

Alienation of a
Leasehold
Interest:
Landlord and
Tenant
Perspectives

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▣ ALIENATION OF A LEASEHOLD INTEREST: LANDLORD AND TENANT PERSPECTIVES

Introduction

The current economic downturn, which is anticipated will continue for sometime, has created tension between landlords and tenants of commercial premises.

While landlords wish to protect the value of their investment, tenants on the other hand wish to reduce their outgoings and have greater flexibility with their accommodation arrangements.

Most modern commercial leases contain restrictions preventing a tenant from assigning, sub-letting or otherwise parting with possession of a premises without a landlord's prior consent and may often contain an absolute prohibition on a partial assignment or sub-letting. Such a provision is incorporated into a lease to enable landlords to retain control over the occupier of the premises and to protect the value of their investment. In changed market circumstances this article proposes to look at the options open to a tenant who has surplus space and to look at such options from the perspective of a landlord.

Tenant's Options

The various options that are available to a tenant are:

Break Option

If a tenant has a break option in its lease the tenant can exercise its option to break and bring the tenancy to an end. The break option will be subject to the conditions as set out in the clause being complied with which may include the following:

- ▣ 6 to 12 months prior notice in writing and the notice provisions in the lease are to be strictly adhered to in this regard. The notice is served as provided in the lease, service by registered post is recommended also;
- ▣ payment of a penalty of approximately 6/12 months rent to the landlord prior to the date of surrender;

- ▣ compliance with all the covenants in the lease. Failure to do so could prevent a valid exercise of the break option;
- ▣ payment of all rents, outgoings, etc. to the date of the surrender;
- ▣ time is of the essence.

Surrender

In the event that there is no break option provided in the lease the tenant may attempt to negotiate a surrender of the premises to the landlord in consideration of a reverse charge premium. It is at the discretion of the landlord as to whether or not it will agree to such a surrender.

Group companies

In the event that the tenant has the option to group share it may avail of such an option in order to assist with the payment of the rent subject to the conditions as set out in the clause being complied with which may include the prior renunciation in writing of the group or associate company of its right to renew.

Pre-emption clause

In the event that there is a pre-emption clause in the lease in favour of the landlord the tenant will be in a position to notify the landlord in accordance with the provisions in the lease of its intention to assign the lease providing the landlord with the right to match a third party offer.

Assignment

An assignment involves an out and out transfer of the interest of the tenant. An assignment transfers the tenancy to the assignee and the tenant ceases to have any interest in the premises. The assignee steps into its shoes and assumes all the rights and liabilities of the tenancy for as long as it holds it. The tenant will have no liability going forward under the lease provided that it has completed all the necessary formalities.

Sub-lease

The crucial point in a sub-letting is that the tenant retains its interest in the premises and remains liable to the landlord on the terms under the head lease. Unlike an assignee of the tenant, a sub-tenant has no privity of estate with the landlord. The head lease will specify that the rent in the sub-lease is either the open market rent or equivalent to the rent passing under the head lease for the time being whichever is the greater. Given the current economic climate such a provision may prove to be an obstacle to the tenant as it can only sub-let at the higher rent. When negotiating a lease this is a provision that the tenant should carefully consider.

Unsuitable market conditions which render sub-letting problematic do not relieve the tenant from having to comply with the pre-conditions to sub-letting set out in the lease. This issue arose in the case of *Allied Dunbar Assurance Plc v Homebase Limited* [2002] 2 EGLR 23. In this case the defendant tenant Homebase Limited had been granted a lease for 25 years. After 12 years it no longer needed the premises and wished to sub-let it. The head lease permitted sub-letting with consent but only if it satisfied certain conditions, that the covenants in the sub-lease reflected those in the head lease, that the rent was to be at or above the full market rent and that the rent was to be reviewed to a level no less than the full market rent. The defendant agreed a sub-lease with a sub-tenant satisfying this requirement, however, it entered into a collateral agreement expressed to be personal to the parties, that the defendant would indemnify the sub-tenant for any higher rent following the next rent review effectively fixing the rent for the sub-tenant and against the cost of specified repairs. The plaintiff landlord Allied Dunbar refused consent on this basis and sought an injunction to prevent the sub-let. The defendant counterclaimed, alleging that consent had been unreasonably withheld. On May 17, 2002, the Court of Appeal upheld the High Court's approach finding that the collateral agreement and the head lease were interdependent and to be read as one document. As there was an anticipated breach of the head lease it was held that the plaintiff had not unreasonably withheld its consent. This case in effect decided that side agreements are likely to be ineffective.

Partial Sub-lease

In the event that the tenant has the option to sub-let part of the premises in its lease it may wish to avail of such an option in order to supplement the rent payable or if it has surplus space. The ability to sub-let may often be restricted to one sub-let at any one time or if the premises naturally lends itself to being sub-let it is not uncommon for a lease to permit a sublet on a floor-by-floor basis, however, this may be limited to one or two sub-lets at any one particular time. The tenant will be obliged to comply with all conditions in the lease in

relation to such a sub-let which are generally the same as those applicable to a sub-let of the entire of the premises. If this is not permitted in the lease it is recommended that the tenant liaises directly with the landlord seeking permission. It is at the discretion of the landlord as to whether or not to agree to such a sub-let.

Landlord's Considerations

Assignment

An assignee will be the person to whom the landlord will look for payment of the rent and compliance with all the covenants and conditions in the lease. The last thing a landlord wants is a tenant who refuses to take care of the premises and who fails to pay the rent regularly. A landlord will carefully approve the proposed assignee who will be subject to financial tests and may be required to provide guarantees and/or rent deposits. A typical test to establish the financial viability of the assignee is to see whether its accounts show pre-tax profits of not less than three times the rent payable.

Requirement of a landlord when approving an assignee:

- ▣ financial standing—The landlord will have to ensure that the assignee is of good financial standing otherwise the landlord could suffer because of the cost and inconvenience of enforcement of the covenants in the lease and because of the adverse effect that an assignee of doubtful financial standing could have on the value of the reversion.

Sub-lease

The following conditions are commonly imposed by landlords in leases in respect of a sub-letting in order to protect the value of its investment:

- ▣ rent reserved in the sub-lease - The landlord will be concerned about the rent to be reserved in any sub-lease and accordingly the head lease will almost certainly impose some requirements in this respect. Generally it will provide that no sub-lease is to be granted at a fine or premium and that the rent reserved under the sub-lease should be no less than that reasonably obtainable in the open market or the rent for the time being passing under the head lease whichever is the greater;
- ▣ rent reviews - The landlord will also seek to tie in rent review provisions into the sub-lease to ensure that the sub-lease rent keeps pace with the head lease;

- ▣ covenants and conditions - The covenants and conditions in the sub-lease are generally the same as those in the head lease.

In the event that a head lease is forfeited for whatever reason the sub-tenant may be left to claim equitable relief against forfeiture though the sub-tenant may have its position preserved under s.78 of the Landlord and Tenant (Amendment) Act 1980. It is for this reason that a landlord will also apply the same requirements, i.e. good financial standing, satisfactory tenant etc. when approving a proposed sub-tenant as it does with an assignee in the event that a sub-tenant seeks the approved reliefs to remain on in the premises following forfeiture.

Partial Sub-lease

Generally a landlord will impose the same conditions in a lease in respect of the sub-letting of the entire of the premises to the sub-letting of part of the premises. However, it is far more desirable to have one good tenant than multiple tenants in a premises which increases the risk for the landlord and possible breaches of the tenancy such as non-payment of rent. The landlord needs to consider the following matters that may arise in the event that a partial sub-let is agreed:

- ▣ devaluation of the premises - when a premises has been fragmented by assignments or sub-lettings of small portions this may reduce the value and marketability of the landlord's reversion. In such cases the landlord should always be advised to obtain professional advice from a valuer. If the valuer is of the opinion that either the value or marketability of the reversion would be prejudiced then clearly the landlord should be advised not to consent to the division of the premises;
- ▣ statutory rights - From the landlord's point of view it is crucial to ensure that such a sub-letting does not give the sub-tenant statutory rights to renew. In the event of consenting to such a sub-let the landlord would have to ensure that the sub-tenant renounced its right to renew and executed a valid deed of renunciation;
- ▣ management and administration - The sub-division of the premises may cause the landlord problems as management, administration and control would be increased if the tenant dropped out of the picture in such a way as to render the landlord the immediate landlord in respect of the sub-divided premises;

- ▣ deterioration of the premises - In addition, the landlord may be concerned that sub-division taken too far will result in the deterioration of the premises.

Consent Application

In seeking consent whether to an assignment or sub-letting it is a matter for the tenant to provide the landlord with all the necessary information required in accordance with the terms and conditions provided in the lease. When making the application the tenant should put the landlord on notice as to how urgent it is. Time begins to run as soon as the landlord has received all the necessary information and provided that all the preconditions in the lease have been satisfied.

Reasons for Landlord to Refuse Consent

- ▣ The proposed assignment/sub-let would adversely affect the value of the landlord's reversion.
- ▣ The proposed assignee/sub-tenant is clearly unacceptable even if diminution in the value of the reversion cannot be shown.
- ▣ The proposed tenant cannot demonstrate that it is in a position to fulfil the covenants under the lease. This usually arises in the area of finance which would have a negative affect on the landlord's investment.
- ▣ That the proposed user is not in keeping with the development or that it is already a restrictive user.

In this jurisdiction it is up to the tenant to prove the unreasonableness of the landlord. A recent case on unreasonable refusal to grant consent to an assignment is *Meagher & Anor v Luke J Healy Pharmacy Ltd* [2005] IEHC 120. In accordance with the terms of the lease the defendant tenant Luke J Healy Pharmacy Ltd had covenanted to maintain and keep the premises including the roof and exterior walls in good and proper and sufficient order, repair and condition. The defendant further covenanted not to assign the premises without the consent in writing of the landlord and to use and occupy the premises for the defendant's trade as a pharmaceutical chemist and other ancillary uses. In this case the plaintiff landlord Meagher & Anor took a case against the defendant on the basis that it had not carried out the repairs to the premises, the defendant counterclaimed for damages because the plaintiff refused and delayed consent to assign and to sub-let. The defendant requested consent

twice to assign and to sub-let but was refused on both occasions on the basis that the necessary repair works had not been carried out. The defendant made a third application for consent to assign and confirmed to the plaintiff that it was intended that the proposed assignee would complete the schedule of dilapidations within one year from completion. The plaintiff did not respond to this request. The defendant then substantially complied with the schedule of dilapidations previously furnished to it and requested the plaintiff to consent to a further assignment, yet again, no reply was received by it from the plaintiff. The premises were eventually assigned to another assignee. The judge held in favour of the defendant on the basis that the plaintiff had acted unreasonably and that his refusal was on account of the fact that the defendant was a competitor to him as they were both in a pharmacy business. The delay in relation to the third request for consent was deemed unreasonable. The damages awarded by the court were the rent and rates payable by the defendant from the time that the third request for consent for an assignment fell through to the completion of the successful assignment, this also included the agent's fees and outlay for the assignment.

A recent case on unreasonable refusal to grant consent to a change of use is *Dunnes Stores [Ilac Centre] Ltd v Irish Life Assurance PLC & Anor* [2008] IEHC 114. This case involved the plaintiff tenant Dunnes Stores, requesting a change of use of one of its units to a "high quality food hall use". It was refused by the defendant landlord Irish Life Assurance PLC & Anor "on the grounds of good estate management" and they later stated that "the plaintiff's proposed use would not be consistent with the defendants' vision and image for that part of the Ilac Shopping Centre, namely as a primarily retail fashion area". Prior to the application for change of user the defendant and the plaintiff had been in discussions in relation to the surrender of all or part of the leases. The plaintiff sought a declaration on the basis that consent was unreasonably withheld. The judge granted the declaration to the plaintiff on the basis that there was a strong possibility that the defendant refused consent in order to secure the surrender of all or some of the plaintiff's leases in respect of its units held at the Ilac Shopping Centre in order to gain possession and by virtue of the fact that the refusal of the consent was inconsistent with the provisions in the lease which provided that when considering applications for change of user regard had to be given to the necessity and desirability of the business being "as diverse as possible".

Both cases are strongly against the landlord. It is possible that this can only increase in the current climate as judges are becoming more and more sympathetic to tenants who through no fault of their own are in a difficult financial position.

In *International Drilling Fluids Limited v Louisville Investments (Uxbridge) Limited* (1986) 277 E.G. 62, the judgment of Balcombe L.J. contained a summary of the principles to apply in

determining whether or not a landlord's consent has been unreasonably withheld which are summarised as follows:

- ▣ the purpose of the restriction against alienation is to protect the landlord from having its premises used or occupied in an undesirable way or by an undesirable tenant;
- ▣ a landlord is not entitled to refuse consent on grounds that have nothing to do with the landlord-tenant relationship;
- ▣ the onus of proving that consent is unreasonably withheld is on the tenant;
- ▣ the landlord does not have to prove that its reasons for refusing consent were justified if such an opinion was to be held by a reasonable individual in the circumstance;
- ▣ it may be reasonable to refuse consent on the grounds of the proposed use of the premises even if that use is not prohibited in the lease;
- ▣ it is a question of fact in each case depending on the circumstances as to whether or not consent has been unreasonably withheld.

Statutory provisions provide that a landlord cannot unreasonably withhold its consent in accordance with s.66(1) of The Landlord and Tenant (Amendment) Act 1980, that regardless of what prohibitions are in a lease in respect of assignment or sub-letting, the landlord is bound by these provisions.

Remedy for Landlord if the Tenant Proceeds Without Consent

- ▣ Damages - it may be difficult to show a loss of reversion, especially if the lease is still alive and may not be relied upon if the landlord does not seek a reversion. Compensatory damages may be awarded if appropriate. Damages are only usually sought in the alternative or in addition to another remedy.
- ▣ Forfeiture - this is a commonly used remedy however given the current economic situation it may not be favourable for a landlord to have the premises vacant.
- ▣ Injunction - this may be granted if appropriate but is discretionary.

Remedy for Tenant if the Landlord Unreasonably Withholds Consent

- ▣ Court declaration - the court can declare that the consent has been unreasonably withheld and grant an order permitting the tenant to proceed with the assignment or sub-letting without the consent of the landlord. It is not always practical for a tenant to do this in view of the delay involved.
- ▣ Proceed with no consent - can be done, however, this may be risky.
- ▣ Damages - the amount awarded may not just be compensatory but also exemplary.

Conclusion

Given the current economic situation, it is crucial to both the tenant and the landlord that they understand each other's position and endeavour to reach an agreement that is suitable to both parties in the event that this is required, i.e. if the tenant cannot repay the rent as it is too high it is better for the landlord to reduce the rent to a level that is reasonable to both parties. This should prove to be advantageous to both parties in so far as the landlord will still have the premises let and the tenant can remain on the premises for the effective running of its business.

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Author: Louise Wright

CONTACT US

Our Offices

Dublin

33 Sir John Rogerson's Quay,
Dublin 2,
Ireland.
Tel: +353 1 667 0022
Fax.: +353 1 667 0042

Cork

8 Webworks Cork,
Eglinton Street,
Cork, Ireland.
Tel: +353 21 425 0630
Fax: +353 21 425 0632

Boston

26th Floor,
225 Franklin Street,
Boston, MA 02110,
United States of America.
Tel: +1 617 217 2866
Fax: +1 617 217 2566

New York

245 Park Avenue
39th Floor
New York, NY 10167
United States
Tel: +1 212 792 4166
Fax: +1 212 792 4167

Tokyo

12th Floor,
Yurakucho Itocia Building
2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: +813 6860 4885
Fax: +813 6860 4501

e-mail: enquiries@dilloneustace.ie
website: www.dilloneustace.ie

Contact Points

For more details on how we can help you, to request copies of most recent newsletters, briefings or articles, or simply to be included on our mailing list going forward, please contact any of the team members below.

Paul Eustace

e-mail: paul.eustace@dilloneustace.ie

Tel : +353 1 667 0022

Fax: + 353 1 667 0042

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DILLON  EUSTACE

DUBLIN CORK BOSTON NEW YORK TOKYO

33 Sir John Rogerson's Quay, Dublin 2, Ireland.
www.dilloneustace.ie

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