable to the release of assigning tenants as it is to guarantors.[271]

4.163 We agree that the law is uncertain; however we are also uncertain about some of the analysis in the extracts above.

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268 See para 4.109 above.

269 See R l'Anson Banks, *Lindley and Banks on Partnership*, 21st ed (2024), para 18-96.

270 See R l'Anson Banks, *Lindley and Banks on Partnership*, 21st ed (2024), ch 18, n 291.

271 S Hartley, "Partnerships and leases: A bad combination?", *Solicitors Journal* (2016), 160(40) (Property Focus), 22.

4.164 Before explaining our view, we must examine who is the tenant under a lease held by partners (or any co-owners) and then consider what it is that the 1995 Act – including the Anti-Avoidance Provision – is doing.

4.165 In a case where A and B (in our example) are, together, the tenant under a lease, then they will be "joint tenants".[272] It is not possible for the legal ownership of the leasehold interest created by the lease to be held otherwise.[273] In this situation, we do not think it is right to view A and B as somehow separate tenants under the lease who are individually assigning their interest in it to A and C. Rather it is our view that A and B are (together) a single tenant assigning to a new, single tenant, A and C (together). It is also our view that the two tenants – "A and B", and "A and C" – are legally distinct.

4.166 As a result, from a legal perspective (and ignoring the Anti-Avoidance Provision for the moment) there is nothing in section 5 that prevents the assignor tenant (A and B) from being released from the tenant covenants on an assignment and the assignee tenant (A and C) immediately becoming bound by them. From a practical perspective, the effect of section 5 in that situation would be as follows:

(1) A (as an individual) would be bound by the tenant covenants both before and after the assignment (in their capacity as part of the assignor, and then part of the assignee);

(2) B (as an individual) would be bound by the covenants before the assignment and released afterwards (their its capacity as part of the assignor); and

(3) C (as an individual) is bound by the covenants after the assignment (in their capacity as part of the assignee).

4.167 The question, then, is whether the Anti-Avoidance Provision prevents that outcome. As a reminder, the Anti-Avoidance Provision provides that:

> Any agreement relating to a tenancy is void to the extent that … it would … have effect to … frustrate the operation of any provision of this Act…[274]

4.168 Assuming our analysis of who and what constitutes the tenant is correct, it is our view that, subject to what we say at paragraph 4.171 and following below, there is a good argument that the Anti-Avoidance Provision would not automatically invalidate the assignment from A and B to A and C. On our analysis, the two tenants – A and B (together), and A and C (together) – are legally distinct. Again, subject to what we say at paragraph 4.171 and following below, we do not believe that the operation of section 5 of the 1995 Act is being frustrated. In this case, a tenant (A and B) is

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272 We use the phrase "joint tenants" in a legal sense. It is complex, but, in short, being "joint tenants" means that each person who is a joint tenant has equal rights to the whole of the property. Contrast "tenants in common" where each person owns a separate share in a property (for example, one person might own 80% of a property's value, and the other owns 20%). It is not possible to own a legal (rather than a beneficial) interest in a land as tenants in common.

273 Law of Property Act 1925, s 36(2).

274 1995 Act, s 25(1).

released from its obligations under the lease and a new tenant (A and C) takes on those obligations.

4.169 In addition to that being our assessment of the legal position, we also note section 28(4) of the 1995 Act, which explains that:

> Where two or more persons jointly constitute either the landlord or the tenant … any reference … to the landlord or the tenant is a reference to both or all of the persons who jointly constitute the landlord or the tenant, as the case may be ….

4.170 However, even if this analysis were wrong, we highlight that the assignment of a lease to a person who was, immediately prior to the assignment, bound by the tenant covenants under a lease was considered in the *UK Leasing Case*. In that case, Mr Justice Morgan concluded ("after some hesitation") that:

> … when the lease is assigned by T2 to T1 [in a situation where, immediately prior to the assignment, T1 was also still bound by the tenant covenants in the lease because the assignment was in breach of covenant and so caught by section 11 of the 1995 Act], T1 is released from its original obligations [that it took on when the lease was granted] … but becomes bound [again] by the tenant covenants ….[275]

The position reached by Mr Justice Morgan adds weight to the argument that an assignment from A and B (together) to A and C (together) would not be invalidated by the Anti-Avoidance Provision.

4.171 The discussion above concerns an assignment that is freely entered into, not in pursuance of any prior agreement. We consider now the position of an agreement to enter into a future assignment (rather than the assignment itself).

4.172 Consider the following variation to the example above:

(1) The tenant, A and B (together) take a lease of a property from a landlord, L. The lease contains an obligation that, on an assignment, A and B will become a co-tenant with any future assignee.

(2) A and B wish to assign the lease to A and C, and the landlord demands, in accordance with the obligation in the lease, that B also becomes a co-tenant with A and C (despite B planning to vacate the premises).

4.173 We consider that a court might have the latitude to conclude that the provision in the lease was void (and, in saying that, we note, again, that an anti-avoidance provision in a statute is to be "interpreted generously").[276] If the provision were to be enforceable, then A and/or B may never escape liability on any future assignment, despite either or both wishing to have nothing further to do with the premises. It is important to bear in mind that it is the policy of the 1995 Act to release a tenant on an assignment and, in the language of the Anti-Avoidance Provision, the provision in the lease is arguably a

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275 *UK Leasing Case* [2015] EWHC 53 (Ch) at [32]. Also see para 4.96 above.

276 See *London Diocesan Fund v Avonridge Property Company Limited* [2005] UKHL 70 at [14] and [18] by Lord Nicholls and para 4.117 above.

term which "frustrate[s] the operation of any provision [being section 5 in this case] of [the 1995] Act".

4.174 We are, nevertheless, cautious about what we say above. We acknowledge that it does not sit easily with our (stronger) view that the assignment from A and B (together), if freely entered into, to A and C (together) would be acceptable under the 1995 Act. Nor would B be in precisely the position the 1995 Act was trying to avoid on its implementation; at the very least, B, being a co-tenant, would have a possessory interest in the premises that guarantors (and original covenantors before the advent of the 1995 Act) do not have.

4.175 We consider the law to be unclear at this time. That lack of clarity is, in itself, unhelpful. However, in addition, if there is an inability to bind individual partners to enter into future assignments (at least "within" the same partnership), that inability is problematic. For example, consider the following:

(1) A partnership has 5 partners, A, B, C, D and E. Partners A, B, C and D are the tenant for the purposes of a lease.

(2) The lease contains two provisions relating to the assignment of the lease.

(a) The first is a lengthy provision and relates to the situation where what is proposed by the tenant is an assignment to a third-party. Amongst other things, it provides that the landlord must be satisfied, acting reasonably, that the assignee tenant has the same (or greater) covenant strength as the assignor tenant, and that the assignor enter into an AGA to guarantee the performance by the assignee of the tenant covenants.

(b) The second is a "streamlined" assignment provision relating specifically to the partnership. It sets out that where an assignment is to four partners carrying on the same business, the landlord's consent is not required and no AGA is required. However, it also contains an obligation such that, where any of the partners who comprise the "tenant" under the lease retire from the partnership or die, the tenant will procure that the partner who leaves is replaced by another partner by assigning the lease to the remaining partners and the new partner.

4.176 We explain above that there may be concern about the obligation in (b) – being a future obligation to enter into an assignment – being void. That is despite it being an advantage to the tenant partnership to be able to use the streamlined assignment provision.

4.177 In what follows, we turn back to our original example set out at paragraph 4.157 above (being A and B in partnership trading as A and B Services) and consider the position of G, the guarantor.

4.178 In the situation set out in that example, we believe the law is clear that the parties' plan – which they are all amenable to – of having G be the guarantor of A and B's performance of the tenant covenants before the assignment, and of A and C's obligations after the assignment, will fail.

4.179 We explained above that a tenant is released from its obligations under the tenant covenants in a lease on its assignment because of section 5 of the 1995 Act. Section 5 provides that, as from the assignment, "the tenant is released from the tenant covenants of the tenancy".

4.180 However, a guarantor is released from its liabilities because of section 24 of the 1995 Act. Section 24 has the effect of releasing a guarantor "to the same extent as the tenant is released from that tenant covenant".

4.181 On our analysis, the tenant – A and B (together) – is released from the obligations under the lease as from the assignment to A and C. It follows that G must also be released from its obligations to the same extent because of section 24.

4.182 If G purports to guarantee the performance of the tenant obligations by A and C, then G is, in practice, not released at all (while A and B (together) are released absolutely).[277] The effect is that, if G gave the repeat guarantee, it could be said that section 24 of the 1995 Act was frustrated and the Anti-Avoidance Provision would render G's repeat guarantee void.

Conclusion

4.183 We believe that the current law is both unclear and unsatisfactory. Subject to the protections we note in paragraphs 4.189 and following below, we believe the law should be made clear that (using the actors in the example set out at paragraph 4.157 above):

(1) A and B should be able to assign a lease to A and C (we believe this is possible under the existing law, but acknowledge there are differing views and the law is uncertain – see paragraph 4.160 and following above);

(2) G should be able to act as a direct guarantor (not merely as a sub-guarantor under an AGA) both before and following the assignment to A and C (we believe that this is not possible under the existing law – see paragraph 4.177 and following above); and

(3) It should be possible to enter into an agreement with the landlord to achieve the outcomes expressed above.

4.184 Furthermore, and again subject to the protections we note in paragraphs 4.189 and following below, we believe that the law should be clear that other variations of the outcomes set out in the paragraph above are valid, including that:

(1) A and B should be able to assign a lease to A, B and C with G continuing to act as direct guarantor (as above, we believe that G's repeat guarantee is not possible under the existing law – see paragraph 4.109 above).

(2) A and B should be able to assign a lease to G (this is not possible under the existing law).

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[277] We note that the 1995 Act would allow for A and B to give an AGA, and for G to guarantee the obligations of A and B under the AGA. See para 4.84 above.

(3) A and B should be able to assign a lease to A, C and G (this is unlikely to be possible – we explained that G cannot provide a repeat guarantee, but, equally, G cannot become the tenant; what is unclear is whether the effect of the 1995 Act would be to allow such an assignment to have effect as an assignment to A and C, or whether the entire assignment would be void).

(4) It should be possible to enter into an agreement with the landlord to achieve the outcomes expressed above.

4.185 Nonetheless, despite us believing greater flexibility for partnerships would be beneficial, we are more cautious about reform where there is a partnership (with or without a guarantor being involved) than we are where there are companies (or LLPs) within the same group. Three factors underpin this view:

(1) Partnerships can be less well organised and "consciously" constructed than corporate group structures – they can come into being without formality.

(2) While this will not always be true, we believe it will be less likely that partnerships (and individual partners within them) will obtain legal advice than companies and LLPs within group structures.

(3) The partners in a partnership may move in and out of the business relationship. Where those partners are individuals, a partner may, for example, wish to retire while the partnership carries on.

4.186 There is a risk that enabling too many types of transaction could lead to issues similar to those that gave rise to the 1995 Act. For example, a partner, long-since retired, being pursued for the performance of obligations because they have been forced to remain a guarantor or co-tenant (no matter how many times, or to whom, the lease is assigned).

4.187 We believe that the law should be made more flexible, but that there must also be some important protections and limitations established.

4.188 For example, while we countenance B being part of the assignee tenant in the circumstances above, we do not countenance B becoming a guarantor (otherwise than under an AGA). In our view, if a landlord could insist on that, it would be a step too far. However, nothing would prevent a landlord being able to insist on B (together with A), as the assigning tenant, entering into an AGA (as may happen now).

4.189 Accordingly, in the scenarios we consider at paragraphs 4.183 and 4.184 above, and to the extent that they are not already permitted by the 1995 Act, we believe that they should be permissible. However, that would only be where the assignment, or the agreement relating to the assignment, is from a tenant comprised of one set of partners who are in a partnership to another set of partners who are (or are in part) in substantially the same partnership.

4.190 That test would require two definitions:

(1) "**partnership**": we believe the most appropriate definition of partnership for the purposes of our provisional proposal would be that contained in section 1 of the Partnership Act 1890:

> Partnership is the relation which subsists between persons carrying on a business in common with a view of profit.

(2) "**substantially the same partnership**": this would be a new definition, we envisage it would be met where:

(a) the component partners making up the assignee tenant and the component partners making up the assignor tenant were engaged in substantially the same business; and

(b) at least one of the component partners in the assignee and assignor is the same.

4.191 We make a provisional proposal to achieve the above outcomes. We are also keen to understand from consultees whether they have any concerns about abuse of individuals comprising a single tenant (such as A, B and/or C in the example we use above – whether they are in a partnership or not) or their guarantors, particularly where those parties are not advised.

4.192 We are particularly interested in understanding whether, in giving certainty to the types of transactions mentioned above, it might result in landlords requiring those outcomes (for example, requiring G to be an assignee under any assignment). We consider this risk is mitigated by the need for the assignee parties to be in "substantially the same partnership" as the assignor, but we welcome consultees' views.

Consultation Question 9.

4.193 We provisionally propose that the 1995 Act should clearly facilitate assignments within partnerships as set out in the Consultation Paper at paragraphs 4.154 to 4.192 and for repeat guarantees to be valid in such circumstances.

The above would require that the partners comprising the assignor and assignee to be in substantially the same partnership. This would be met where:

(1) the component partners making up the assignee tenant and the component partners making up the assignor tenant were engaged in substantially the same business; and

(2) at least one of the component partners in the assignee and assignor is the same.

Do consultees agree? Please explain why.

Consultation Question 10.

4.194 We invite consultees' views on whether the greater flexibility afforded by the provisional proposal set out in Consultation Question 9 risks tenants and/or their guarantors (particularly those who are not advised) being put in a materially worse position than under the existing law.

Facilitating other substantial business relationships

4.195 In addition to concerns relating to transactions involving group companies and partnerships, we have been told of other relationships where greater flexibility would be beneficial. For example, we understand there are franchise arrangements where the franchisor is a co-tenant under a lease where the franchisee is the other co-tenant, but there is no partnership or group company relationship.

4.196 We believe it may be possible to accommodate other substantial business relationships within the framework of the 1995 Act, if that is required. For example, it might be possible to facilitate transactions where there is a "connecting party" (such as a franchisor) with a "substantial business relationship" between a party who is leaving the "tenant" relationship in the lease ("A") and the party who is taking on that relationship ("B").[278]

4.197 It will be clear from the provisional proposals at paragraphs 4.142 and 4.193 above – and the discussion preceding them – that we are less concerned about widening exclusions to the effect of the 1995 Act too far in the case of transactions involving group companies, and more concerned in the case of transactions involving partnerships. However:

(1) groups of companies are not a small undertaking. They are, generally speaking:

(a) planned (with each component company having some function within the group);

(b) well-advised; and

(c) (while each component company within the group is legally distinct) the group is, generally speaking, likely to be have at least some "direction" as a whole.

(2) so far as partnerships are concerned, there can be:

[278] In the franchise example, the franchisor would be the connecting party who has a substantial business relationship with both A and B (even though A and B have no relationship as between themselves). (For the avoidance of doubt, it would not be enough for the "substantial business relationship" to relate solely to the assignment of the lease itself).

(a) less formality in establishing a partnership, indeed one can arise without formal documentation;[279] and

(b) less certainty in relation to direction and membership, for example a partner may wish to retire,[280] or otherwise leave a partnership (and there may be power in an established partnership to expel a partner).[281]

4.198 Putting our concern another way, our apprehension about widening exclusions to the effect of the 1995 Act too far becomes greater as the relationship between assignor tenants, assignee tenants, and their guarantors, becomes, or risk becoming, more nebulous and/or "tenuous".

4.199 We do not discount the possibility of widening the exclusions further, for example to facilitate the type of franchise agreement mentioned above. However, we do not have sufficient information at present to make a provisional proposal.

4.200 We welcome from consultees information regarding the types of business relationships that exist and which would not benefit from the provisional proposals we make at paragraphs 4.142 and 4.193 above. We also seek evidence of the prevalence of such business relationships in the market and any adverse impact that the 1995 Act has on them.

Consultation Question 11.

4.201 Where consultees believe the 1995 Act currently has an adverse impact on business relationships (other than in respect of transactions involving group companies and partnerships) we invite consultees' views, together with evidence where possible, on the following:

(1) the types of business relationships;

(2) the prevalence of such business relationships in the market; and

(3) the nature of the adverse impact caused to the business relationship(s) by the 1995 Act.

Facilitating assignments to guarantors

4.202 Our provisional proposal at paragraph 4.142 above would enable a guarantor of a tenant's performance of obligations under a lease validly to:

(1) take an assignment of the lease; or

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279 See, for example, the Partnership Act 1890, s 2.

280 The Partnership Act 1890, s 26 provides that "where no fixed term has been agreed upon for the duration of the partnership, any partner may determine the partnership at any time on giving notice of his intention so to do to all the other partners".

281 See the Partnership Act 1890, s 25.

(2) guarantee, on an assignment, a new tenant's performance of the obligations under the lease;

but only where all of the parties are group companies.

4.203 Our provisional proposal at paragraph 4.193 above would enable a guarantor of partners in a partnership's covenants under a lease validly to:

(1) take an assignment of the lease (with partners in the partnership); or

(2) guarantee a new group of partners in the partnership's performance of the obligations under the lease following an assignment to those partners;

but only where the tenants who are assigning the lease are in a partnership and where those to whom the lease is assigned are partners in substantially the same partnership as those who are assigning.

4.204 That said, it is our view that the possibility of a guarantor taking an assignment of a lease could be extended beyond the circumstances set out above. For example, consider the following.

(1) GCo Ltd is a small company providing gardening services.

(2) GCo Ltd took a lease of premises from a landlord ("L") several years ago. It was a new company with no assets and L required that a director ("D"), give a guarantee that GCo Ltd would perform its obligations under the Lease, which D was happy to give.

(3) GCo Ltd's business has declined and its shareholders wish to avoid further rent payments and wind up the company. D has a new business venture that she wishes to undertake and both GCo Ltd and D would be happy for D to take an assignment of the lease from GCo Ltd, before GCo Ltd is wound up. L is also happy with that.

4.205 In the above situation, the Anti-Avoidance Provision means it is not possible for D to take an assignment of the lease.[282]

4.206 D is, we believe, the only person (or one of a very small number of people) who definitely cannot take an assignment of the lease; we have explained above that we consider it likely that partners in a partnership can take an assignment, at least in circumstances where they are not obliged to do so, and the *UK Leasing Case* suggests that there are circumstances in which former tenants who have not been released from the tenant covenants can take an assignment to become the tenant once more.

4.207 In our example, D, a guarantor of GCo Ltd – a company that seems unlikely to be able to pay its rent – may have a keen financial interest not only in undertaking their own

[282] See the *EMI Case* at para 4.100 and following above.

business from suitable premises, but also in avoiding GCo Ltd owing money to L. However, the Anti-Avoidance Provision prevents that outcome.

4.208 We see no reason why a guarantor of a tenant should not be able to take an assignment of the lease from the tenant. We do, however, see an issue with guarantors entering into an agreement with the landlord to take that assignment.

4.209 We are concerned that the possibility of such an agreement could mean that landlords require a right to demand all guarantors take an assignment of the lease in circumstances where the tenant is struggling. That would allow landlords to oblige guarantors to take on direct performance of tenant obligations under a lease and, on a subsequent assignment, put the guarantor-now-tenant in the position of giving a direct guarantee under an AGA (which would not be possible under the current law).

Consultation Question 12.

4.210 We provisionally propose that, where a tenant (T) under a lease has the performance of its obligations guaranteed by a guarantor (G), the 1995 Act should facilitate the assignment of the lease by T to G. This proposal would not extend to any agreement entered into in advance by G to complete that assignment.

Do consultees agree? Please explain why.

Evidence for the exception

4.211 In this chapter, we have made provisional proposals to "free" business arrangements and transactions that the parties consider to be beneficial from the Foundation Rules of the 1995 Act by creating new exceptions to their application.

4.212 We mentioned one existing exception is where an assigning tenant enters into an AGA. As will be obvious, the document that is signed – provided that it meets the requirements of an AGA – is good evidence of whether the exception to the Foundation Rules is met.

4.213 There is a question about whether and what evidence might be needed if other exceptions, along the lines of our provisional proposals, are taken forward. We have, for instance, heard it suggested (essentially) that the parties should be able to certify that a transaction meets the requirements of an exception and that the certificate should be conclusive.

4.214 We are unsure about this suggestion. Well-drafted assignments (or agreements for such) will contain recitals that explain how an exception has been met (for example, that the assignor and assignee are both members of the same group of companies). Even if that is not the case, we consider that would be up to the party seeking to challenge a transaction in court (by showing an exception did not apply) to prove that point.

4.215 We acknowledge that it may not be a challenge to the lease that generates interest in whether an exception applies. It might be, for example, because a bank is considering

lending money and wishes to know whether the guarantees in respect of tenant covenants in leases are valid. However, we are not convinced this is sufficient reason to go so far as to make a certificate proof of validity.

4.216 Our concern is that certificates could be contrived in order to facilitate transactions which the law would not otherwise allow. For example, an assigning tenant (who is, perhaps, an owner of a long-leasehold interest in a residential property) may be assigning the lease to a new owner. The assignment might include a precedent clause, intended for companies, where the assignor and assignee certify that they are both members of the same group of companies. However, absurd that might be, it is nevertheless clearly false and we are concerned with anything that might cause the Act to "turn away" from that reality. Certificates could be abused to facilitate transactions which the law would otherwise not allow. Another concern is that the contents of the certificate might not be fully understood by all of those signing them. Making such a certificate conclusive may cause significant difficulties.

4.217 For this reason, we do not consider that such reforms (for example giving statutory significance to certificates) are warranted.

Chapter 5: The 1995 Act – other issues

INTRODUCTION

5.1 The main aspects of the 1995 Act that we are aware are causing problems in commercial leasehold transactions relate to those matters covered in the previous chapter, namely, and broadly speaking, the effect of the Anti-Avoidance Provision and its interaction with other provisions in the 1995 Act.[283]

5.2 However, it is our understanding that there are some other issues with the 1995 Act that may be causing difficulties in practice, which are the focus of this chapter.

5.3 Before we address those matters, we make three important points:

(1) First, while the 1995 Act applies to commercial, residential and agricultural leasehold premises, our Terms of Reference are limited to problems arising in the commercial leasehold sector. Residential and agricultural leasehold law are outside the scope of our review. This limits the reforms that we can consider within this project. For example, it is not possible within our current project to propose changes that would, or may, materially affect the residential leasehold sector, even where such changes might benefit the commercial leasehold sector.

(2) Second, this project is not intended to be a wholesale review of the 1995 Act; any such review (if it were considered necessary) would take considerably longer than the time in which we expect this current project to be complete. We have a sharp focus on issues that are creating unnecessary bureaucracy, delay and costs in the commercial leasehold sector. It follows that we are focussed on issues that have an impact in practice. If certain aspects of the 1995 Act could theoretically give rise to issues, where they are not causing difficulties day-to-day, they are unlikely to meet the threshold for recommending reform.

(3) Third, we explain the scope of our work by reference to the "commercial leasehold sector" and "commercial leasehold transactions". So, we are focussed on issues affecting leases, leaseholders and transactions that are commercial (and not, for instance, residential) in nature. For example, a freehold owner of a block of residential flats may be a commercial entity and/or have a commercial interest in the block of flats (it might be a developer who builds and sells flats). However, the nature of the leases, leaseholders and leasehold transactions are residential. Issues affecting that freeholder, and arising from those residential interests and relationships, are not the focus of this work, and so we do not consider every issue that might affect them in this project.

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283 We explain, and define, the Anti-Avoidance Provision at para 4.47 and following above.

5.4 It follows that the issues that we consider below are not an exhaustive list of every possible issue that might be encountered with the 1995 Act. We ask consultees to consider the issues raised in this chapter with that in mind.

5.5 Nonetheless, we are keen to hear whether there are other aspects of the 1995 Act which are causing difficulties in practice in the commercial leasehold field and that would fall within our Terms of Reference. We therefore encourage consultees to respond to the overarching question about the issues considered in this Consultation Paper and impact in Chapter 1 and the consultation question at paragraph 5.13 and following below.

5.6 In this chapter, we consider the following.

(1) Concurrent leases.

(2) Covenants with management companies.

(3) Agreements for lease.

(4) The registration gap.

(5) Geographical limitations on the service of notices under the 1995 Act.

5.7 We do not make any provisional proposals to reform the 1995 Act in respect of the issues listed above. The reasons for that vary, but, broadly, it is because the issues do not appear to be causing difficulties specifically (or principally) for commercial leasehold transactions, including for all or any of the following reasons:

(1) the issue appears to be one which is experienced more significantly in the residential leasehold context;

(2) the issue is one which we understand causes some difficulties in commercial leasehold transactions but where we would require further evidence of the significance of the impact before we are satisfied that law reform is needed; or

(3) the issue is one which is causing difficulties in commercial leasehold transactions but reform may impact the residential leasehold sector.

5.8 For completeness, we mention here two other issues that have been raised with us. One stakeholder suggested that the distinction between old and new tenancies[284] under the 1995 Act should be revisited so that the provisions applying to new tenancies (for example, the abolition of original tenant liability and the transmission of the benefit and burden of landlord and tenant covenants) would also apply to old tenancies. Another suggestion was that authorised guarantee agreements ("AGA"s)[285] on an assignment should become the default rather than an option.

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[284] See para 3.42 above for an explanation of "old and new tenancies" under the 1995 Act.

[285] See para 4.28 above.

5.9 We are not persuaded that either of these issues are causing sufficiently widespread difficulties in practice to justify reform and we do not explore the issues in further detail in this chapter. In addition:

(1) So far as the suggestion of removing the distinction between old and new leases[286] is concerned: this would affect only those leases that were granted in excess of around 30 years ago. To the extent that such leases exist, we expect that, because of their length, they are less likely to be commercial in nature and more likely to be (in particular) residential in nature. Any such reform would therefore be unlikely to fall within our Terms of Reference.

Any such reform would also raise concerns of retrospectivity. This issue was considered during the passage of the Bill, when Parliament rejected applying similar reforms to existing leases on the basis that retrospective legislation could not be justified.[287]

(2) So far as the suggestion that AGAs should be the default on an assignment, we are unconvinced. To do that would be to make it less likely that tenants (and their guarantors) – who are the parties to a lease who have most to lose where an AGA is entered into[288] – will be aware that an AGA might be demanded on an assignment. In our view this would represent an unjustified shift in the balance between the parties. In addition, unless such a reform were to be limited to leases that are commercial in nature then it would apply more widely, including in the residential sphere. In our view, the former would complicate the law and, possibly, create a risk of uncertainty in some cases, and in the latter case it would fall outside of the scope of this project.

5.10 However, we welcome consultees' comments about our conclusions (and any evidence of the extent and impact of these issues in practice) in response to the consultation question at paragraph 5.13 and following below.

5.11 We emphasise that, regarding the issues mentioned at both paragraphs 5.6 and 5.8 above, the view we have reached is provisional and, as noted above, we are keen to hear whether consultees believe we have considered the key issues (bearing in mind the scope of our work mentioned at paragraph 5.3 above) and the impact of these, and other, issues on commercial leasehold transactions.

5.12 We have asked the questions below to test whether our understanding of the issues (and their impact) is correct. It is possible that the responses we receive will cause us to change that view.

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286 We use the terms "new lease" and "new tenancy" interchangeably. Similarly, we use the terms "old lease" and "old tenancy" interchangeably.

287 See Hansard (HC), 21 April 1995, vol 258, col 489-91 and Hansard (HL) 25 May 1995 vol 564, col 1087-97.

288 In other words, it is the tenant and any guarantor of the tenant, who the landlord might call upon under the AGA in the event that the assignee tenant fails to perform the tenant obligations under the lease.

Consultation Question 13.

5.13 Chapter 5 considers five issues with the 1995 Act as follows:

(1) Concurrent leases.

(2) Covenants with management companies.

(3) Agreements for leases.

(4) The registration gap.

(5) Geographical limitations on the service of notices.

5.14 We invite consultees' views, together with evidence where possible, on the following:

(1) Are the issues considered in this chapter causing difficulties?

(2) Are there any other issues with the 1995 Act which are not considered in this chapter (or in the previous chapter) which are causing difficulties?

5.15 To what extent are the issues identified above causing difficulties specifically in commercial leasehold transactions?

5.16 To what extent would reform of any of the issues identified above also impact upon residential leasehold transactions?

CONCURRENT LEASES

5.17 In this section, we consider issues that we understand may arise in relation to the operation of section 15 of the 1995 Act where there is a concurrent lease.

5.18 When we have been told about the issue, it has been said that the problem relates to "overriding leases". As we explain below, we are referring to the issue as one relating to "concurrent leases". That is because we need to be very careful about the use of language in this chapter. So, before we consider the detail of section 15 of the 1995 Act, we explain what is meant generally by the term "overriding lease" and specifically what it means in the context of the 1995 Act, and then explain why we are using the term "concurrent lease".

Current law

Overriding leases, leases of the reversion and concurrent leases

5.19 The term "overriding lease" is often used to mean a "lease of the reversion". Those sorts of lease are also sometimes referred to as a "concurrent lease". We explain below the meaning of these terms and how we use them throughout the rest of this section.

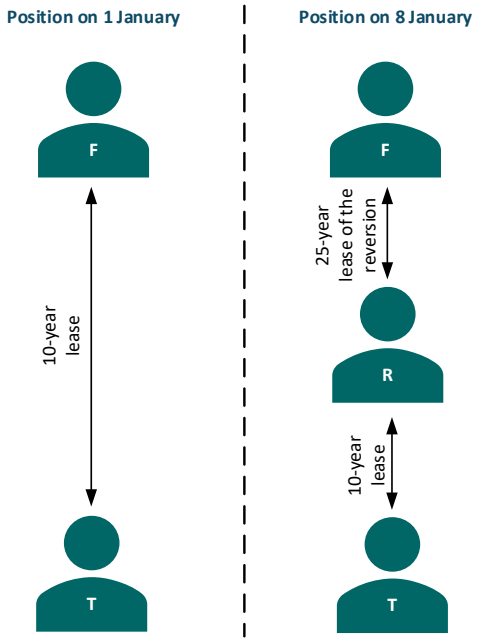
5.20 The “reversion” is the landlord’s interest in a property which has been leased to a tenant. In particular, it is the right to receive rent during the lease, and to regain possession of the property when the lease expires. Accordingly, the landlord is often referred to as the “reversioner”. For example, if the landlord owns the freehold and the lease is granted out of that freehold, the landlord has a freehold reversion.

5.21 A lease of the reversion is a lease which is granted out of that interest. To illustrate this, we use the following example:

(1) On 1 January, a freehold owner (F) grants a ten-year lease of a building to a tenant (T).

(2) On 8 January, F grants a 25-year lease of the same building to another party (R).[289]

5.22 The above situation can be represented as follows:



5.23 As a result of the grant of the 25-year lease:

(1) R becomes the direct[290] landlord of T; and

(2) F becomes the direct landlord of R.

5.24 R does not have an immediate right to possession of the premises because R’s lease was granted at a point when T’s lease was already in existence. R’s lease is therefore

289 It is possible for a concurrent lease to be shorter than the original lease.

290 In this chapter, and in the context of the relationship of landlord and tenant and the leasehold relationships between then, we use the phrase “direct” and “immediate” interchangeably.

granted subject to, and with the benefit of, T's lease. Once T's lease expires, R will be able to take physical possession of the premises.[291]

5.25 We explain at paragraph 5.36 and following the impact of these transactions on the enforceability of leasehold covenants as between F, R and T.

5.26 It is worth noting that, although the relationship between R and T contains many of the features that exist between an intermediate landlord and sub-tenant, there are differences.[292] In particular, the original lease pre-existed the concurrent lease and so it is not derived from the concurrent lease. This is in contrast to a sub-lease which is carved out of a pre-existing superior leasehold interest.

Section 19 of the 1995 Act and a note about terminology

5.27 We state above that the term "overriding lease" is often used to mean a "lease of the reversion". However, in the context of the 1995 Act, an "overriding lease" means something specific.

5.28 Section 19 of the 1995 Act provides that, in some circumstances, a former tenant may require the landlord to grant it an "overriding lease". This takes effect as a "lease of the reversion" or a "concurrent lease". The circumstances arise as follows.

(1) Under section 17 of the 1995 Act, a landlord can only pursue a former tenant (or a former tenant's guarantor) for arrears of rent or other fixed payments – such as service charges – if they have notified the former tenant (or former tenant's guarantor) of the amount, and of the intention to recover the arrears, within six months of it becoming due. This is sometimes referred to as a "default notice" or "section 17 notice". We use the term "section 17 notice" in this chapter.

(2) If a former tenant (or former tenant's guarantor) has been served with a section 17 notice and has made payment of the amount specified in that notice[293] in full, then they are entitled to require the landlord to grant them an "overriding lease".

5.29 For completeness, we note that section 19(2) of the 1995 Act states that:

> For the purposes of [section 19] "overriding lease" means a tenancy of the reversion expectant on the relevant tenancy which –
>
> (a) is granted for a term equal to the remainder of the term of the relevant tenancy plus three days or the longest period (less than three days) that

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291 If R's lease was shorter than T's lease then, unless T's lease was determined before the end its fixed term, R would never be able to take possession. We assume in our example that T does not have security of tenure. Security of tenure, generally speaking, gives a tenant a right to continue to occupy premises after the contractual term of a lease has expired. An example is the security of tenure regime created by pt 2 of the Landlord and Tenant Act 1954 (see our work in respect of that regime at https://lawcom.gov.uk/project/business-tenancies-the-right-to-renew/).

292 See K Lees, "Concurrent leases and break clauses" (2011) *Landlord and Tenant Review* 15(2) 51-55.

293 Together with any interest payable – see 1995 Act, s 19(1).

will not wholly displace the landlord's reversionary interest expectant on the relevant tenancy, as the case may require; and

(b) (subject to [other subsections of section 19] and to any modifications agreed to by the claimant and the landlord) otherwise contains the same covenants as the relevant tenancy, as they have effect immediately before the grant of the lease.

5.30 Section 19 of the 1995 Act contains further provisions on the procedure that should be followed in order for a former tenant (or former tenant's guarantor) to claim the right to an overriding lease.

5.31 Because an overriding lease granted under section 19 of the 1995 Act takes effect as a lease of the reversion, the consequences are similar to those noted at paragraph 5.21 and following above, which are that:

(1) the party taking the overriding lease ("R" in our example above) becomes the direct tenant of the landlord ("F", in our example above); and

(2) the party taking the overriding lease becomes the direct landlord of the defaulting tenant ("T" in our example above).

5.32 This gives the former tenant (and former tenant's guarantor) the right to exercise the landlord's remedies for non-payment of rent against the defaulting tenant, including forfeiting the defaulting tenant's lease.[294]

5.33 It is clear that:

(1) all overriding leases that are created by virtue of section 19 of the 1995 Act take effect as leases of the reversion; but

(2) not all leases of the reversion are overriding leases under section 19 of the 1995 Act.

5.34 For this reason, in the rest of this chapter, we use the following terminology.

(1) Overriding lease – we use this specifically to refer to those leases created under section 19 of the 1995 Act.

(2) Concurrent lease – we use this to refer to all leases of the reversion, which would include overriding leases under section 19 of the 1995 Act.

(3) We do not use the term "lease of the reversion" any further in this chapter.

5.35 We also use the following terminology below.

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[294] A right to forfeit (also referred to as a right of re-entry) enables a landlord to determine a lease earlier than it would otherwise end and recover possession of the property from the tenant. It is exercisable in the event of tenant default.

(1) Original lease – we use this to refer to the lease which existed prior to the grant of the concurrent lease.

(2) Tenant – we use this to refer to the tenant under the original lease.

(3) Intermediate landlord – we use this to refer to the lessee of the concurrent lease.

(4) Superior landlord – we use this to refer to the landlord that granted the original lease and then granted the concurrent lease.

Enforceability of covenants

5.36 In this section, we consider the impact of section 15 of the 1995 Act on the enforceability of covenants in transactions involving concurrent leases.

5.37 Before we do so, it is helpful to consider the position which existed before section 15 of the 1995 Act was enacted, and which remains the law for old tenancies.[295]

5.38 In relation to old tenancies, the grant of a concurrent lease operates as an assignment of the reversion.[296] This means that sections 141 and 142 of the Law of Property Act 1925 (the "1925 Act") apply, the effect of which (for the duration of the concurrent lease term) is as follows:

(1) the intermediate landlord acquires the right to the rent due and the benefit of the tenant's covenants contained in the original lease;

(2) the intermediate landlord acquires the right of re-entry;[297]

(3) the intermediate landlord has the right to enforce the tenant covenants in the original lease; and

(4) the intermediate landlord is responsible (to the tenant) for performing the landlord's covenants in the original lease.

5.39 Accordingly, in old leases, during the term of the concurrent lease, the intermediate landlord assumes a leasehold relationship with the tenant instead, and to the exclusion, of the superior landlord.

5.40 This is in contrast to the position with new leases:

(1) Sections 141 and 142 of the 1925 Act do not apply.[298]

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295 See para 3.42 for an explanation of the difference between "old" and "new" tenancies for the purposes of the 1995 Act.

296 *Megarry & Wade: The Law of Real Property* (10th ed 2024), para 19-144.

297 A right of re-entry is commonly referred to as a right to forfeit. See n 294 above.

298 1995 Act, s 30(4)(b).

(2) The grant of a concurrent lease takes effect as a lease and not as an assignment.[299]

(3) The effect of this is that the transmission provisions contained in sections 3 and 4 of the 1995 Act, which apply on an assignment of the landlord's interest,[300] do not apply on the grant of a new concurrent lease.[301]

(4) Instead, and to avoid the consequences that follow on an assignment,[302] the 1995 Act makes separate provision for the enforceability of covenants on the grant of a concurrent lease under section 15.

Section 15 of the 1995 Act – the issue of dual enforceability[303]

5.41 Section 15(1) of the 1995 Act provides that (emphasis added):

(1) Where any tenant covenant of a tenancy, or any right of re-entry contained in a tenancy, is enforceable by the reversioner in respect of any premises demised by the tenancy, *it shall also be so enforceable* by –

(a) any person (other than the reversioner) who, as the holder of the immediate reversion in those premises, is for the time being entitled to the rents and profits under the tenancy in respect of those premises, or

(b) any mortgagee in possession of the reversion in those premises who is so entitled.

5.42 Section 15(2) of the 1995 Act is drafted in similar terms (emphasis added):

> Where any landlord covenant of a tenancy is enforceable against the reversioner in respect of any premises demised by the tenancy, *it shall also be so enforceable* against any person falling within subsection (1)(a) or (b).

5.43 "Reversioner" is defined as "in relation to a tenancy…the holder for the time being of the interest of the landlord under the tenancy".[304] We note the author of a leading textbook has considered this definition of "reversioner" and concluded that:

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299 *Megarry & Wade: The Law of Real Property* (10th ed 2024), para 19-144; T M Fancourt QC, *Enforceability of Landlord and Tenant Covenants* (3rd ed 2014), para 12-11. The reason for this is because s 28(1) of the 1995 Act defines assignment as a transfer of the whole of L's interest and the grant of a concurrent lease does not satisfy this definition.

300 See para 3.43 and following for a detailed explanation of these transmission provisions.

301 *Megarry & Wade: The Law of Real Property* (10th ed 2024), para 19-144.

302 For example, the prospect of the superior landlord being able to escape liability by obtaining a release from landlord covenants which is available when a landlord assigns their interest. See *Megarry & Wade: The Law of Real Property* (10th ed 2024), para 19-144 and K Lees, "Concurrent leases and break clauses" (2011) *Landlord and Tenant Review* 15(2) 51-55.

303 The term "dual enforceability" is used by Kester Lees and is adopted here. See K Lees, "Concurrent leases and break clauses" (2011) *Landlord and Tenant Review* 15(2) 51-55.

304 1995 Act, s 15(6).

This must mean that landlord who granted the tenancy or the current holder of that landlord's interest in the premises, because if it means the person who for the time being stands in the position of landlord in relation to the tenancy, the provision would fail to distinguish between the "reversioner" and the "person" (other than the reversioner).[305]

5.44 The effect of section 15 of the 1995 Act is, therefore, as follows:

(1) both the superior landlord and the intermediate landlord may enforce the tenant covenants; and

(2) the tenant may enforce covenants against both the superior landlord and the intermediate landlord.[306]

5.45 Returning to the example given at paragraph 5.21 above:

(1) F and R may enforce tenant covenants given by T in the lease dated 1 January; and

(2) T may enforce covenants against F and R in that lease.

5.46 The effect of section 15 of the 1995 Act is characterised by the author of a leading textbook as follows:

> … the [1995] Act thus creates the spectre of two different persons being entitled to enforce the covenants in a tenancy at the same time … a spectre that, in respect of old tenancies, the Law of Property Act 1925, s141(1) had prevented from arising.[307]

5.47 The position regarding rights of re-entry is similar.[308] In principle, section 15 of the 1995 Act allows both the superior landlord and intermediate landlord to enforce a right of re-entry.[309] It has been suggested that the nature of a right of re-entry, being a type of legal interest in property, sits awkwardly with this arrangement because the right can only be shared by way of joint ownership.[310]

5.48 The authors of Megarry and Wade take a different view and suggest that the intermediate landlord takes the concurrent lease subject to the superior landlord's right of re-entry. It follows, on this analysis, that if both the intermediate landlord and superior landlord want to exercise the right of re-entry, the latter will have priority.[311]

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305 T M Fancourt QC, *Enforceability of Landlord and Tenant Covenants* (3rd ed 2014), para 17-13.

306 We note for completeness that section 15 also applies to any mortgagee in possession of the reversion of the premises. However, we have not heard any specific issues with regard to mortgagees in possession and we say no more about them here.

307 T M Fancourt QC, *Enforceability of Landlord and Tenant Covenants* (3rd ed 2014), para 12-11.

308 See n 294 above.

309 T M Fancourt QC, *Enforceability of Landlord and Tenant Covenants* (3rd ed 2014), para 17-13.

310 T M Fancourt QC, *Enforceability of Landlord and Tenant Covenants (*3rd ed 2014), para 17-14.

311 *Megarry & Wade: The Law of Real Property* (10th ed 2024), para 19-114.

5.49 The comments of Mr Justice Lightman in *First Penthouse Ltd v Channel Hotels & Properties (UK) Ltd*[312] provide a helpful analysis of the issue:[313]

> Section 3 of the 1995 Act provides that the benefit of tenant covenants is annexed to the estate held by the landlord at the date of the grant of the lease in question. Section 3 read on its own leaves naked of benefit and protection the grantee by the landlord of an overriding lease such as the Overriding Lease in this case. Only at the last hour did Parliament supplement section 3 and fill this lacuna by introducing into the 1995 Act section 15.
>
> Section 15 renders tenant covenants enforceable by and against the [the person who takes a concurrent lease] …The critical question arises as to who is entitled to the fruits [such as rent] of such enforcement. It is not immediately apparent whether: (a) the party who obtains the court order enforcing the obligations is solely entitled to the benefit; (b) the benefit is to be shared between all parties entitled to enforce or enforcing the covenant; (c) the holder of the landlord's original estate alone is alone entitled as under section 3 entitled to "the benefit of the covenant" and not merely to enforce it; (d) the party is entitled who may be deemed to have the better claim to the fruits; or (e) entitlement turns on the expressed or (in default of expressed) presumed intention of the parties. The position is far from clear.[314]

5.50 Mr Justice Lightman therefore concluded that it was not clear whether the superior landlord or the intermediate landlord would have been entitled to receive the benefit of the tenant covenants. In considering the issue, he drew a distinction between fruits of an income nature and fruits of a capital nature; it was considered that, in the absence of expressed intention, it may be presumed that:

(1) the intermediate landlord is entitled to receive the benefits of an income nature (for example rent and reimbursement of insurance premiums) and (so far as they adversely affect the concurrent lease) damages for dilapidation as well as the right to possession arising on the exercise of the right of re-entry; and

(2) the superior landlord is entitled to retain and hold for his own benefit damages for breaches of covenant so far as they adversely affect his reversionary interest and other fruits of a capital nature – for example, the rights arising on the exercise of pre-existing options.

Problems with the law

Rights of re-entry – dual enforceability

5.51 We understand there is concern that an intermediate landlord could take a grant of a concurrent lease from a freeholder and find that the freeholder retains the right to forfeit the original lease. If the freeholder did forfeit the original lease, there is concern that the intermediate landlord would be left with an empty building and no rental

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312 [2003] EWHC 2713 (Ch).

313 Mr Justice Lightman's comments were "obiter dicta". This means that they were not part of the ratio, and are consequently only persuasive in subsequent cases.

314 *First Penthouse Ltd v Channel Hotels and Properties (UK) Ltd* [2003] EWHC 2713 (Ch), at [54].

stream. The concerns that have been raised refer to the *First Penthouse* case which highlights, but does not clearly resolve, this issue.[315]

5.52 As a starting point, we do not regard this issue as being one that only affects the commercial leasehold sector. As noted above, it is not within our remit to propose changes that would materially affect the residential or agricultural leasehold sector, even where such changes might benefit the commercial leasehold sector. However, even if that were not the case, we would conclude that this is an issue that is unlikely to meet the threshold for reform without significant evidence of it creating problems in practice.

5.53 As matters stand, we agree that the 1995 Act creates the potential for a problem. However, that, in itself, is not reason enough to effect reform. We have not heard that this issue is one that arises in practice, only that the 1995 Act raises the possibility that it could.

5.54 Indeed, along similar lines, one leading textbook acknowledges the issue "subject to any estoppel arising from the grant of the [concurrent lease]" but suggests that it is not a situation that is likely to arise "because the effect of terminating the original lease will be that the lessee of the reversion becomes entitled in possession".[316] In other words, because of the existence of the concurrent lease, it is difficult to understand why a superior landlord would forfeit the original lease because they will not gain possession.

5.55 We also note that the matter of dual enforceability, specifically who is entitled to the fruits of enforcement, may be dealt with (for the most part) by the inclusion of express provision in the relevant concurrent lease. That is in line with Mr Justice Lightman's comments in the *First Penthouse* case when he explained that:

> Obviously it is desirable that express provision is made in any overriding lease regarding entitlement generally.[317]

5.56 Finally, we consider there may be good reason why section 15 of the 1995 Act moved away from the position under sections 141 and 142 of the 1925 Act and was drafted in terms which makes the covenants enforceable by and against both the intermediate landlord and superior landlord. We observe that, in relation to covenants being enforceable against both, if the position under the law prior to section 15 coming in to force were to have been retained, a superior landlord could avoid liability under the original lease in certain circumstances.[318] In relation to covenants being enforceable by both, it is arguable that landlords who are statutorily required to grant an overriding

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315 As noted at n 313 above, the comments made by Mr Justice Lightman were obiter dicta and the issue was not considered in detail on appeal.

316 *Megarry & Wade: The Law of Real Property* (10th ed 2024), para 19-114.

317 *First Penthouse Ltd v Channel Hotels and Properties (UK) Ltd* [2003] EWHC 2713 (Ch), at [57].

318 The grant of a concurrent lease must take effect as a lease and not an assignment "to avoid the possibility that on an assignment of a lease of the reversion the landlord might be able to obtain a release from the landlord covenants of the original lease". See *Megarry & Wade: The Law of Real Property* (10th ed 2024), para 19-113.

lease under section 19 may legitimately have an interest in retaining their ability to enforce covenants against the original tenant.[319]

5.57 Our provisional view is that this issue is not one which is adversely affecting commercial leasehold transactions in practice such that reform should be considered. In addition, it is likely that any reform to deal with this issue could also substantially impact the residential leasehold sector (whether adversely or not). Accordingly, it is likely to fall outside of our Terms of Reference.

5.58 However, we welcome consultees' comments about our conclusion (and any evidence of the extent and impact of this issue in practice) in response to the consultation question at paragraph 5.13 and following above.

Deeds of variation

5.59 We understand that one consequence of section 15 of the 1995 Act is that it is considered that the superior landlord has to be a party to subsequent deeds of variation which are entered into between the intermediate landlord and the tenant. It is our understanding that this can create additional cost and can be administratively burdensome.

5.60 We note that this concern was raised only in the context of residential leases the consideration of which, as explained above, extends beyond our Terms of Reference. However, we accept that this issue might also be relevant to commercial leasehold transactions.

5.61 To the extent that this is an issue which adversely affects commercial leasehold transactions we note that the particular nature of a concurrent lease may well mean that it is desirable for the superior landlord to be a party to any deed of variation. This is because:

(1) in a concurrent lease situation, the superior landlord maintains a relationship with the intermediate landlord and the tenant;

(2) if the concurrent lease is for a term that is shorter than the original lease, the superior landlord may become the immediate landlord of the tenant on its expiry; and

(3) in situations where the concurrent lease is for a term that is longer than the original lease, if there is any risk that the concurrent lease might be surrendered, forfeited or otherwise expire before the original lease, then the superior landlord may retain a keen interest in the terms of the original lease.

5.62 Our provisional view is that this issue does not sit within our Terms of Reference. This primarily relates to residential leases (and we have not heard that it is causing difficulties in commercial leasehold transactions). On this basis, therefore, we do not consider reform. However, if this issue was one that impacted significantly on

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[319] "…there would be a benefit in such a case to the original landlord retaining the ability to enforce the tenant covenants, if only as a safety measure in case the concurrent lease fails to do so". See K Lees, "Concurrent leases and break clauses" (2011) *Landlord and Tenant Review* 15(2) 51-55.

commercial leasehold interests, we note the points we have raised at paragraph 5.61 above.

5.63 We welcome consultees' comments about our provisional conclusion (and any evidence of the extent and impact of this issue in practice) in response to the consultation question at paragraph 5.13 and following above.

Surrenders

5.64 We understand that there is uncertainty in relation to surrenders involving concurrent leases.

5.65 A surrender enables a lease to be terminated by mutual agreement. It involves the tenant giving back to the landlord the remainder of its interest and the landlord accepting it. Surrenders may be made expressly, by deed, or impliedly, by operation of law. A surrender must be made by the tenant to the immediate landlord.[320]

5.66 It is our understanding that where a tenant wants expressly to surrender their interest to the intermediate landlord, difficulties can arise. That is because it is unclear, where the concurrent lease is a new tenancy, who should be a party to the deed of surrender. For example:

(1) On 1 January, a freehold owner (F) grants a ten-year lease of a building to a tenant (T).

(2) On 8 January, F grants a 25-year lease of the same building to another party (R).

(3) Six months later, T wants to surrender its ten-year lease.

Should T surrender to F, to R or to both?

5.67 In relation to old tenancies, the position appears to be less complex; because the grant of a concurrent lease takes effect as an assignment,[321] T can surrender to R.

5.68 However, in relation to new tenancies, the grant of a concurrent lease does not take effect as an assignment.[322] In addition, section 15 of the 1995 Act contemplates that both the intermediate and superior landlord are both to remain engaged in matters concerning enforceability of covenants. Applying that principle to surrenders, it is our understanding that some practitioners consider that F, R and T should all be a party to the deed of surrender and that this creates additional cost and can be administratively burdensome.

5.69 As discussed in relation to deeds of variation, the nature of a concurrent lease may well mean that there are some situations where it is desirable for a superior landlord to be a party to the surrender.

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320 Woodfall: Landlord and Tenant, para 17.035.

321 See para 5.38 above.

322 See para 5.40 above.

5.70 At present, we do not have a clear view on the extent to which this issue is affecting commercial leasehold transactions in practice such that reform should be considered. In addition, it is likely that any reform to deal with this issue could also impact the residential leasehold sector (whether adversely or not). Accordingly, it is likely to fall outside of our Terms of Reference.

5.71 However, we welcome consultees' comments about our conclusion (and any evidence of the extent and impact of this issue in practice) in response to the consultation question at paragraph 5.13 and following above.

Situations where the intermediate landlord is not entitled to receive the rents

5.72 We understand that section 15 may cause difficulties in situations where a concurrent lease has been granted and the intermediate landlord is not, under the terms of the concurrent lease, entitled to receive rents from the original tenants.

5.73 For example:

(1) F owns the freehold of a large building. The ground floor has a number of retail units, each one let to a different tenant. One is let to T. There are various common parts that the tenants can use.

(2) F then grants a concurrent lease of the building to R, to facilitate a development of parts of the building that are unlet and the delivery of services. Under the concurrent lease, R is not entitled to receive the rent from T.

(3) If T breaches its lease covenants (for example, by damaging the common parts) then, under section 15, R cannot enforce any of the tenant covenants in T's lease because R is not the person "who, as the holder of the immediate reversion in those premises, is for the time being entitled to the rents and profits under the tenancy in respect of those premises."[323]

5.74 At present, we do not have a clear view on the nature of the issue or the extent to which this issue is affecting commercial leasehold transactions in practice such that reform should be considered. In addition, it is likely that any reform to deal with this issue could also impact the residential leasehold sector (whether adversely or not). Accordingly, it is likely to fall outside of our Terms of Reference.

5.75 However, we welcome consultees' comments (and any evidence of the extent and impact of this issue in practice) in response to the consultation question at paragraph 5.13 and following above.

Provisional view

5.76 At present, our provisional view is that the majority of issues raised in this section do not sit clearly within our Terms of Reference because they are not issues which exclusively or predominantly impact the commercial leasehold sector and it is unlikely reform could be implemented without either (a) significantly affecting the residential leasehold sector, or (b) effecting piecemeal reform for the commercial leasehold

[323] See the 1995 Act, s 15(1)(a).

sector that would significantly complicate the 1995 Act by changing how different leases are treated by the 1995 Act.

5.77 Even if that were not the case, in relation to all of the issues we discuss above, we do not have sufficient evidence that they are causing difficulties in practice in relation to commercial leasehold transactions.

5.78 However, we welcome consultees' comments about our provisional conclusion (and any evidence of the extent and impact of these issues in practice) in response to the consultation question at paragraph 5.13 and following above.

COVENANTS WITH MANAGEMENT COMPANIES

5.79 Some leases might have more parties owing obligations than the landlord, tenant and any guarantor. One such party could be a management company.[324]

5.80 An example might be a five-year lease of a unit in a shopping centre with the following parties and example covenants:[325]

(1) A landlord, "L", is a party to the lease in order to create the leasehold interest. Examples of landlord obligations might be:

(a) to afford the tenant quiet enjoyment of the premises;

(b) to enforce the tenant covenants in leases of neighbouring units (where, of course, the tenant has no relationship with the occupier(s) to enforce the covenants itself); and

(c) to maintain the structure of the building.

(2) A management company, "M", is a party to the lease in order to provide the services necessary to operate the building as a shopping centre. Examples of the management company's covenants might be to:

(a) provide security services; and

(b) keep the shopping centre clean and tidy.

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[324] A management company, generally speaking, is a body that does not have an ownership interest in a property (unlike the landlord and the tenant), but is obliged to undertake management and/or service functions in respect of it. For example, it might be obliged to undertake cleaning, maintenance and security functions. The involvement of management companies is common in residential leases. For example, in a residential leasehold development, the developer landlord (as owner of the freehold) may not want to deal with the provision of services or management of the development itself. Instead, it will contract with a separate management company to undertake these obligations (and the management company's obligations can be owed direct to the residential leaseholders). However, we understand some commercial leases are set up in a similar way.

[325] A lease of a unit in a shopping centre may be an extremely complex document and the rights and obligations of each of the parties may be extensive. We do not suggest in this example that the rights and obligations would represent a workable lease arrangement in practice.

(3) A tenant, "T", is a party to the lease because it wishes to trade from the premises. Examples of the tenant's covenants might be to:

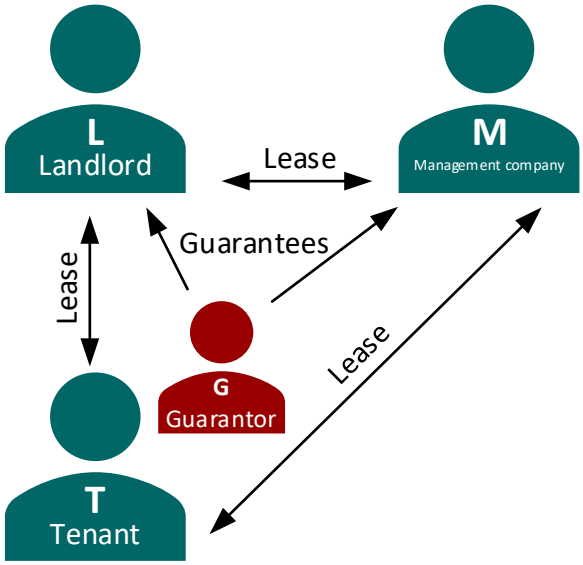
(a) keep the interior of the unit in good repair; and

(b) pay the management company (M) a service charge to reimburse it for the performance of its obligations under the lease.

(4) A guarantor, "G", is a party to the lease because the landlord (L) would not grant the lease to T unless G also entered into the lease to guarantee T's performance of the tenant covenants. An example of G's covenants might be:

to indemnify the landlord (L) and/or management company (M) against losses arising from any failure by T to perform the tenant covenants in the lease.

5.81 The above example can be visualised as follows:



Current law

5.82 Section 12 of the 1995 Act applies where "a person other than the landlord or tenant … is under a covenant of a tenancy liable … to discharge any function with respect to the demised premises…". It does not apply where the liability is the liability of a guarantor.

5.83 In the example above, M is not the landlord, nor the tenant, nor a guarantor and it has obligations to discharge functions with respect to the demised premises, namely the provision of security and cleaning services; section 12 of the 1995 Act therefore applies.

5.84 The effect of section 12 is to treat rights exercisable by the landlord or tenant against the third party (M, in the example), or by the third party against the landlord or tenant, as tenant or landlord covenants of the lease for the purposes of transmission of the benefit and burden of the covenant, and any release from it.

5.85 Section 12 only applies to covenants of a tenancy "to discharge any function with respect to all or any of the demised premises". This is referred to in section 12 as a "relevant function".

5.86 Section 12 of the 1995 Act is necessary because covenants by or with management companies are not landlord or tenant covenants within the definition of section 28(1). This means that, without section 12, the provisions in the Act which apply to the transmission of the benefit and burden of those covenants would not apply to rights and obligations entered into with management companies. Accordingly, making specific provision for management companies was important to ensure that original tenants were no longer liable to management companies after assignment, while ensuring landlords could not easily circumvent the provisions of the 1995 Act.[326]

Problems with the law

5.87 It is our understanding that there is uncertainty in situations where a management company owes covenants to tenants which extend beyond the premises that are let to tenants. For example, such covenants might include those that relate to the common parts of the building (such as obligations to keep in repair and decorated entrances, lifts and/or staircases), the structure of the building (such as maintaining the roof) or the estate as a whole (such as undertaking gardening services, and the maintenance of car parks and estate roads).

5.88 We understand that the uncertainty arises because section 12 only extends to covenants given by the management company with respect to a "relevant function" and, as explained above, "relevant function" is defined by reference to the demised premises. On a narrow construction, it therefore appears that section 12 may not apply to any covenants which extend beyond the demised premises, such as those obligations referred to at paragraph 5.79 above.[327]

5.89 We understand that the way in which this potential issue is dealt with currently is as follows.

(1) The lease will include a covenant which prevents the tenant assigning the lease until the tenant has procured from the assignee a deed of covenant which contains direct covenants between the assignee and the management company.

(2) Where title to the lease is registered at HM Land Registry, a restriction is entered on the register of title for the lease which prevents registration of a disposition (for example, an assignment to a new owner) until the assignee has produced a certificate from the landlord or management company confirming

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326 *Megarry & Wade: The Law of Real Property* (10th ed 2024), paras 19-102 to 104.

327 See for example, Lexis Nexis, Lexis+ UK, *Management of mixed-use schemes – overview*; Butterworths Property Law Service, para 733.2; and Thomson Reuters' Practical Law, *Overview of residential leasehold development schemes*, https://uk.practicallaw.thomsonreuters.com/3-504-0363, Resource ID: 3-504-0363.

that a deed of covenant in the terms mentioned at (1) above has been delivered to the management company.[328]

5.90 We are not aware of any reason why section 12 should exclude covenants which extend beyond the demised premises and have seen nothing to suggest that a narrow interpretation of this provision is to be preferred.[329] So far as the passage of the Landlord and Tenant (Covenants) Bill (which later became the 1995 Act) was concerned, it appears that the issue was not considered. For example, during the debate in the House of Lords, Lord Mackay explained why management companies are addressed in the Bill:

> It is necessary to ensure that the burden and benefit of a covenant with a management company will pass to an assignee tenant or landlord and that the assignor tenant or landlord will not retain the benefit of it so as to be able to sue the management company. It is also necessary to ensure that the assignor will be released from the burden of the covenant. The new clause introduced by Amendment No. 30 achieves this by defining a third party in terms which encompass management companies but exclude surety covenants, and by providing for covenants given by or to such a third party to be treated as landlord covenants or tenant covenants as appropriate for the purposes of transmission and release and apportionment.[330]

5.91 We note that Butterworths Property Law Service states that this extract "seems to make clear that a wider construction of the resulting section 12 was intended…".[331] We tend to agree. Had the intention been to limit section 12 in a narrow way, we would expect there to have been reference to this intention within the debate. In addition, had the drafter intended to limit the covenants that transfer pursuant to section 12 solely to those relating directly to the demised premises, clearer and more direct wording could have been used to achieve that result.

Provisional view

5.92 We state above that we understand that section 12 could apply to commercial leasehold transactions. However, the concerns that we have been made aware of relate only to the residential sector. We have not heard that this is an issue which is causing problems for commercial leasehold transactions.

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328 See Thomson Reuters' Practical Law, *Overview of residential leasehold development schemes*, https://uk.practicallaw.thomsonreuters.com/3-504-0363, Resource ID: 3-504-0363. There are other forms of restriction that might be used. For details of restrictions in the land registration context generally, see HM Land Registry, Practice guide 19: notices, restrictions and the protection of third-party interests in the register (available at https://www.gov.uk/government/publications/notices-restrictions-and-the-protection-of-third-party-interests-in-the-register/practice-guide-19-notices-restrictions-and-the-protection-of-third-party-interests-in-the-register).

329 The specific concern does not appear to be addressed in leading textbooks such as T M Fancourt QC, *Enforceability of Landlord and Tenant Covenants* (3rd ed 2014) or *Megarry & Wade: The Law of Real Property* (10th ed 2024).

330 Hansard (HL), 21 June 1995, vol 565, col 369.

331 Butterworths Property Law Service, para 733.2.

5.93 It follows that, at present, our provisional view is that this issue does not sit within our Terms of Reference. However, in addition, we consider it to be arguable that (a) the current law is being construed in an over-restrictive manner and that (b) the solutions adopted under the current law (if those operating in the market consider them necessary) lessen the need for reform.

5.94 We welcome consultees' comments about whether they think reform is required specifically in the commercial leasehold context (and any evidence of the extent and impact of this issue in practice) in response to the consultation question at paragraph 5.13 and following above.

AGREEMENTS FOR LEASE

5.95 It is our understanding that the definition of "tenancy" under the 1995 Act may cause uncertainty in relation to agreements for leases.

Current law

5.96 An agreement for lease is a legally enforceable agreement by which one person agrees to grant, and another agrees to take, a lease.[332]

5.97 Generally, agreements for lease are used where the landlord or tenant (or both) cannot complete a lease immediately, but the parties want to ensure each is contractually obliged to do so in future. An agreement for lease can be conditional or unconditional. A conditional agreement for lease relies on some future circumstance arising (for example, the grant of planning permission) before an absolute (unconditional) obligation to grant (and take) a lease arises. It is therefore possible that, under a conditional agreement for lease, no lease may ever be granted.

5.98 Examples of when a conditional agreement for lease may be entered into include the following.

(1) The premises have not yet been constructed.

(2) A third-party consent is required before the lease can be granted (for example, lender's consent or superior landlord's consent).

(3) Planning permission is required, for example, to build the premises and/or permit their change of use.

(4) The landlord has not yet obtained vacant possession of the premises from another tenant.

5.99 The 1995 Act applies to a landlord covenant or a tenant covenant of a tenancy whether or not the covenant has reference to the subject matter of the tenancy and whether the covenant is express, implied or imposed by law.[333] Under section 28(1) of the Act, the definition of "tenancy" includes "an agreement for a tenancy". The provisions of the Act with regards to transmission of the benefit and burden of

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[332] Woodfall: Landlord and Tenant, para 4.001.

[333] 1995 Act, s 2(1).

covenants can, therefore, apply to agreements for leases. However, they do not apply to all agreements for leases.

5.100 In particular, the extent to which certain types of agreements for lease might not represent an "agreement for a tenancy" within the 1995 Act was considered by Mrs Justice Proudman in *Ridgewood Properties Group Ltd v Valero Energy Ltd*.[334] In this case, a key issue was whether the provisions in the Act that transmit the benefit and burden of covenants applied to options to take a lease which had not yet been exercised,[335] or to conditional agreements for lease. Mrs Justice Proudman considered that those provisions did not apply to either, explaining, in relation to conditional agreements, that:

> Conditions precedent to the grant of a lease are not in my judgment covenants which are part of the agreement for a tenancy nor are they comprised within landlord or tenant covenants within the meaning of section 28(1) of the 1995 Act.[336]

5.101 Following this, it is generally accepted that, if an agreement is not "specifically enforceable" (such as a conditional agreement for lease before the condition has been satisfied), it cannot constitute a tenancy within the 1995 Act.[337]

Problems with the law

5.102 It is our understanding that there is uncertainty about whether the 1995 Act is intended to transfer the benefit and burden of both conditional and unconditional agreements for lease when the landlord transfers its interest.[338] We also understand that the treatment of conditional agreements for lease under the 1995 Act can create additional complexity in certain types of models of development finance.

Provisional view

5.103 At present, we do not have a clear view on the extent to which this issue is affecting commercial leasehold transactions in practice such that reform should be considered. In addition, it is likely that any reform to deal with this issue could also impact the residential leasehold sector (whether adversely or not). Accordingly, it is likely to fall outside of our Terms of Reference.

5.104 However, we welcome consultees' comments about our conclusion (and any evidence of the extent and impact of this issue in practice) in response to the consultation question at paragraph 5.13 and following above.

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334 [2013] EWHC 98 (Ch).

335 An option to take a lease is an agreement which gives the grantee the option (but not the obligation) to take a lease. In order to exercise the option, the grantee will need to satisfy certain contractual requirements, including notifying the grantor that it is exercising the option.

336 *Ridgewood Properties Group Ltd v Valero Energy Ltd* [2013] EWHC 98 (Ch) at [55].

337 T M Fancourt QC, *Enforceability of Landlord and Tenant Covenants* (3rd ed 2014), para 11-02.

338 We consider it to be clear that the 1995 Act was intended to apply to covenants in certain agreements for lease (see para 5.99 above). What is unclear is whether the Act was intended to draw a distinction between conditional and unconditional agreements for lease.

REGISTRATION GAP

5.105 In this section, we consider issues arising from the registration gap in the context of the 1995 Act.

5.106 We note that issues relating to the registration gap in the context of the 1954 Act are dealt with in detail in Chapter 11 of the second consultation paper that we have published as part of our Business Tenancies Project.[339] There will inevitably be a degree of overlap in our discussion of the issue here but there are also key differences which we highlight below.

Current law

5.107 Where a property that is registered at HM Land Registry is sold to another person, there will be a period of time between the sale of the property and the point at which HM Land Registry registers the purchaser as its proprietor. This period of time is known as the registration gap.

5.108 During the registration gap, the legal and equitable ownership of a property is unavoidably split between the seller and the buyer; the seller retains legal ownership of the property and the buyer acquires only an equitable interest. The buyer acquires legal ownership when they are registered as proprietor by HM Land Registry.

5.109 The existence of the registration gap is inevitable because, at this time, it is not possible for a purchaser of a registered property to be instantaneously registered as its proprietor upon completion of a purchase.

5.110 For many buyers and sellers of properties, the registration gap is not an issue. However, in some cases it can cause problems. This is because it can create uncertainty about whether the seller (as legal owner) or buyer (as equitable owner) is the correct party to undertake certain actions relating to the property after completion, such as the service of notices.

Problems with the law

5.111 We are aware that the service of a section 17 notice can be difficult during the registration gap.[340]

5.112 We explain the way in which section 17 works at paragraph 5.28 above but, briefly it operates in the following circumstances:

(1) if a current tenant has failed to make payment of a fixed sum (such as rent) under the lease; and

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339 Business Tenancies: the right to renew – Consultation Paper 2: modernising security of tenure (2026) Law Commission Consultation Paper No 275 (available at https://lawcom.gov.uk/project/business-tenancies-the-right-to-renew/). We call this the "Second Business Tenancies Consultation Paper" in this chapter.

340 We note that other notices may be served under the 1995 Act. These are briefly discussed at para 5.123 below. However, we have only heard the registration gap causes difficulties in relation to section 17 notices.

(2) a former tenant entered into an authorised guarantee agreement[341] in favour of the landlord so that the former tenant guarantees the current tenant's performance of the covenants under the lease, including those relating to payments of rent; then

(3) a landlord may seek payment of the arrears from the former tenant, but only if the landlord has first served a section 17 notice on the former tenant.

5.113 We note that the provisions of section 17 (and the ability of a landlord to serve a section 17 notice) apply to both old tenancies and new tenancies. However, the problem we are aware of relates only to new tenancies, and they are the focus of our discussion.

5.114 If a landlord (L1) assigns their interest, but HM Land Registry has not registered the assignee (L2) as registered proprietor, a question arises as to who the relevant landlord is for the purposes of section 17 of the 1995 Act. Is it L1, the legal owner, or L2, the equitable owner? Or is it L1 and L2 together?

5.115 An article explores this issue in detail.[342] The authors observe that the transmission of the benefit of the tenant's covenants on an assignment by L1 to L2 will be effected by section 3(3)(b) which states that:

> … where the assignment is by the landlord under the tenancy, then as from the assignment the assignee … becomes entitled to the benefit of the tenant covenants …

5.116 The authors question whether this means the equitable assignment or the legal assignment but conclude that assignment should be interpreted as meaning "from the date of the transfer" not "from the date of registration". This is consistent with the definition of assignment in the 1995 Act, which includes equitable assignments,[343] and with the conclusions drawn in a leading textbook.[344]

5.117 However, they also note that section 28 defines "landlord" as "the person for the time being entitled to the reversion expectant on the term of the tenancy". They explain that:

> … in the registration gap, there are still two persons entitled to the reversion, even if the equitable assignment suffices to transfer the benefit of the covenants: there is still one person entitled to the reversion in law, pending registration, and someone else is entitled to it in equity.

5.118 On that basis, the authors suggest that during the registration gap L1 and L2 are both the "landlord" for the purposes of section 17. Under the 1995 Act, where two or more

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341 See para 4.28 and following for an explanation of what is an authorised guarantee agreement under the 1995 Act.

342 N Taggart and L Nye (Landmark Chambers), "'Mind the Gap', Landlords, the Registration Gap and the Landlord and Tenant (Covenants) Act 1995" (2009).

343 1995 Act, s 28(1).

344 T M Fancourt QC, *Enforceability of Landlord and Tenant Covenants* (3rd ed 2014), para 2-01.

persons jointly constitute the landlord, any reference to the landlord is a reference to both or all of them.

5.119 Accordingly, the authors' recommendation (and, we understand, the approach adopted by practitioners) is for both L1 and L2 to serve a section 17 notice jointly. We understand that this approach can be administratively burdensome and increase costs.

Provisional view

5.120 We have sympathy with the concerns referred to above. However, we are cautious about making any proposals for law reform on this issue at this stage, for the following reasons.

(1) Although the issue discussed above is reasonably discrete, as we noted in Chapter 11 of the Second Business Tenancies Consultation Paper we are concerned that reforms to address issues relating to the registration gap might not be straightforward, might risk unintended consequences and could represent a disproportionate and inappropriate solution to deal with issues that exist between the date a transaction occurs and the date HM Land Registry processes it.

(2) We are not yet persuaded as to the extent of the issue in practice, and the effect on commercial leasehold transactions, and would require further evidence before we are satisfied that law reform is needed.

(3) The practice of L1 and L2 joining in to serve the section 17 notice jointly may be beneficial from the perspective of the former tenant. The former tenant will be able to verify independently that L1 is the legal owner by undertaking a search at HM Land Registry. If only L2 served notice on the former tenant, then the former tenant would have no simple way of verifying their identity and their entitlement to the sums demanded.

5.121 However, we welcome consultees' comments about our conclusion (and any evidence of the extent and impact of this issue in practice) in response to the consultation question at paragraph 5.13 and following above.

SERVICE OF NOTICES UNDER THE 1995 ACT – GEOGRAPHICAL LIMITATION

5.122 In this section, we consider an issue concerning the statutory provisions that govern the service of notices under the 1995 Act.

Current law

5.123 The situations in which statutory notices under the 1995 Act may need to be served are as follows.

(1) Where a landlord seeks to recover a fixed sum from a former tenant, they will need to serve a section 17 notice (see paragraph 5.28 above).

(2) Where a landlord has assigned their interest in the reversion, they will need to serve notice on the tenant, in accordance with section 8 of the 1995 Act, in order to obtain release from the covenants under the lease.

(3) Where a landlord or tenant assigns part of their interest in the premises, there is provision to enable the assignor and assignee to agree to apportion liability under certain covenants relating to the part of the premises not assigned, and to make such agreement binding on the other party to the lease. The procedure for making the apportionment binding on a party involves the service of a notice on that party under section 10 of the 1995 Act.

5.124 The service of notices under the 1995 Act is governed by section 23 of the Landlord and Tenant Act 1927 (the "1927 Act").[345] Section 23(1) provides that:

> Any notice, request, demand or other instrument under this Act shall be in writing and may be served on the person on whom it is to be served either personally, or by leaving it for him at his last known place of abode in England or Wales, or by sending it through the post in a registered letter addressed to him there, or, in the case of a local or public authority or a statutory or a public utility company, to the secretary or other proper officer at the principal office of such authority or company, and in the case of a notice to a landlord, the person on whom it is to be served shall include any agent of the landlord duly authorised in that behalf.

5.125 In summary, the methods of service under the 1927 Act are as follows.

(1) Personal service.

(2) Leaving the notice at the last known place of abode in England or Wales.

(3) Sending it through the post in a registered letter by recorded delivery[346] addressed to the person on whom it is to be served at the last known place of abode in England or Wales. Or, in the case of a local or public authority or statutory or public utility company, it may be addressed to the secretary or other proper officer at the principal office of such authority or company.

(4) In the case of a notice to the landlord, it may be served on a duly authorised agent.

5.126 It is important to note that the methods of service under the 1927 Act are permissive, not mandatory. This means that it is possible to serve a notice validly under the 1995 Act by a method which is not listed above (for example, by email or by ordinary post).[347] However, where another method is chosen and the recipient claims not to have received the notice, then difficulties might arise in proving valid service.

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345 1995 Act, s 27(5).

346 The Landlord and Tenant Act 1927, s 23, as amended by the Recorded Delivery Service Act 1962, s 1, refers to the use of "registered post or recorded delivery". However, Royal Mail currently offers two levels of service above standard first-class and second-class delivery – "Royal Mail Signed For" and "Special Delivery Guaranteed" – both of which can provide proof of delivery.

347 See *Galinksi v McHugh* (1989) 21 HLR 47.

Problems with the law

5.127 We are aware that there is a concern that the 1927 Act imposes a burden on parties who wish to serve notice on a person who resides in the United Kingdom (but not in England or Wales), for example in Scotland.

Provisional view

5.128 As a starting point, we do not regard this issue as being one that only affects the commercial leasehold sector. As noted above, it is not within the scope of our project to propose changes that would materially affect the residential leasehold sector, even where such changes might also benefit the commercial leasehold sector. However, even if that were not the case, we would conclude that this is an issue that is unlikely to meet the threshold for reform without significant evidence of it creating problems in practice.

5.129 Whilst we can understand that the service of property notices can sometimes be technically complex and practically challenging, we have not heard that this issue is causing difficulties in practice in the context of the 1995 Act to the extent that reform should be recommended. As noted above, serving a notice at an address outside of England or Wales does not automatically render the notice invalid.

5.130 However, we welcome consultees' comments about our conclusion (and any evidence of the extent and impact of this issue in practice) in response to the consultation question at paragraph 5.13 and following above.

Chapter 6: Consultation Questions

Consultation Question 1.

6.1 We invite consultees' views, together with evidence where possible, as to what financial and other impacts our provisional proposals to amend the 1987 Act and/or the 1995 Act will have on:

(1) commercial landlords, tenants and their advisers;

(2) the commercial leasehold market;

(3) residential landlords, tenants and their advisers; and

(4) the residential leasehold market.

Paragraph 1.22

Consultation Question 2.

6.2 We invite consultees to tell us if they believe, or have evidence or data to suggest, that changes to either the 1987 Act or the 1995 Act that are being considered in this Consultation Paper could result in advantages or disadvantages to certain groups or to individuals based on certain characteristics (with particular attention to age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex, and sexual orientation).

Paragraph 1.25

Consultation Question 3.

6.3 We invite consultees to tell us about any particular considerations or experiences in Wales, which consultees think are relevant to the potential reforms of the 1987 Act and 1995 Act set out in this Consultation Paper.

Paragraph 1.32

Consultation Question 4.

6.4 We invite consultees' views on whether the issues considered in Chapters 2 to 5 are, in the context of the 1987 Act and the 1995 Act, the issues most in need of being addressed by law reform from the perspective of commercial leasehold law.

Paragraph 1.41

Consultation Question 5.

6.5 We provisionally propose that:

(1) a disposal by way of the grant of a lease by a landlord of a part of the premises that is:

(a) exclusively occupied or used, or

(b) intended to be exclusively occupied or used;

for non-residential purposes should not trigger the Right of First Refusal; and

(2) where one or more residential tenants of the premises share, or have a right to share, the use of parts of the premises (the "Shared Premises"), and the sharing of those Shared Premises is ancillary to their own residential use of part of the premises (that is, their flat), then a disposal of the whole or part of the Shared Premises shall in no circumstances satisfy the test in (1) above.

Do consultees agree? Please explain why.

Paragraph 2.121

Consultation Question 6.

6.6 We provisionally propose that the 1995 Act should clearly facilitate assignments and guarantees between members of the same group of companies as set out in the Consultation Paper at paragraphs 4.132 to 4.141.

Do consultees agree? Please explain why.

Paragraph 4.142

Consultation Question 7.

6.7 We provisionally propose that the rule proposed in Consultation Question 6 should apply to both the assignment itself and any agreement to enter into the assignment (including allowing for it to be made a condition of a landlord giving consent to assign). However, where there is an agreement to enter into the assignment and a later assignment, the relevant parties to both should be – at the time each is entered into (or consent to an assignment is given) – members of the same group of companies.

Do consultees agree? Please explain why.

Paragraph 4.143

Consultation Question 8.

6.8 We provisionally propose that what constitutes a group of companies for the purpose of facilitating more transactions involving them to be valid for the purposes of the 1995 Act should be based on section 42 of the Landlord and Tenant Act 1954. Do consultees agree? Please explain why.

6.9 In particular, we invite views from consultees on the possibility of using the definition in section 42 of the Landlord and Tenant Act 1954 and whether there is a more appropriate definition that might be employed.

Paragraph 4.152

Consultation Question 9.

6.10 We provisionally propose that the 1995 Act should clearly facilitate assignments within partnerships as set out in the Consultation Paper at paragraphs 4.154 to 4.192 and for repeat guarantees to be valid in such circumstances.

The above would require that the partners comprising the assignor and assignee to be in substantially the same partnership. This would be met where:

(1) the component partners making up the assignee tenant and the component partners making up the assignor tenant were engaged in substantially the same business; and

(2) at least one of the component partners in the assignee and assignor is the same.

Do consultees agree? Please explain why.

Paragraph 4.193

Consultation Question 10.

6.11 We invite consultees' views on whether the greater flexibility afforded by the provisional proposal set out in Consultation Question 9 risks tenants and/or their guarantors (particularly those who are not advised) being put in a materially worse position than under the existing law.

Paragraph 4.194

Consultation Question 11.

6.12 Where consultees believe the 1995 Act currently has an adverse impact on business relationships (other than in respect of transactions involving group companies and partnerships) we invite consultees' views, together with evidence where possible, on the following:

(1) the types of business relationships;

(2) the prevalence of such business relationships in the market; and

(3) the nature of the adverse impact caused to the business relationship(s) by the 1995 Act.

Paragraph 4.201

Consultation Question 12.

6.13 We provisionally propose that, where a tenant (T) under a lease has the performance of its obligations guaranteed by a guarantor (G), the 1995 Act should facilitate the assignment of the lease by T to G. This proposal would not extend to any agreement entered into in advance by G to complete that assignment.

Do consultees agree? Please explain why.

Paragraph 4.210

Consultation Question 13.

6.14 Chapter 5 considers five issues with the 1995 Act as follows:

(1) Concurrent leases.

(2) Covenants with management companies.

(3) Agreements for leases.

(4) The registration gap.

(5) Geographical limitations on the service of notices.

6.15 We invite consultees' views, together with evidence where possible, on the following:

(1) Are the issues considered in this chapter causing difficulties?

(2) Are there any other issues with the 1995 Act which are not considered in this chapter (or in the previous chapter) which are causing difficulties?

6.16 To what extent are the issues identified above causing difficulties specifically in commercial leasehold transactions?

6.17 To what extent would reform of any of the issues identified above also impact upon residential leasehold transactions?

Paragraph 5.13

Appendix 1: Extracts from the Report of the Committee of Inquiry on the Management of Privately Owned Blocks of Flats

1.1 In this Appendix we refer to the 1985 Report of the Committee of Inquiry on the Management of Privately Owned Blocks of Flats[348] as "the Report".

1.2 The following is an extract from the Report (see paragraphs 2.2 to 2.10). It provides useful historical background regarding the changing nature of flat building and leasing that preceded the committee's work.

> From the 1840s onwards there had been some developments of purpose-built blocks of artisans' flats in England, for charitable housing trusts such as Peabody, Guinness and Sutton. The first non-charitable private blocks of flats were built in London in 1853 but there was little in the way of large-scale flat-building until the 1880s. The next 25 years saw over a thousand blocks built in central and inner London where the great majority of blocks were concentrated. Like almost all housing prior to the First World War, such blocks were built exclusively for private renting.
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> The second great wave of flat-building for private rental took place in the second half of the 1930s. Again, much of it was concentrated in London and the South East. By the outbreak of the Second World War, at least 1300 new blocks totalling well over 60,000 flats had been built in London. There was also considerable flat-building in many of the south coast resorts.
>
> Although there was some limited new building for rent in the 1950s and early 1960s, 1939 marked the effective end of large scale private rental construction in Britain. From the mid 1950s onwards an increasing number of flats and maisonettes were developed, purpose-built for sale on long leases. It was then but a short step from the building of flats for sale to the idea of selling existing privately rented flats.
>
> By the early 1960s some companies had begun to grant long leases on unfurnished tenancies at a nominal annual rent in return for a substantial premium but mortgage availability tended to restrict sales. The picture began to change in the mid 1960s for several reasons. Landlords realized that, following the introduction of the fair rent system in the Rent Act 1965, increases in registered rents were not keeping pace with rising costs, thus reducing net income at a time when capital values of flats with vacant possession were rising sharply. This combination of circumstances gave many traditional property companies a further impetus to sell flats either individually or as blocks and to offer long leases to sitting tenants at a discount on the vacant possession value. This, combined with the effect of tax changes introduced in the Finance Act 1965, caused many property companies to transfer their residential holdings into trading portfolios. At the same time, flat dwellers, in common with other

[348] Report of the Committee of Inquiry on the Management of Privately Owned Blocks of Flats (October 1985).

householders, were becoming increasingly attracted to owner-occupation. Changes in the incidence of personal taxation increased the number of people able to benefit from tax relief on mortgage interest and building societies became increasingly willing to accept long leasehold flats as security for mortgage advances.

During the late 1960s and early 1970s many ‘traditional’ landlords moved out of the residential property market. While some chose to sell off their flats gradually, either to sitting tenants at a discount or on the market as they became vacant, others opted for the quicker and easier process of selling blocks of tenanted flats to a new type of company specialising in the ‘break-up’ of blocks by selling flats wherever possible.

This process was accelerated by the rapid inflation in residential property prices from 1971 to 1973 and by the ready availability of finance. As a result, speculative trading in blocks of flats increased rapidly. The secondary banking crisis and the collapse of the property boom in late 1973 and 1974 slowed the ‘break-up’ market but it became increasingly active again after 1978, fuelled by pressure of rising costs on landlords and the upsurge in house prices. Several major insurance companies and institutions who had not sold their blocks of flats prior to 1973 now did so.

The results of these events for the privately rented purpose-built flat sector were considerable. The large scale traditional residential investment landlords, with a vested interest in both good landlord-tenant relations and the long-term maintenance of their residential property assets to provide a steady source of income, were replaced in many cases by speculative break-up companies whose interest was primarily in short-term capital gains from sales. This has frequently led to the intensification of management problems as the interests of landlords, renting tenants and long lessees have come into conflict. Many blocks have experienced a succession of different landlords, some with no base in Britain. The pool of detailed local management expertise and goodwill built up by the management departments of the older style residential investment companies has been largely dissipated and a growing secondary market (not always conducive to good management) has developed in the sale of freehold interests.

The increase in new blocks of long leasehold flats since the mid 1950s and the growing number of flat ‘conversions’ for sale have given rise to problems partly because many of the pitfalls were not fully appreciated at the time and partly because the landlord’s interest was often short-term, ending upon the completion of sales. Many leases were poorly drafted but even if the deficiencies had been fully appreciated at the time they were granted the financial advantages which accrued to sitting tenants upon the purchase of a long lease at a discount may have often outweighed detailed consideration of the terms of the lease.

The overall result of the advent of ‘break-ups’, new leasehold flat building and flat conversions is the growth of management problems and potential areas of dispute ….