Unnecessary complications

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Direct deeds of covenant: not worth the paper that they are written on, says Nicholas Roberts

IN BRIEF

- Long residential leases still commonly include a requirement that assignees enter into a "direct" deed of covenant with the landlord and management company.
- Do these serve any useful purpose since the passing of the Landlord and Tenant (Covenants) Act 1995?

Leasehold conveyancing is in its nature already a complicated matter, so why do some practitioners persist in retaining a complication that at best is a waste of time, and at worst suggests a failure to understand the current law? The complication referred to is the covenant still to be found in many long residential leases for an assignee to enter into a deed of covenant with the landlord, and (if applicable) the management company, whether this is a genuine residents' management company (RMC), controlled by the leaseholders, or a company which is the alter ego of the landlord.

Pre-1996

In the case of leases granted prior to 1996, when the Landlord and Tenant (Covenants) Act 1995 (LT(C)A 1995) took effect, such deeds of covenant do serve some useful purpose. Although the general principles of the law on privity of estate would have ensured that assignees would automatically have been liable on the tenant's covenants (and able to sue on the landlord's), the position of RMCs under tripartite leases was always unclear, so, prior to 1996, it was prudent to ensure that assignees were in a direct contractual relationship with any RMC. Many leases also required that an assignee should covenant to pay the rent and observe the covenants under the lease for the remainder of the term. This would therefore have had—and still has—the result that each new assignee would, in effect, be guaranteeing the covenants even after having parted with the lease. Although this might seem unfair—and one suspects that few assignees were advised that this was what they were undertaking—it did, from the viewpoint of the landlord (and any RMC) serve a useful, if questionable purpose. The covenant, in the case of pre-1996 leases, ought still to be observed.

Post-1995

LT(C)A 1995 did of course effect a substantial change to the law on privity of contract and privity of estate. Its most notable effect was to abolish the principle that an original tenant would remain liable on lease covenants throughout the whole of the term, and, as a *quid pro quo* for landlords, to provide that authorised guarantee agreements (AGAs) might be required as a condition of assignment: either where reasonable in the circumstances, or (by amendment to s 19 of the Landlord and Tenant Act 1927) where a prior condition to that effect had been included in the lease. Most solicitors involved with commercial conveyancing are well aware of the changes wrought by LT(C)A 1995, and a request that a proposed assignee enter into a deed of covenant ought to result in a refusal. A request that a proposed assignee should enter into a deed of covenant which endures for the remainder of the term is likely to result in the recipient firmly directing the attention of the proposer to s 25 of LT(C)A 1995, which clearly states that any attempt to frustrate or restrict the operation of the Act is to be treated as void (this has been broadly construed by the courts: see *London Diocesan Fund v Phithwa sub nom Avonridge Property Co Ltd v Mashru* [2005] UKHL 70, [2006] 1 All ER 127). But it is a matter of surprise to the author that developers' solicitors who draft residential leases include in them, in spite of LT(C)A 1995, clauses which require assignees to enter into a "direct" deed of covenant with the ground landlord, and (where applicable) with any RMC. Solicitors acting for original lessees and for purchasers, moreover, seem content to go along with this.

The present author finds it impossible to discern what legal function such "direct" deeds of covenant can fulfil in post-1995 leases. Every assignee becomes liable on the tenant's covenants, and able to sue on the landlord's covenants, by virtue of s 3(2) of LT(C)A 1995. This was always so, under the doctrine of privity of estate, but it is explicitly covered by the LT(C)A 1995. Any uncertainty over the position of RMCs is resolved, in respect of post 1995-leases, by s 12 of LT(C)A 1995. This is expressed in broad terms, and it is impossible to see what a "direct" deed of covenant is intended to add to it, or may add to it. Insofar as any "direct" covenant extends beyond the period in which the leasehold term is vested in the assignee, and purports to impose liability on the assignee for the remainder of the term, it is self-evidently an attempt to frustrate the operation of LT(C)A 1995, and is therefore void under s 25.

We therefore have the situation where:

- insofar as a "direct" deed of covenant imposes liabilities on the assignee for the duration of the term, it adds nothing to s 3(2) of LT(C)A 1995;
- insofar as it brings the assignee into a direct relationship with any RMC, it replicates the effect of s 12 of LT(C)A 1995; and
- insofar as it purports to impose any

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liability on the assignee—whether to the landlord or to an RMC—after the assignee has himself parted with the leasehold term, then it is entirely void under s 25 of LT(C)A 1995.

The only possible function that a "direct" deed of covenant may fulfil is a practical one: it is at least arguable that it serves as a reminder to someone who acquires a lease that they will be bound by its terms. A surprising number of leasehold owners claim to be unaware that they are taking on precisely the same obligations as the original lessee. But it is questionable whether executing a standard form deed of covenant does ensure that an assignee will actually have read the lease, or require that it be explained to him. The solution has to be for conveyancers and solicitor who act for prospective assignees to do their job in this respect.

But in practice...

Of course, if one is faced with a post-1995 lease which contains this wholly redundant requirement for a direct deed of covenant, in practical terms it may be difficult to avoid complying with it. The seller's solicitor is likely to include a special condition in the contract requiring the execution of a direct deed of covenant. Even if a contract contains such a term, is difficult to see how any court could insist upon someone entering into a covenant which was—if it purported to endure for the remainder of the term—*pro tanto* void, as an attempt to frustrate s 25. On the basis of the maxim that "Equity does not act in vain" it is at least questionable whether any court should go even as far as to require someone to execute a document which merely replicates the effect of s 3 (and s 12, if applicable) and is therefore redundant. But clearly it is going to be cheaper and less trouble to comply with the requirement for a direct deed of covenant than to challenge it in court.

If a transaction were completed without a direct deed of covenant being executed, then one might also be faced with a restriction at the Land Registry to the effect that no disposition should be registered unless eg the solicitor for the management company had certified compliance with the provision. Enquiry of the Land Registry did not elicit any definite answer to this question, but it seems likely that any dispute as to whether a disposition should be registered notwithstanding a failure to comply with such a restriction would be referred to the First-tier Tribunal (Property Chamber). One would hope that the tribunal would find the arguments in this article compelling and decline to require an assignee to go to the trouble of executing a document which was entirely redundant. Again, it is likely to be less trouble, and at the end of the day cheaper, to comply than to take up a point of principle. One may question whether the Land Registry should be accepting applications for the inclusion of such restrictions in the first place, though perhaps it is asking too much to expect that such requests be vetted.

Comment

All in all it seems regrettable that solicitors for developers continue to include a requirement for a direct deed of covenant in new leases when such covenants cannot serve any useful purpose; serve only to complicate conveyancing; suggest that those who draft them do not understand the modern law; and imply that it is fair practice to charge costs for drafting or approving a document which is frankly meaningless. NLJ

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