
# VIRTUAL ASSIGNMENTS AND LEASEHOLD ALIENATION COVENANTS

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enrichment analysis in conventional subrogation cases (*Cheltenham & Gloucester plc.* v. *Appleyard* [2004] EWCA Civ 291 at [49]), although they do now seem committed to it as the explanation underpinning subrogation (*Filby* v. *Mortgage Express (No. 2) Ltd.* [2004] EWCA Civ 759 at [62]). Uniformity in the common law is desirable, but it seems this is another instance where "the common law is no longer monolithic" (*B.* v. *Auckland District Law Society* [2003] UKPC 38 at [55], [2003] 2 A.C. 736).

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## VIRTUAL ASSIGNMENTS AND LEASEHOLD ALIENATION COVENANTS

COMMERCIAL leases invariably contain express limitations on the otherwise unfettered right of tenants to assign or sublet their leasehold interest to third parties. Landlords use these clauses to insulate themselves from financially risky or undesirable assignees or subtenants. Traditionally, the courts have interpreted covenants against alienation strictly and *contra proferentem*. Thus, it is unsurprising that the Court of Appeal held in *Clarence House Ltd.* v. *National Westminster Bank plc.* [2009] EWCA Civ 1311, [2009] 1 W.L.R. 1651 that the "virtual assignment" of a lease did not breach standard-form leasehold covenants against alienation.

Despite being described by Ward L.J. in *Clarence House* as "strange new beasts in the forest", virtual assignments have become increasingly common in the commercial leasehold sector. Under these contracts a tenant generally transfers to a third party all of the economic benefits and burdens accruing under a lease (including management responsibilities), but not the leasehold interest itself.

Tenants with large property portfolios apparently prize virtual assignments for their capacity to facilitate leasehold dealings, without falling foul of covenants against alienation. Arguably, since their effect is only contractual rather than proprietary, there is no need to seek the landlord's consent to the transaction. The potential delay, expense and risk of refusal inherent in seeking consent can therefore be avoided. From the landlord's perspective, virtual assignments offer tenants an unwelcome ability to undermine the effectiveness of expressly agreed covenants against alienation.

These issues were at play in *Clarence House* itself. The case involved a 25-year commercial lease of office premises in Manchester ("the property"). The lease contained various common restrictions against alienation including covenants prohibiting the (i) execution of any declaration of trust over the property or the lease; (ii) sharing, possession

or occupation of all or part of the property, or parting with possession or occupation; (iii) underletting the whole of the property without the landlord's prior written consent; and (iv) assigning the property without the landlord's prior written consent.

The tenant, National Westminster Bank plc. ("NatWest"), underlet the whole property to another company, Mercer, in 2001 whilst retaining a nominal three-day reversion of the leasehold interest. The sub-lease was entered into with the permission of the landlord ("Clarence House"), and NatWest ceased occupying the premises. In 2005 NatWest's parent company, the Royal Bank of Scotland Group plc. ("RBS"), entered into a virtual assignment of its leasehold interest in the property with New Liberty Property Holdings Ltd. ("New Liberty"), an offshore Gibraltarian company. Under this agreement the economic benefits and burdens of NatWest's lease, and the sub-lease with Mercer, passed to New Liberty. NatWest appointed New Liberty as its agent giving it authority to act on its behalf and in its name when paying rent, negotiating rent reviews, and collecting rent due from Mercer. Additionally, NatWest executed a Power of Attorney in favour of New Liberty that gave it authority to do whatever was "necessary or advisable" to give proper effect to the virtual assignment.

Clarence House remained unaware of the virtual assignment until some months later. On discovering that it was dealing with an "unforthcoming Gibraltarian company", rather than its pre-credit crunch "copper-bottomed high street bank", Clarence House sought a declaration that the virtual assignment breached the covenants against alienation. Clarence House's concerns about New Liberty were well-founded; not only was the rent in arrears, but also provisional liquidators of New Liberty were later appointed.

The Court of Appeal (Ward, Jacob and Warren L.JJ.) in *Clarence House* agreed with the High Court decision of H.H.J. Hodge Q.C. that there had been no breach of the covenants against sub-letting, assignment or declaration of trust. However, unlike the High Court, the Court of Appeal held that there had not been a breach of the covenant against sharing or parting with possession. Ward L.J. confirmed that "possession" should not be conflated with "occupation", but rather should be defined in its "normal, and technically legally correct meaning" (*per* Neuberger L.J. in *Akici* v. *LR Butlin Ltd.* [2005] EWCA Civ 1296, [2006] 1 W.L.R. 292, at [26]). As such, "possession" refers not only to exclusive occupation, but also includes "the receipt of rents and profits or the right to receive the same, if any" (section 205(1)(xix) of the Law of Property Act 1925 ("LPA 1925")).

Ward L.J.'s somewhat opaque remarks [32(2)–(5)] in *Clarence House* suggest mistakenly that NatWest had already fully divested itself of "possession" of the property in 2001 when it entered into the

permitted underlease with Mercers. Thus it was argued that NatWest could not have parted with or shared possession under the virtual assignment with New Liberty, and would not have breached the alienation provisions. Whilst it is true that NatWest did not occupy the premises after 2001, it retained its reversionary leasehold estate and continued to receive rent from its subtenant Mercers. As such NatWest continued to fall within the broader technical meaning of "possession" under section 205(1)(xix) LPA 1925. Thus, at the point of entering into the virtual assignment with New Liberty, contrary to Ward L.J.'s suggestion, NatWest could be said to have parted with or shared possession in breach of its leasehold covenants with Clarence House.

So far, so good for Clarence House. However, Ward L.J. noted that the virtual assignment and Power of Attorney were grounded in contractual, agency-like terms. New Liberty collected rents in NatWest's name, not its own. Thus there was no transfer or sharing of the right to receive rents as envisaged by section 205(1)(xix) LPA 1925. Whilst New Liberty held those rents for its own benefit, this was due to the contractual arrangements contained in the virtual assignment, rather than in the sense of sharing or being put into possession of the property.

Whilst this approach may be technically defensible, it underlines the highly pro-tenant bias of the English courts when faced with the interpretation of leasehold covenants. It remains open to landlords to include express prohibitions against virtual assignments, if they know of their existence and wish to do so. However, as in *Clarence House*, the emphasis upon protecting tenants does not always fairly reflect the relative business acumen of the parties to commercial leases.

EMMA WARING

## PRE-NUPS, PRIVATE AUTONOMY AND PATERNALISM

MARITAL agreements (i.e. pre-nuptial, post-nuptial and separation agreements) are among the most debated topics in family law and form part of the Law Commission's Tenth Programme of Law Reform. For now, the latest word on pre-nuptial agreements is the decision of the Court of Appeal in *Radmacher* v. *Granatino* [2009] EWCA Civ 649. The decision is important first because it marks a clear departure from previous case law, and secondly because of its open criticism of the approach of the Privy Council in *MacLeod* v. *MacLeod* [2008] UKPC 64, [2009] 3 W.L.R. 437 (noted by Miles [2009] C.L.J. 285) and its clear emphasis on private autonomy over paternalism. The third issue of importance is the international dimension of the case, which cannot be explored here (but see Miles [2009] C.F.L.Q. 513).