

LEGAL ALERT

Dangers of underletting without landlord's consent

The recent case of *Crestfort Ltd & ors v Tesco Stores Ltd & anor* [2005] EWHC 805 (Ch) will serve as warning to tenants and undertenants that seek to enter into an underlease which is in breach of the dealing provisions of the headlease. In this case, as a result of the unlawful underletting by the tenant, Tesco, the High Court granted an injunction ordering the surrender of the underlease and an inquiry into compensatory damages. But all is not lost for tenants, as the case may have also reopened the door for the use of collateral agreements as a means of getting round restrictive provisions.

The Facts

Crestfort owned premises which were let to Tesco. The dealing provisions of Tesco's lease provided that any underlease had to be granted "subject to like covenants as are herein contained except as to the rent thereby reserved and the length of the term thereby granted". However, despite Crestfort's refusal of consent, Tesco granted a sublease which contained less onerous repairing obligations than the headlease in the belief that Crestfort had no effective remedy against the underletting if they did not wish to forfeit Tesco's lease. However, Crestfort issued legal proceedings seeking an injunction requiring the surrender of the underlease and damages.

Decision

The High Court held that as Tesco granted an underlease that did not satisfy the preconditions imposed by the headlease in relation to the undertenant's repairing obligations, this meant that Crestfort was not even obliged to consider the application to underlet. Accordingly the Court dismissed Tesco's counterclaim that Crestfort had unreasonably withheld consent. The Court granted an injunction requiring the underlease to be surrendered as Tesco was in breach of the covenant in the headlease and because the undertenant was liable in tort as it had induced a breach of contract between Crestfort and Tesco as it knew that Crestfort's consent was required by had not been granted.

While discussing the issue of damages the judge decided to revisit the effectiveness collateral agreements as a means of getting round restrictive provisions in the headlease. In the earlier case of *Allied Dunbar Assurance Plc v Homebase Ltd & anr* [2002] EGLR 23 the headlease required that any underlease should be at the full passing rent. In an attempt to side step this difficulty the tenant entered into a side agreement with the subtenant to refund to it part of the rent expressed to be payable in the sublease. However the court held that this was not effective as the side letter effectively varied the terms of the underlease so that it was in breach of the requirements of the headlease. However in this case it was held that a collateral agreement between a subtenant and a third party is "totally different" to a collateral agreement between the tenant and subtenant directly and is therefore likely to be valid.

Comment

This case should serve as a warning to tenants that seek to breach the alienation covenants of their leases in a similar fashion on the assumption that the only remedy open to the landlord is one of forfeiture. The ability to seek an injunction forcing the undertenant to surrender its lease to the tenant provides a landlord with a viable alternative to forfeiture and one that protects against any unwanted underlettings whilst maintaining the valuable rental income. On the other hand the comments made in relation to collateral agreements have perhaps opened the door once again for their use (albeit in a modified form) as a means of sidestepping the restrictive covenants in the headlease as opposed to breaching them. This is particularly useful when tenants wish to sublet their over-rented properties at less than the passing rent, despite a prohibition against this in its lease.

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