



“Virtual Assignments” and Covenants against Alienation

1. In *Clarence House Limited v National Westminster Bank Plc* [2009] EWCA Civ 1311 (Ward, Jacob and Warren LJJ), the Court of Appeal considered for the first time¹ the issue whether, by entering into a “virtual assignment” of leasehold premises, the tenant of those premises acts in breach of the standard-form alienation covenants contained in the lease under which the premises are held.
2. Virtual assignments are a comparatively recent innovation or, to put it another way, “*strange new beasts in the forest.*”² In *Clarence House*, Ward LJ (adopting the trial judge’s description) described a virtual assignment, at [2], as:

“[An] arrangement under which all the economic benefits and burdens of the relevant lease (including any management responsibilities) are transferred to a third party, but without any actual assignment of the leasehold interest or any change in the actual occupancy of the premises in question. It is typically employed where the relevant lease contains covenants against assigning or parting with the possession of the demised property without the consent of the landlord, and there are concerns either that the landlord may be unwilling to consent to a legal assignment of the lease because of perceived concerns about the financial standing of the assignee, or that the landlord’s consent may not be available in advance of the scheduled date for completion of the transaction.”

¹ Although, see *Abbey National Plc v Commissioners for Revenue and Customs* [2005] EWCA Civ 886 (which concerned the VAT consequences for a virtual assignor).

² *Per* Ward LJ, at [47].

As Ward LJ goes on to say, a virtual assignment has other uses too: it can be employed as a means of removing lease liabilities from the balance sheet; capital can be released to be better invested elsewhere in the assignor's business; property risks can be transferred to a third party; and the assignor's property liabilities can be more closely aligned to business needs because surplus property can be vacated before the term of the lease expires.

3. *Clarence House* concerned a lease ("the Lease") made on 3 June 1986 between Sun Life Assurance of Canada ("Sun Life") as landlord and County Bank Ltd ("County Bank") as tenant relating to a suite of offices on the ground and first floors of the building known as Clarence House in Manchester. Clarence House Ltd ("Clarence House") was successor in title to Sun Life; and National Westminster Bank Plc ("NatWest") was successor in title to County Bank. At all material times, the premises were occupied by William M Mercer Ltd ("Mercer"), to whom NatWest had granted an underlease.

4. The Lease contained the following alienation covenants:

"30 (1) Not to assign or charge the Demised Premises in any part less the whole

(2) Not to charge the Demised Premises...

(3) Not to execute any declaration of trust with regard to the Demised Premises or any part thereof of these Presents

(4) Not to share or permit sharing of possession or occupation of the Demised Premises or part thereof or part with possession or occupation of the same...

(5) Not to underlet any part or parts of the Demised Premises or permit the same to be underlet...

(6)(a) Not to underlet the whole of the Demised Premises or permit the creation of any derivative underlease...

(8) Not to assign the whole of the Demised Premises...

(10) Not to assign, transfer or underlet the whole of the Demised Premises or underlet parts thereof pursuant to paragraph 30(5) of this Schedule otherwise than in accordance with and without in each and every such case first complying with the foregoing provisions and subject thereto not without obtaining the previous consent in writing of the Landlord which consent shall not be unreasonably withheld."

5. The Virtual Assignment was made on 10 June 2005 between New Liberty Property Holdings Ltd ("New Liberty") and NatWest. The material provisions of the Virtual Assignment were these:

"2. Economic Benefit

The intention of the Virtual Assignment is to pass to the buyer [New Liberty] all of the economic benefits and burdens of the Leases and Underleases in respect of the Properties together with the obligation to manage all dealings with the Landlords and Undertenants as if the Properties had been assigned to the Buyer. Therefore any monies from any Undertenants pursuant to any Underleases, together with all proceeds for the surrender of any Underleases, shall belong to the buyer.

3. Indemnity

... The Buyer will from the Completion Date at all times duly pay to the Landlord in full all Rent on the relevant dates for payment under the Leases and will observe and perform all covenants and obligations contained, and will indemnify and keep the Seller indemnified against payment of all Rent and all costs, liabilities and claims arising out of any actual or alleged breach or non-observance of all covenants or obligations contained in [the Leases].

4. Dealings with Properties

... The Seller hereby irrevocably appoints the Buyer to be its agent to act on its behalf and in its name in all dealings connected with the properties. This will include but not be limited to:

4.1.1 paying all Rent due under the Leases including negotiating any rent reviews under the Leases;...

4.1.3 collecting and getting in all Rent due under the Underleases and negotiating rent reviews;...

4.1.7 negotiating and completing any surrender; ...

4.1.8 dealing with any renewal of any Underlease...

4.1.9 negotiating and completing all assignments...

4.1.17 anything else related to the operation of the Leases and Underleases.

4.2 The Seller will not while this Virtual Assignment is in existence, do or attempt to do any of the things set out in Clause 4.1.

4.3 Neither the agency appointment in Clause 4.1 nor the Power of Attorney shall entitle the Buyer to do any of the following in the name of the Seller

4.3.1 vary the Lease...

4.3.2 renew or re-grant...the Lease...

4.3.3 increase the Rent...

4.4. To enable the Buyer to perform its functions better, the Seller will provide at the cost of the Buyer:

4.4.1 confirmation to Landlords and Undertenants that the Buyer is acting on its behalf;...

and will agree themselves not to approach the Landlords or Undertenants...

4.5 The Buyer will not be entitled to use the name of the Seller in any litigation or other dispute resolution procedure in connection with any of the powers granted by the Seller under this Virtual Assignment without first obtaining the prior written consent of the Seller (which consent shall not be unreasonably withheld or delayed)...

8. Monies Paid and Received Under the Virtual Assignment

All monies paid and received by the Buyer under the Virtual Assignment (whether or not by way of Rent) will be to the account of the Buyer and the Seller will have neither any obligation to pay monies nor any right to receive monies (other than by reason of an Indemnity given by the Buyer in the Virtual Assignment) under or by virtue of the Virtual Assignment.”

6. Upon Clarence House learning that NatWest had “virtually assigned” the Lease, it issued a claim seeking a declaration that by entering into the Virtual Assignment, NatWest had acted in breach of the terms of the Lease in that the arrangements constituted a declaration of trust or a sharing of or parting with possession of the creation of a derivative underlease or an underletting or an assignment without consent. That issue came before His Honour Judge Hodge QC, sitting as a judge of the Chancery Division, who found for Clarence House on the basis that NatWest had either parted with possession or was sharing or was permitting the sharing of possession of the premises.³ NatWest appealed against this decision.

³ In his judgment, the judge held, at [21]: “by executing the Virtual Assignment, the Defendant has either parted with possession of the Property to New Liberty or, at least, is sharing, or permitting the sharing of, possession of the Property with New Liberty. ... the general definitions section of the Law of Property Act 1925 defines “possession” as including “receipt of rents and profits or the right to receive the same, if any”: see section 205 (1)(xix). Whilst that definition is provided for the purposes of a particular statute, and may be excluded where the context otherwise requires, in my judgment it encapsulates a concept well known to, and understood by, real property lawyers engaged in the drafting of leasehold documentation. Moreover, the alienation restrictions in the present Lease expressly differentiate between the concepts of “possession” and “occupation” which ... should therefore not be conflated. ... On the footing that the entire Property is underlet to a third party, the effect of this arrangement is

7. On appeal, Ward LJ started by considering the nature and effect of the Virtual Assignment. He said that, taken together, Clauses 4 and 3 of the Virtual Assignment operated to achieve the objective set out in Clause 2, namely to pass all, but only, the economic benefits and burdens of “*the Leases and the Underleases.*” What the Virtual Assignment did not do was to transfer to New Liberty any proprietary right or interest in the premises whatsoever. Nor did the Virtual Assignment confer on New Liberty any contractual or occupational right in relation to the premises.
8. With these (and other) introductory observations in mind, Ward LJ held that the judge was wrong to find that NatWest had parted with possession of the property to New Liberty or at least shared or permitted the sharing of possession of the premises with New Liberty. This was because, applying the dicta of Neuberger LJ (as he then was) in *Akici v L R Butlin Ltd* [2005] EWCA Civ 1296, at [23]-[30], and of Lord Browne-Wilkinson in *J A Pye (Oxford) Ltd v Graham* [2002] UKHL 30, at [40], and in accordance with the standard strict meaning given to a standard covenant against sharing or parting with possession, New Liberty was never in legal possession of the premises in the sense that it did not have the requisite factual possession and intention to possess. (In fact, the only person in possession of the demised property was Mercer.) By entering into the Virtual Assignment,

that New Liberty is to deal with the Property as the Defendant, as its head leasehold owner, would otherwise have been expected to deal with it, and the Defendant no longer has the right to do so. In my judgment, that amounts to a parting with or sharing of possession.”

NatWest had not wholly ousted or completely excluded itself from the legal possession of the demised premises for all purposes. Ward LJ went on to conclude (at [41]-[52]) that, as a matter of construction, the Virtual Assignment did not amount to a declaration of trust with regard to the demised property nor a breach of the prohibition on assignment.

9. *Clarence House* thus confirms the continued possible use of virtual assignments as a mechanism to facilitate portfolio transactions for tenants without damaging landlords' interests and/or as a means to side-step potentially onerous alienation covenants.

NICHOLAS TROMPETER

Selborne Chambers

10 Essex Street

WC2R 3AA

8 December 2009