

Changing structure, maintaining security

Limited liability partnerships As the benefits of different business structures change over time, tenant businesses may decide to convert, but this might jeopardise their security of tenure, warns Simon Hartley

When the Limited Liability Partnerships Act 2000 (“the 2000 Act”) introduced the concept of limited liability partnerships (“LLPs”) into English law, many professional businesses changed their structure from a partnership to a LLP to keep the partners’ personal assets separate from those of their business (except in cases of fraud). This year’s budget included changes to the tax treatment of partners and LLPs, which have led to many businesses considering incorporation.

Not all of the risks of changing a business structure are readily apparent. One such risk may arise if the business is a leasehold occupier of commercial property.

Security of tenure

Security of tenure under Part II of the Landlord and Tenant Act 1954 (“the 1954 Act”) can be very valuable to tenants when the costs of relocation are high. Care must be taken when tenants change their business structure during the term of a protected lease to ensure that security is not lost.

Take, for example, a partnership wishing to transfer its business to a LLP during the term of a protected tenancy held in the partners’ names. The lease prohibits dealings with the premises, including parting with or sharing possession, save for assignment with the landlord’s consent, not to be unreasonably withheld or delayed.

Assignment

If the lease is assigned to the LLP with landlord’s consent before the term expires, security of tenure will be maintained. The partners should bear in mind that applying for licence to assign can be a lengthy process. The tenants may have to deal with multiple requisitions or address conditions raised by the landlord before getting consent.

If the landlord unreasonably withholds or delays consent, assigning without consent would not be a breach of covenant. To proceed on that basis without the comfort of a court declaration would be risky. The partners should commence any

application for a declaration at the earliest opportunity to avoid the lease expiring before the proceedings conclude.

Whether or not consent is obtained, the tenancy would still vest in the LLP as the assignee of the lease – see *Old Grovebury Manor Farm Ltd v W Seymour Plant Sales and Hire Ltd* [1979] EWCA Civ 2; [1979] 2 EGLR 52. However, an unlicensed assignment where the landlord acted reasonably in refusing consent would be a breach of covenant.

Business transfer

Likewise, converting the partnership’s business structure before an assignment would also be a breach of the lease. Section 1(2) of the 2000 Act states that a LLP is a separate entity from its members. The partners would effectively have permitted a third party to occupy the premises.

Such breaches would risk forfeiture and opposition to the grant of a renewal lease under section 30(1)(c) of the 1954 Act. If the breach was an illegal assignment, following *Esso Petroleum Co v Kingswood Motors (Addlestone)* [1974] QB 142 and

Test Valley Borough Council v Minilec Engineering [2005] 2 EGLR 113, there is also the risk of a mandatory injunction requiring the LLP to reassign the lease to the partners. This would present a problem at expiry of the lease as the partners would be the tenants but the occupier would be the LLP.

If the tenancy is reassigned to the partners, or remains with them following a business transfer to the LLP, that could prevent not only the partners but also the LLP having security of tenure, even if some, or all, of the members of the LLP were named as tenants in the lease. Occupation would be for the purposes of the LLP’s business rather than that of the partners, meaning the conditions for security of tenure under section 23(1) of the 1954 Act would not be met. Section 41A of the 1954 Act, concerning partnership, would not apply, as none of the joint tenants would be carrying on the business on their own account.

However, under section 41 of the 1954 Act, occupation by the LLP would be equivalent to occupation by the partners if the partners held the lease on trust for the LLP. Unfortunately, that would still give rise to a breach of the alienation covenant.

The safest course for the tenants would be, if possible, to obtain written consent to the assignment in advance of the conversion. Tenants taking new leases should seek sufficient flexibility when negotiating alienation clauses to allow for changes to the structure of their business during the lease term.

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THE IMPACT ON STATUTORY COMPENSATION

Where there is security of tenure, if a building has been occupied for the purposes of the occupier’s business for 14 years prior to termination of the current tenancy, the tenant will be entitled, on vacating the premises, to statutory compensation equivalent to twice the rateable value of its holding following opposition to the grant of a new lease based on grounds (e), (f) or (g) of section 30(1) of the 1954 Act (section 37 of the 1954 Act).

If there has been a change in occupier during those 14 years, provided the new occupier was the successor to the business carried on by the former occupier, the compensation will still be twice the rateable value. If not, compensation will only equal the rateable value. If the conditions above can only be established for part of the tenant’s

holding, double compensation will only be payable in respect of that part.

If there is an assignment of all the assets and undertaking of a partnership to an LLP, that LLP is likely to be regarded as a successor to the partnership’s business and, therefore, that change would not preclude an entitlement to double compensation.

Many commercial leases seek to expressly exclude statutory compensation in their boilerplate clauses. However, section 38(2) of the 1954 Act provides that if the tenant has been in business occupation for five years or more up to the date of quitting and any new occupier during that five years was a successor to its predecessor’s business, such a provision is void in respect of any part of the premises satisfying those conditions.