December 2010

Review

Property @ction

Welcome to the Sixth Edition of the Quarterly Review from Hammonds' Property@ction Team. In this issue we will look at the following:

(i) You can't take it with you! - when a chattel becomes a fixture;

(ii) Authorised Guarantee Agreements – Guarantors;

(iii) When is an excluded lease not excluded?;

(iv) Rent as an administration expense;

(v) A Strategic Approach to LPA Receiverships;

We welcome all contributions to this review and if you would like to discuss this further please contact any of the editorial team.

'You can't take it with you!'

Whether you are a tenant or a freehold owner, you may think that whatever you put into a property remains yours to take away again when you leave. However, this is not always the case. Once an item is placed within a property it can become a "fixture", deemed to belong to whoever owns the property. Fixtures will (unless specifically excluded by contract) be covered by a mortgage of the property, be included in a sale of the property and may pass to the landlord of a leasehold property on expiry or transfer of the lease.

HOW DOES AN ITEM BECOME A FIXTURE?

1. Is there a sufficient degree of annexation?

If the item rests on its own weight, then unless there is a demonstrable intention to use it as a fixture (see below) it will remain a "chattel" – the personal property of the person who bought the item and not of the landowner. This is the case regardless of the size of the item. A windmill resting on a brick floor, a wooden barn resting in specially prepared stone caps and a granary resting on staddles were all held to be chattels.

A relatively minor amount of fixing, such as nailing, screwing or bolting the article to the floor, will suffice to turn a chattel into a fixture, although an item that is only attached for the purpose of being powered (e.g. by an electric lead plugged into a wall socket) will remain a chattel.

An item will be a fixture even though it is not attached to the land, if it is necessary to the operation of a fixture. For example, the keys to a house are fixtures. However, spare parts for fixtures remain chattels until they are put into use.

2. What is the purpose of the annexation?

Even if an item is firmly attached to the land, it will remain a chattel if it was fixed for the better use or enjoyment of the object itself rather than the "permanent and substantial improvement" of the property. This is an objective test and does not depend on the actual intention of the person who placed the item. For example:

- Cinema seats that were fixed to the floor of a cinema permanently became fixtures; however, cinema seats on loan for 12 weeks that were also fixed to the floor for the duration of the loan remained chattels.

- Paintings, tapestries and antique fireplaces have all been held to be fixed for the better enjoyment of the item rather than the improvement of the property, while an ordinary, non-ornamental fireplace was deemed to be a fixture.

Items which are not physically fixed to the land can still be fixtures if they are a "permanent improvement". Examples include blocks of stone placed together to make a dry stone wall, statues that formed part of the architectural design of a building, and frescoes forming part of the permanent decoration of a theatre.

TENANT'S FIXTURES

Fixtures in leasehold property will either be a "tenant's fixtures" or a "landlord's fixtures". A fixture is a tenant's fixture if:

- The fixture was annexed to the property by the current tenant; and
- The fixture was annexed for the purposes of the tenant's trade or for ornamentation and convenience; and
- The fixture is capable of removal from the land without substantial damage to the land and without losing its utility.

Tenant's fixtures can be taken from the premises when the tenant leaves, although the tenant must make good any damage caused. Unless the lease provides otherwise, the tenant has no obligation to remove its fixtures – however, the fixtures must be in the state of repair required by the repairing covenant in the lease. By contrast a tenant must remove its chattels in order to give vacant possession of the property to the landlord.

Fixtures that are not tenant's fixtures are landlord's fixtures. The tenant must repair landlord's fixtures under the repairing covenant and cannot remove the fixtures on leaving the premises. If the tenant supplies a replacement for a piece of machinery originally supplied by the landlord, it will be a landlord's fixture.

CONCLUSION

The legal position of fixtures may come as a surprise to an occupier, especially a leasehold occupier. It is important to bear in mind the consequences of effecting permanent improvements to a property and to take appropriate action to protect the occupier's interests by agreement with the freeholder or purchaser.

Authorised Guarantee Agreements – Guarantors

In the case of *Good Harvest Partnership LLP v Centaur Services Limited*[1] the High Court considered the validity of a requirement of a guarantor to enter into an authorised guarantee agreement (an "AGA") when a lease is assigned. The principles of this case were then approved by the High Court in *K/S Victoria Street v House of Fraser (Store Management) Limited*[2] in November this year.

What is an AGA?

If a tenant assigns a lease granted after 1 January 1996, he is automatically released from any tenant covenants under the lease by s.25 of the Landlord and Tenant (Covenants) 1995 (the "1995 Act"). The 1995 Act contains provisions to prevent the avoidance of this right. However an AGA is a valid exception to these anti-avoidance provisions. Therefore, in the vast majority of assignments, the tenant will have continuing liability for the performance of the covenants in the lease by the assignee by virtue of being required to enter into an AGA. The 1995 Act introduced the concept of an AGA but does not directly define what an AGA is. Instead, it provides a number of requirements that an agreement must satisfy to qualify as an AGA. These requirements can be summarised as follows:

- under the AGA the tenant guarantees the performance of the relevant covenant to any extent by the assignee; and
- the AGA is entered into in the specified circumstances and its provisions conform with the relevant statutory requirements.
- the AGA is entered into pursuant to a lawfully imposed condition of the Landlord's consent to the assignment.

1 [2010] EWHC 330 (Ch)   2 [2010] EWHC 3006 (Ch)

The decision in Good Harvest Partnership LLP v Centaur Services Limited

Earlier this year, the High Court had to consider whether an agreement that requires the tenant's guarantor (in addition to the tenant) to guarantee the obligations of an assignee of the lease is valid.

The facts of the case are that the subtenant assigned his sublease and in accordance with the terms of the sublease, as a condition of the landlord's consent, both the subtenant and the subtenants' guarantor entered into an AGA.

The High Court held that the AGA was void. The requirement for the subtenants' guarantor to also guarantee the assignee's obligations under the sublease went further than was intended by the 1995 Act.

The decision in K/S Victoria Street v House of Fraser (Store Management) Ltd

In November this year, the High Court had to consider this issue again and followed the decision in the Good Harvest case

- The Landlord was K/S Victoria Street who leased a store to House of Fraser (Stores Management) ("HoF")
- There was an agreement which contained an obligation for HoF to assign the lease to another group company within the House of Fraser group by a specific point in time, with House of Fraser itself acting as a guarantor.
- The assignment did not take place and the Landlord brought proceedings against HoF, the other group company and House of Fraser in its position as proposed guarantor.
- House of Fraser argued that following the Good Harvest case, the agreement was unenforceable as it breached the anti-avoidance provisions in the 1995 Act.
- The Landlord sought to argue that the Good Harvest case had been wrongly decided or that the facts of this case meant that the principle in Good Harvest could not be applied in this case.

The High Court held that an agreement that required the tenant's guarantor to guarantee the assignee's obligations, at such time as the lease was assigned, was void (due to the provision in s.25 of the 1995 Act).

The court did have some reservations about parts of the reasoning in Good Harvest case, but did not feel that the facts of the HoF case were materially distinguishable and therefore followed the principles laid down in the Good Harvest Case.

It seems then that whether a guarantee has actually been given or is to be given in the future has no effect on the analysis and application of the anti-avoidance measures in the 1995 Act.

It is likely that in the future, any agreement that seeks to bind a guarantor once a lease has been assigned will be void.

Latin Quarter

Caveat Emptor

Caveat Emptor literally means "let the buyer beware". So far as goods are concerned, consumer law has moved away from the caveat emptor model, with laws passed that have enhanced customer rights and allow greater leeway to return goods that do not meet legal standards of acceptance.

In property transactions though, the principle remains. The onus is on the buyer to ascertain the quality and condition of the property before proceeding with its purchase. The seller is under no obligation to disclose defects, but may not actively conceal known defects if asked.

When is an excluded lease not excluded?

The effect of Part II of the Landlord and Tenant Act 1954 is to grant the tenants of business premises security of tenure. Security of tenure means that the tenant has an expectation that the lease will continue after the date of expiry and that the landlord will only be able to terminate the lease and refuse a further lease in certain circumstances. So long as the correct procedure is followed, a landlord and tenant are free to agree that the protections afforded by the 1954 Act should be excluded, subject to certain requirements.

The case of *Newham LBC v Thomas-Van Staden*[1] highlighted that the requirements for contracting out are to be applied strictly and that any deviation can result in the tenant gaining security of tenure, even where the parties clearly intended that this should not be the case.

This case concerned a contracted out lease of commercial premises. The lease specified that the term was to be from the 1 January 2003 to 28 September 2004 including "any period of holding over or extension of it whether by statute or at common law or by agreement." The lease had been contracted out of the protections afforded by the Landlord and Tenant Act 1954 and it was accepted that the procedure followed in contracting out had been valid. Following expiry of the term of the lease the tenant continued to occupy the premises and pay rent.

The lease also contained a clause allowing for the lease to be terminated by the landlord on 28 days' written notice. The landlord served such notice on the tenant in July 2005 but the tenant did not vacate the premises. The landlord commenced proceedings for possession which were initially successful, but the tenant appealed on the basis that following the expiry of the fixed term she occupied the premises under a periodic tenancy with security of tenure under the 1954 Act. If this were true, the landlord's notice would be deemed ineffective as it was not a notice under section 25 of the Act.

The landlord argued that no monthly tenancy had been agreed; and therefore that the tenant was simply holding over on the terms of the initial tenancy and as the initial tenancy excluded the 1954 Act, the current occupancy could not now have the benefit of the statutory protections.

In deciding the case, Lord Justice Rimer accepted that both parties entered into the lease with the intention that the created tenancy would be contracted out of the 1954 Act protections. However, section 38(4) of the 1954 Act explicitly states that a lease can only be contracted out where it is for a "term of years certain," and therefore regardless of intention it is this issue which is decisive. Lord Justice Rimer identified two possibilities for the proper construction of the lease; that the term was the period until 28 September 2004 plus any further period, or that the term was the period until 28 September 2004 and any further period was a matter of uncertainty. If the first possibility were true then it could not be for a term of years certain. If the second possibility were true then the lease had been granted for no more than a term of years certain. In this case the lease was validly contracted out and the nature of the tenant's ongoing occupation would be a matter to be addressed separately.

It was held that the first interpretation was correct, as it was difficult to ascribe any other meaning to the clause which would make sense. The landlord's submission that the words were "meaningless surplussage" was rejected; the fact that they were included in the lease meant that they were plainly intended to have an effect. Accordingly Lord Justice Rimer held that the lease was not for a term of years certain and therefore could never have been validly contracted out of the security of tenure provisions in the 1954 Act. The landlord's written notice was ineffective and the tenancy would continue.

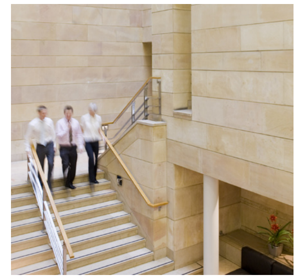
This case illustrates that a business landlord must be very careful when entering a lease on the basis that it is contracted out of the statutory provisions contained in the Landlord and Tenant Act 1954. Any reference to a continuation of the term must be deleted as any element of uncertainty as to the term may result in the tenant being afforded security of tenure.

If a landlord were to find himself in a similar position to the one in the above case it may be possible to challenge the lease on the basis that it is void for uncertainty. Lord Justice Rimer gave a passing mention to this possibility in his judgement, but as it was not argued by the landlord he offered no view on the point.

Although not central to the facts of the case, it should also be noted that on the expiry of a contracted out lease the landlord should act promptly to prevent any further tenancy arising by implication. Where the tenant does not vacate the premises possession action should be taken promptly, and the landlord should not accept rent in the meantime.

1 [2008] EWCA Civ 1414

Rent as an administration expense



In the current economic climate, the decision in *Goldacre (Offices) Ltd v Nortel Networks UK Ltd*[1] has given hope to landlords whose tenants remain in occupation after going into administration but fail to pay rent falling due. Historically, a landlord could only seek redress by requesting permission to forfeit the lease, by issuing a debt claim or arguing that it should receive rent for any period of occupation in the interests of fairness

The Decision

Goldacre considered the issue of rent falling due while a company is in administration and continues either to occupy or make use of any part of the premises. The Court held that if the use is for the purpose or benefit of the administration, rent will be either an administration expense, or a necessary disbursement. The administrators remain liable for the entire period of occupation or use pursuant to the terms of the lease. Payments rank ahead of administrators' fees and payments to other non-fixed charge holders.

The Goldacre decision considered the following:

> **In Re Lundy Granite Company ex parte Heavan**[2] – that rent will be treated as an expense of liquidation where an insolvent company either occupies or makes use of the premises for the benefit of the liquidation. In Goldacre this was held to apply equally to administrations so that rent will be an expense of an administration where the company either occupies or makes use of the premises for the benefit of the administration.
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> **Exeter City Council v Bairstow**[3], which established that business rates should be met either as an administration expense properly incurred by an administrator in performing his duties; or as a necessary disbursement incurred by an administrator in the course of an administration under the Insolvency Rules 1986 (Rule 2.67). It established that the Court does not have discretion to decide what can be an expense, it is prescribed by law.
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> **Lehman Brothers International (Europe) Limited**[4] which established that a necessary disbursement would be a payment that is just and equitable, so not necessary just because a landlord threatened proceedings such as forfeiture.
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> **Powdrill v Watson**[5] which established that the Court does not have discretion regarding the amount of rent payable, as both the right to occupy and the amount of rent derive from the lease. Rent must be paid in accordance with the lease, even if there is only partial occupation.

Goldacre was recently followed by *Cheshire West and Chester Borough Council v In the Administration of Springfield Retail Limited*[6]. In this case, administrators were liable to pay rent as an administration expense because they granted a licence of the premises to a third party for the purpose of the administration.

A Landlord's Perspective

Once an administrator has been appointed, landlords should ask him to confirm the manner and extent to which the premises will be used and assert the right to recover full rent in accordance with the lease. In particular, landlords should act where an administrator occupies the premises because they are integral to the tenant's business or where there may be a premium on assignment. Landlords should also make administrators aware that vacant possession will be required in accordance with the lease and that they may incur reinstatement liabilities, for which funds will be required.

Landlords must check lease provisions carefully when a tenant enters administration. If the lease provides that rent should be payable quarterly in advance, landlords will be entitled to receive a full quarter's rent even if the administrator vacates the premises part way through the quarter. Landlords should also review the terms of any licences granted by the administrator, ensuring that fees will be collected quarterly in advance and that they cover the rental period as well as the licence period. If the rental costs will not be passed to the licensee, landlords should check that the administrator has sufficient funds to pay rents due. If not, landlords may have to seek enforcement action or negotiate a settlement.

The Goldacre case has placed landlords in an advantageous position, whereby they will be able to recover liabilities pursuant to the lease and so strengthen their negotiating position or alternatively, the decision would support a landlord's application for a declaration or an order to lift the moratorium. The decision also has wider implications, leading many commentators to conclude that other types of leasehold liabilities, such as dilapidations, will be treated as administration expenses in the future.

1 [2009] EWHC 3389 (Ch) 2 (1871) L.R. 6 Ch.App. 462 3 [2007] EWHC 400 (Ch) 4 [2009] EWHC 2545 (Ch) 5 [1995] 2 All ER 65 6 [2010] CSOH 115

A Strategic Approach to LPA Receiverships

The current financial crisis which began in 2007 was triggered by a liquidity shortfall in the United States banking system (sub-prime mortgage crisis), widely referred to as the 'credit crunch'. It has resulted in the collapse of large financial institutions such as Northern Rock and Lehman Brothers, the bail out of banks by national governments from RBS and Lloyds to federal take over of Fannie Mae and Freddie Mac, and downturns in stock markets around the world. Later events have seen a near collapse of the Euro with financial bail outs for Greece and Ireland, with potentially more to follow!

It is considered by many economists to be the worst financial crisis since the Great Depression of the 1930s. It has contributed to the failure of key businesses leaving already indebted banks and financial institutions with a further headache – how to deal with distressed assets, extract value and adopt a long term approach as opposed to a quick 'fire sale' of assets. One such approach is to use the ability to appoint a Receiver contained in The Law of Property Act 1925.

In dealing with Value Recovery and LPA Receivership Appointments in the UK Property Recoveries Sector, it is important to understand the difference between Process and Strategy. The traditional 'old world' approach to LPA Receiverships has been a 'zero sum' game and that is because a 'Process' approach has been adopted.

In game theory and economic theory, 'zero-sum' describes a situation in which a participant's gain or loss is exactly balanced by the losses or gains of the other participant(s). If the total gains of the participants are added up, and the total losses are subtracted, they will sum to zero.

The basic nature of a Process approach to LPA Receiverships is an assumed 'zero sum' game. The Process approach aims to reduce financial losses, simultaneously reducing tensions between debt (mortgagees) and equity holders (mortgagors) and tries to facilitate a prompt resolution of a distressed lending situation by engineering a sale – but then factor in the 'free-fall' in Market Values triggered by the Economic Recession and the implications for Value Recovery are clear – the Mortgagee is likely to suffer a significant shortfall in the level of Debt Recovery.

In 'new wave' Property Recoveries thinking, the approach to LPA (Fixed Charge) Receiverships is based on developing a 'Strategic Brief' as the most effective instrument of 'Value Recovery' and the emphasis is on the 'Pre-Appointment Strategy'. This approach can be split into three stages:

Stage 1: Recovery Objectives

A 'Strategic Briefing' Document can be developed with the Appointing Mortgagee called a 'Strategic Options' Report which provides:

- The identification of the Value Recovery Objectives
- A review of the various 'Value Recovery Options' available and identification of the Best Value Recovery Solution
- An agreed 'Recovery Brief' and the Instrument of Appointment agreed following a 'Loan Security Review' carried out by the appropriate 'Panel Solicitor'
- A working relationship with the Mortgagee 'Risk Management' on a Value Recovery Plan and the appointment of a 'Client Liaison' – usually the LPA Receiver and Case Manager to implement the agreed Recovery Objectives.

Stage 2: Valuation and Strategic Advice

- The Draft Dedicated Value Recovery Plan (the "Workout Plan") can then be finalised with indicative 'scenario' Valuations:

  The Workout Plan should include the following 'Outputs':

  - Agreed Action Points
  - Provisional Timescales and Horizon for Resolution
  - Service Deliverables and Outputs
- Drafting of a series of 'Scenario led' Outcome Statements are drafted
- Setting up the framework process for the Co-ordination of the appropriate Professional Advisory Team

1 [1976] 1 WLR 852

- Reviewing and upgrading where appropriate the framework process for the costing, procurement and management Specialist Support Services and Advice i.e. Independent Valuation; Property and Facilities Management; Building Surveying and Project Management Consultancy, Rating, Planning Consultancy, Plant and Machinery, Assets and Chattels Valuation and Disposal Advice.

- Agreeing with the Appointing Principal a series of 'trigger dates' to continuously review the 'Value Recovery Strategy' and the operational Asset Management Plan – to allow for re-specification, further resource allocation, realignment of Value Recovery Objectives and Anticipated Outcomes.

- Working towards achieving a Value Recovery Solution and final Case Resolution with a series of 'Briefings' and 'Reports' deal with Case Administration and Progression in communicating with the Appointing Principal and keeping all the key stakeholders fully informed.

Stage 3: Asset Management

The embedded process in any LPA Receivership Appointment is Asset Management.

It is important to use 'Estates Capability' instruments and techniques to understand how to change the whole approach to an LPA Receivership Appointment. These need to be set-up and aligned to pursue the best 'Value Recovery' outcome.

It is recommended to structure the 'service delivery model' for LPA Receivership Appointments into four distinct 'service packages':

- Turnaround
- Consultancy
- Ongoing Management
- Disposal

The LPA Receiver should then choose the best alignment of services to meet the agreed 'Value Recovery objectives for each case and agree the applicable 'key performance indicators' in measuring the effectiveness and quality of the services procured and provided i.e Are they 'Value for Money'? Are they appropriate and meeting expectations?

Asset Management is therefore a combination of **Value Creation** and **Cost Containment** in **driving the performance** of **Property Assets** through the **use of Value Recovery Plans** in **implementing Debt Recovery Solutions.**

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