



Neutral Citation Number: [2009] EWCA Civ 1311

Case No: A3/2009/0304

IN THE HIGH COURT OF JUSTICE
COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM CHANCERY DIVISION
HHJ HODGE (SITTING AS A JUDGE OF THE HIGH COURT)
HC08C01016

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 8th December 2009

Before :

LORD JUSTICE WARD
LORD JUSTICE JACOB
and
MR JUSTICE WARREN

Between :

Clarence House Limited

Claimant
Respondent

- and -

National Westminster Bank Plc

Defendant
Appellant

Mr Christopher Nugee Q.C. and Mr Julian Greenhill (instructed by Linklaters LLP) for the
appellant

Mr Jonathan Gavaghan (instructed by Brian Drewitt Solicitors) for the respondent

Hearing dates: 13th and 14th July 2009

**Judgment Approved by the court
for handing down
(subject to editorial corrections)**

Lord Justice Ward:

1. The issue in this case is 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. On 23rd January 2009 His Honour Judge Hodge Q.C. sitting as a judge of the Chancery Division, declared that it did but only because the tenant either parted with possession or was sharing or was permitting the sharing of possession of the premises. He ordered an inquiry into damages. Jacob L.J. granted permission for this appeal.
2. For those who do not gambol in this arcane field and have not previously encountered a “Virtual Assignment”, let me endeavour to explain what it is. I cannot do better than repeat the judge’s description:

“A ‘virtual assignment’ is 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.”

It has other uses: 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; 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. For these reasons the clever construct of a Virtual Assignment was invented by and has been deployed by commercial property lawyers in the City. They see the Virtual Assignment as “an invaluable mechanism which has facilitated a number of vital portfolio transactions for tenants without damaging landlords’ interests. Reports of its death [a reference to this case] are premature. It is here to stay and the market should be grateful.” So wrote Anthony Burnett-Scott, partner of Ashurst LLP and Nicholas Cheffings, partner of Lovells LLP, in the *Estates Gazette* on 23rd May 2009 at p. 44. The respondent protests that Virtual Assignments may be “well-known to a handful of large City Law Firms acting for tenants with large property portfolios but they remain a device which is new and (so far) comparatively rarely used and untested between landlord and tenant.” This case will, therefore, decide its fate.

3. This Virtual Assignment was made on 10th June 2005 between New Liberty Property Holdings Ltd, a company registered in Gibraltar, which I shall call “New Liberty” and National Westminster Bank Plc (“NatWest”), pursuant to the Master Agreement made the previous day between the Royal Bank of Scotland Group PLC and New Liberty. The Master Agreement is a complicated document to which, fortunately, I need not

make much reference. It deals with the disposal of a large portfolio of property both freehold and leasehold. The Virtual Assignment also covers many properties, some of which are “white leaseholds” where the virtual assignor is no longer in occupation and “grey leaseholds” where the virtual assignor remains in occupation. The material provisions are 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 Under tenants 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 Under tenants ...

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.”

4. On the same day NatWest executed a Power of Attorney in favour of New Liberty. By clause 2:

“[NatWest] hereby irrevocably appoints [New Liberty] to be its true and lawful attorney to do all acts and things on its behalf and in its name which [New Liberty] may consider properly necessary or advisable to effect or to give proper effect to the provisions of the Virtual Assignment ... and deliver as its act and deed ... [everything] properly necessary or acquired for any of the following purposes [namely the acts similar to those set out in clause 4.1 of the Virtual Assignment itself].”

5. The Lease with which we are concerned was a lease made on 3rd June 1986 between Sun Life Assurance of Canada as landlord and County Bank Ltd as tenant relating to a suite of offices being part of the ground and first floors of Clarence House in Manchester. The term was for 25 years commencing on 25th December 1985 and so expiring on 24th December 2010. The current landlord is Clarence House Ltd, the respondent to this appeal, and the current occupier is William M. Mercer Ltd (Mercers) to whom NatWest, the successor to the County Bank, underlet the entirety of the premises with the consent of the landlord for a term of years expiring on 21st December 2010, thus retaining a nominal reversion of 3 days. It is common ground that at no material time has NatWest been in actual occupation of any part of the property.
6. The alienation covenants in this lease are as follows:
 - “30. (1) Not to assign or charge the Demised Premises in any part less than 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 or these Presents
 - (4) Not to share or permit sharing of possession or occupation of the Demised Premises or any 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 nor permit the creation of any derivative underlease ...
 - (8) Not to assign the whole of the Demised Premises ...
 - (10) Not to assign, transfer, charge 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.”
7. The facts giving rise to the litigation can be very shortly stated. Messrs Speechly Bircham who acted for NatWest wrote to FPD Savills Commercials Ltd, the respondent’s managing agent in Manchester to explain that NatWest had “virtually assigned” its leasehold interest in the premises to New Liberty and that New Liberty would be paying the rent on behalf of the Bank and also that New Liberty had the Bank’s authority to deal directly with Savills as agent on all matters relating to the lease. Unfortunately that letter was never received. It was by chance that the respondent’s solicitor learnt from a conversation with a member of the Bank’s property department that a “Virtual Assignment” had been entered into six months

previously. The respondent's solicitors did not know what a Virtual Assignment was, and I confess to having sympathy with them. Speechly Bircham refused to produce copies of the documentation and it needed an application for pre-action discovery to force the documents from the Bank. Not surprisingly this added to the landlord's suspicions. What was this mysterious arrangement? Why was NatWest refusing to deal with its landlord and insisting instead that it deal with New Liberty or its agent? Who was this unforthcoming Gibraltar company who had been foisted upon it without its knowledge or consent in place of its approved tenant, a copper-bottomed high street bank? The respondent made plain how unhappy it was dealing with the interloper, especially in the light of the disconcerting fact that since its involvement, the rent was in arrears. Their concerns could not be assuaged. Their concerns were not without foundation. We have now been informed that on 28th October Provisional Liquidators of New Liberty were appointed.

8. On 10th April 2008 the respondent issued its 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 or the creation of a derivative underlease or an underletting or an assignment without consent. It claimed damages and sought an order for an inquiry into damages. By consent the Master directed that there be a trial of the preliminary issue of liability only.
9. That came before His Honour Judge Hodge Q.C. who found for the claimant on 23rd January 2009 to the limited extent I have already indicated.

The judgment under appeal

10. The judge discussed the case of *Abbey National Plc v Commissioners of Revenue and Customs* [2006] EWCA Civ 886, [2006] 3 EGLR 153, [2006] STC 1961 on appeal from the decision of the late Hart J. [2005] EWHC 831 (Ch), [2006] STC 852. The researches of counsel have not revealed any other case where the courts have had to consider the implications of a Virtual Assignment. He concluded, however, that whilst the decisions were a useful aid to understanding the concept of and the commercial motivation for entering into a Virtual Assignment, he could derive little further assistance from the case because it was concerned with the VAT consequences for the virtual assignor, in that case, the Abbey National Building Society.
11. Dealing with the alleged breaches of the alienation covenant, he found that "neither in form nor in substance did the Virtual Assignment amount to an underletting." There was no breach of the covenant against assignment because the covenant covered only a legal assignment and in any event it would have had to have been completed by registration against the title. There was no declaration of trust involved because "the relationship between the defendant and New Liberty seems to me to be founded in contract rather than in equity."
12. He did, however, find that there was a breach of the restriction against permitting sharing of possession or occupation. He held:
 - "21. ... In my judgment, 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 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."

13. NatWest appeal against the declaration granted on that basis and by its respondent's notice, Clarence House contend that the judge should have accepted as grounds for his declaration that NatWest had acted in breach of the lease by entering into the Virtual Assignment and thereby executing a declaration of trust, and/or by assigning the whole of the demised premises to New Liberty without obtaining the previous consent in writing of Clarence House and/or by underletting the whole of the demised premises or permitting the creation of a derivative underlease without consent.

Discussion

14. It is helpful to begin with an overview of the nature and effect of the Virtual Assignment. It is an agreement between the tenant and a third party – the landlord is not a party and, as in this case, may even be blissfully unaware of these contractual arrangements. That is not to say that the agreement does not have a practical impact on the landlord. The reaction of this landlord shows its concerns. The key feature seems to me to lie in the appointment of New Liberty as NatWest's agent: see clause 4 of the Virtual Assignment and the Power of Attorney. In collecting rent from the sub-tenant, Mercers, and paying it to the landlord, Clarence House, New Liberty acts not in its own right but as agent for NatWest. As such these actions by the agent do not impinge upon the legal relationship which exists and continues to exist between landlord and tenant (the respondent and the appellant). There is a different understanding between NatWest and New Liberty. Although New Liberty must pay rent to the respondent and does so as agent in discharge of NatWest's debt, nevertheless the Virtual Assignment imposes the obligation to pay the rent firmly upon New Liberty without its having the right of indemnity to recover those payments from NatWest that an agent would ordinarily have against his principal. Likewise when collecting rent from Mercers, it will call for that rent as NatWest's agent, but, again contrary to an ordinary agency, it keeps the rent and does not account to its principal for it.

15. The other key provision is the indemnity contained in clause 3. New Liberty must pay the rent and perform all the covenants and obligations contained in the leases and underleases and must indemnify NatWest against any liability in respect of those matters.
16. Taken together, clauses 4 and 3 operate to achieve the objective set in clause 2, namely to pass all – but only – the *economic* benefits and burdens of the leases and underleases. What it does not do is alter the underlying relationship between landlord and tenant. The Virtual Assignment does not transfer to New Liberty any proprietary right or interest in the premises whatsoever: NatWest continues to be both tenant under the lease and landlord under the sub-lease. Nor does the voluntary assignment confer on New Liberty any contractual right in relation to the premises: New Liberty has no entitlement to occupy the premises, the right of occupation being NatWest's.
17. Thus as its clever name suggests, we are dealing with what is virtually an assignment – almost an assignment but not quite. Hence I agree with Mr Christopher Nugee Q.C., who now appears for the appellant, that:

“As its name suggests, the V.A. is not in fact an assignment – it merely mimics the economic result of one without changing the legal position vis à vis third parties at all.”

18. In broad terms this analysis can stand easily alongside this Court's analysis of the different Virtual Assignment made by the Abbey National Building Society. There Abbey transferred all its economic benefits and burdens under its leases to a company called Mapeley Columbus Ltd under a Virtual Assignment, the terms of which were similar but not always identical to those in NatWest's case. Mr Jonathan Gavaghan for the respondent, draws attention to and emphasises the caveat which appears in the clause in that case setting out the aspirations of the parties but which does not appear in clause 2 of the Virtual Assignment before us. There the relevant clause reads as follows with the italicised words being those upon which Mr Gavaghan relies:

“4. The intention of the Virtual Assignment is to pass to the Purchaser 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 Purchaser *but without this Virtual Assignment creating, vesting or granting any legal or equitable estate in the Premises to the Purchaser*. To this end, any monies from the Undertenant pursuant to any Underleases, together with all proceeds of any disposal of the Leases or for the surrender of any Underleases, shall belong to the Purchaser.”

19. In some cases Abbey had sublet their leasehold property and was no longer in occupation (the “white leaseholds”). Mapeley was entitled to receive the rent from the underlessees. In other cases Abbey remained in occupation (the “grey leaseholds”) and Abbey paid Mapeley “a principal fee” similar to the rent it would have paid had there been a formal lease back. The Customs and Excise Commissioners concluded that in neither case was there an exempt supply consisting of the “leasing or letting of immovable property” within the meaning of the relevant

VAT Directive but rather a standard-rated supply of agency and property management services. The Commissioners contended that the effect of the Virtual Assignment was to give neither a legal nor an equitable interest to Mapeley and accordingly Abbey remained the legal and equitable lessee. Since Abbey had conferred no right to occupy on Mapeley, Mapeley could not have made a supply of letting of the property back to Abbey, nor could Mapeley make a supply of “letting” to the sub-tenants. In the first case, the white leaseholds, the rents due to Abbey under the underleases but paid to the virtual assignee were, as the VAT and Duties Tribunal and Hart J. held, exempt from VAT. There was no appeal from this part of the decision. In the other cases, the grey leaseholds, where Abbey remained in occupation, the Tribunal held that the assignee had made a standard-rated supply of agency and property letting services to Abbey. Abbey’s appeal against that decision was allowed by Hart J., but on this point his decision was reversed by the Court of Appeal.

20. The Court of Appeal analysed the nature and effect of the contractual arrangements between Abbey and Mapeley both as a matter of English national law and also as a matter of Community law. As to the former, Jonathan Parker L.J. held:

“[50] As noted earlier, it is common ground that these contractual arrangements did not involve the transfer of any proprietary interest in the properties in question from Abbey to Mapeley, whether at law or in equity. Further, it is rightly accepted by Mr Goy that they did not, and were not intended to, transfer to Mapeley any contractual right to occupy the properties (for obvious reasons, given the existence of covenants against parting with possession without the consent of the landlord). In consequence, Abbey's status as tenant remained the same after as before the execution of the virtual assignment: it continued to occupy the properties the subject of the virtual assignment in right of its status as tenant under the leases. It follows as night follows day that since Mapeley had itself no proprietary or contractual right to occupy the properties in question, it was not in a position to 'lease back' (in the sense of re-transfer) such a right to Abbey. As the Tribunal rightly concluded (see paragraph 52 of its Decision ...), the contractual arrangements between Abbey and Mapeley were effective merely to regulate, as between the two of them, Abbey's exercise of its continuing right (*qua* tenant) to occupy the properties.”

Paragraph 52 of the Tribunal’s decision said this:

“52. The single answer to these two attractive arguments is that [Abbey's] right of occupation, and the right to enjoy the properties by assignment or underletting, derived from the lease with its landlord and not from the virtual assignment. The virtual assignment was a personal collateral agreement between [Abbey] and Mapeley which did not grant rights of occupation but which did regulate how certain rights were to be exercised but only as between [Abbey] and Mapeley. The fact that [Abbey] agreed with Mapeley that [Abbey] would occupy the

premises subject to the occupancy regulations made no difference. The regulation of the right to occupy is not the same as the grant of a right to occupy. The right to occupy was given by the lease and the occupancy regulations were merely an agreement as to how the rights of occupation should be exercised as between [Abbey] and Mapeley.”

21. As for the application of Community law Jonathan Parker L.J. said this:

“86. In my judgment the Community law authorities which I have examined leave no room for doubt that a right of occupation is an essential and fundamental element of a transaction of leasing or letting for the purposes of Article 13B(b). It follows that since, for reasons given earlier, Mapeley acquired no right of occupation of the properties the subject of the virtual assignment, and hence was never in a position to transfer such a right back to Abbey, the supply made by Mapeley to Abbey under the contractual arrangements in question is not a supply of '*leasing or letting*' within the meaning of Article 13B(b) and hence is not exempt from VAT. In my judgment the Commissioners are correct in characterising the supply by Mapeley as a standard-rated supply of agency and property management services.

...

89. In the instant case Abbey is, in my judgment, attempting to have it both ways in just the manner described by the ECJ in the last sentence of paragraph 33 of its judgment in *Cantor Fitzgerald* [2001 STC 1453, [2002] QB 546 ... Any grant by Abbey to Mapeley of a proprietary interest in the properties in question required its landlords' consent, as did any conferring by Abbey on Mapeley of a contractual right of occupation of those properties. Hence, given the absence of such consent, the need to resort to the device of a virtual assignment designed to produce the same commercial results, but without involving Abbey in doing either of those things. Yet Abbey is now contending that for VAT purposes it is to be treated as having done precisely that which the virtual assignment was specifically designed not to do.”

22. Mr Gavaghan argues for the respondent that the added words in the Abbey/Mapeley transfer of the economic benefits and burdens (“without ... creating ... any legal or equitable estate in the Premises”) make that case crucially different from this present case because that reservation is absent from our clause 2 which I have recited in [3] above. Thus he submits that Abbey can and must be distinguished. I doubt the correctness of that submission. It *may* make a difference to the question of whether or not the Virtual Assignment creates a trust which is an issue which arises under the respondent's notice, but Mr Nugee is surely right when he contends that it is not a relevant distinction because it cannot, I think, be suggested that the Virtual Assignment did actually transfer any estate in the premises. The respondent also

contends that the case is of limited assistance because of the concessions that were made as recorded at paragraph 50 of Jonathan Parker L.J.'s judgment, concessions which are certainly not being made here by Mr Gavaghan. There it did not lie in the mouth of the tenant to say that VAT should not be charged because it had transferred a property interest, or a right to occupy without the consent of the landlord – that would be to have it both ways which was the stance Jonathan Parker L.J. criticised in paragraph 89. Even though the concessions played an obvious part in the decision, as I read the judgment of Jonathan Parker L.J., he found the concessions to be inevitable and so I would not regard the authority of that case to have been so undermined that we can disregard it. With respect, I think it was the right decision. The fact that Abbey was in occupation whereas NatWest are not in occupation makes no difference to that conclusion.

23. With those introductory observations, I turn to the issues which directly arise on this appeal.

The first issue: parting with possession

24. The judge found and declared that by entering into the Virtual Assignment NatWest either parted with possession of the property to New Liberty or at least shared or permitted the sharing of possession of the property with New Liberty. Mr Nugee challenges the correctness of that finding. Mr Gavaghan supports it for the reasons given by the judge.
25. There are, very broadly, two strands to the judge's reasoning which I can précis as follows: first, warning that possession and occupation must not be conflated, he concluded that because of the wide meaning to be given to "possession", the receipt of rents by New Liberty was to put them in possession; and, secondly, by requiring New Liberty to deal with the property as NatWest would otherwise have done, NatWest was at least parting with or sharing possession.
26. Mr Gavaghan submits that it is well settled, per Neuberger L.J. in *Akici v L.R. Butlin Ltd* [2005] EWCA Civ 1296, [2006] 1 W.L.R. 292 at [26] that:

“... the covenant against parting with possession of the whole or part of the premises ... should be given its normal, and technically legally correct, meaning, unless there is any good reason to construe it in some other way.”

He emphasises the “technically legally correct” meaning. That technically legally correct meaning which has been accepted both before and since the Law of Property Act 1925 includes possession arising from the receipt of rents and profits or the right to receive them. This was the established meaning applied in *Lyell v Kennedy* (1889) 14 App Cas 437. This is now reflected in the definition of possession to be found in section 205(1)(ix) of the Law of Property Act 1925, namely that:

“‘Possession’ includes receipts of rents and profits or the right to receive the same.”

It is, however, important not to lose sight of the opening words of section 205(1), namely:

“In this Act unless the context otherwise requires, the following expressions have the meanings hereby assigned to them respectively, that is to say ...”

27. To establish New Liberty’s right to receive the rents, Mr Gavaghan relies on clause 4.1.3 of the Virtual Assignment under which NatWest appoint New Liberty to collect and get in all rents due under the underlease and clause 4.2 which prevents NatWest doing so itself. Clause 8 makes it plain that the rent belongs to New Liberty (“will be [received] to the account of the buyer”). He submits that reliance on the agency relationship is misplaced because the true substance of the role taken on by New Liberty is to collect the rents for itself and not for anyone else. In reality it is New Liberty which can decide whether or not to sue for any arrears of rent and it is impossible to envisage that NatWest would ever be able to refuse to give consent to proceedings being brought for the purpose of securing New Liberty’s economic benefits.
28. Mr Nugee’s answers are, very broadly, that “possession” in a covenant restraining parting with or sharing possession in the premises is to be given its “normal” meaning of the right to enter and occupy the land to the exclusion of others and it should not be given its extended meaning as including the right to receive rents and profits of land. Even if that extended meaning applies, New Liberty is not in receipt of the rents nor does it have a personal right to receive them because it merely collects the rents as agent for NatWest and not in its own right. Even if New Liberty had the right to collect rent, it did so as the assignee of a chose in action, not because of any proprietary right or interest in the land, and in particular, not as assignee of the lease.
29. Having given careful consideration to these respective arguments, I unhesitatingly conclude that I prefer Mr Nugee’s analysis. The position appears to me to be as follows.
30. The starting point is *Akici* because that case, decided by the master in this field, Neuberger L.J. as he then was, dealt with covenants against parting with or sharing possession in this way:

“23. The difference between possession and occupation is rather technical, and, even to those experienced in property law, often rather elusive and hard to grasp. Nonetheless, it is very well established, and is particularly important, and indeed well known, in the field of landlord and tenant law, especially in relation to the question of whether an agreement creates a tenancy or a licence, and in relation to alienation covenants such as clause 4.18.

24. While the interpretation of a word or phrase in a document must ultimately depend upon the documentary and factual circumstances in which it was agreed, it is desirable that the courts are as consistent as they properly can be when construing standard phrases in standard contexts. In that connection, a covenant against parting with possession is included in many, quite possibly most, modern commercial leases. Further the courts have consistently given the strict

meaning to such covenants as was adopted in unreserved terms by the Privy Council in the *Lam Kee Ying* case [1995] AC 247, and in the five cases therein referred to, at pp. 255/256.

25. Accordingly, while one cannot lay down any immutable rule as to how a particular word or expression is to be construed in every document or lease, I consider that any court must be very cautious before construing the word "possession" as extending to occupation which does not amount to possession, especially in a familiarly expressed covenant against parting with possession in a detailed professionally drafted commercial lease, such as that in the present case.

26. In these circumstances, I consider that it would require a very strong and clear case before a covenant against parting with possession should be construed in any way other than that adopted by the Privy Council in the *Lam Kee Ying* case, particularly in the light of the consistent approach taken in the earlier authorities cited therein. In agreement with Judge Dean QC, therefore, I would hold that the covenant against parting with possession of the whole or part of the premises in the present case should be given its normal, and technically legally correct, meaning, unless there is any good reason to construe it in some other way.

27. I turn to the covenant against sharing possession. On the face of it, one would expect the word "possession" to have the same meaning each time it appears in clause 4.18, particularly in light of the fact that it is a word which is familiar, especially in the context of leases, to lawyers. The only reason for not giving the word "possession" its normal technical meaning in a covenant against sharing possession appears to be that identified by Sir Douglas Frank QC, namely that possession is, as it were, unitary and cannot be shared.

28. I do not accept that possession cannot be shared. ... as a matter of ordinary language, a lessee who lets another person into possession of the demised premises, so that they are both in possession, can properly be said to "share" possession with that other person. ...

29. ... [The covenant] has a real effect, namely to prevent the conversion of a tenancy to a single lessee into what, in practical terms, will amount to a joint tenancy.

30. It may be said that this conclusion will result in a covenant against sharing possession having relatively little value. The answer to that point may be said to be the same as that given in the *Lam Kee Ying* case [1975] AC 257, 256C, namely that "the words of the covenant must be strictly construed, since if the covenant is broken a forfeiture may result". That approach may

well be a little less powerful than it was 30 years ago, on the basis that such canons of construction are now given rather less weight. Nonetheless, the modern approach, namely that such covenants should be given what is, in their documentary, factual and commercial context, their natural and commercially sensible meaning, indicates, to my judgment, the same result. Further, I do not think one should lean in favour of giving a wide meaning to an absolute covenant (i.e. one which is not subject to a proviso that consent cannot be unreasonably withheld).”

31. The strict meaning given to the covenant in *Lam Kee Ying* was stated at p. 256 to be that:

“A covenant which forbids a parting with possession is not broken by a lessee who in law retains the possession even though he allows another to use and occupy the premises.”

Their Lordships approved the judgment of Farwell J. in *Stening v Abrahams* [1931] 1 Ch. 470, 473-474 that a lessee who grants a licence to another to use the demised premises does not commit a breach of the covenant:

“Unless his agreement with his licensee wholly ousts him from the legal possession ... nothing short of a complete exclusion of the grantor or licensor from the legal possession for all purposes amounts to a parting with possession.”

32. How are we to apply those principles to a consideration of the covenant in this case which is “not to share or permit sharing possession or occupation of the Demised Premises or any part thereof or part with possession or occupation of the same”? There is no question of sharing or parting with occupation: the case turns on possession. As I see it the proper approach must be as follows:

(1) We must give possession the same meaning it bears in respect of sharing possession as it bears in respect of parting with possession.

(2) Because this is a common phrase in a standard alienation clause, “possession” must be given its *normal*, albeit also its technically legally correct, meaning. The true meaning must take its colour from its context. Whilst “possession” and “occupation” are different concepts (the difference between the tenant and the licensee such as the lodger) and whilst they must not be conflated as Judge Hodge said, nevertheless their juxtaposition is part of the context and serves to emphasise that aspect of physical control which is part of possession. As Lord Browne-Wilkinson pointed out in a different context in *J.A. Pye (Oxford) Ltd v Graham* [2002] UKHL 30, [2003] 1 A.C. 419 at [40]:

“... there are two elements necessary for legal possession:

(1) a sufficient degree of physical custody and control (“factual possession”);

(2) an intention to exercise such custody and control on one's own behalf and for one's own benefit ("intention to possess")."

And as Chadwick L.J. said in *Manchester Airport Plc v Dutton* [1999] 1 Q.B. 133, 142:

"... possession is synonymous ... with exclusive occupation - that is to say occupation (or a right to occupy) to the exclusion of all others, including the owner or other person with superior title."

The hallmark of the right to possession is the right to exclude all others from the property in question. That is the ordinary and normal sense of the word and that is the meaning which it should be given in this covenant.

(3) In the standard covenant against sharing or parting with possession, we should, therefore, adopt the standard strict meaning and only find the breach of the covenant (i) against sharing possession if, by entering into this arrangement, NatWest has allowed New Liberty to enjoy joint possession of the demised premises with it; or (ii) against parting with possession if, by entering into the Virtual Assignment, NatWest wholly ousted itself or completely excluded itself from the legal possession of the demised premises for all purposes.

(4) The short answer to the case is that at the time the Virtual Assignment was entered into and at all material times thereafter, NatWest was not and has not itself been in possession of the demised premises at all. The demised premises are the suite of offices on the ground floor and first floor of this building in Clarence Street, Manchester. The occupier and person in possession is Mercers, not NatWest. By virtue of the underlease NatWest had divested itself of possession and the only person in possession was, is and remains, Mercers and Mercers alone. The Virtual Assignment did not alter that state of affairs. Not having been in possession of the premises, NatWest cannot possibly be said to have parted with possession to New Liberty or to have shared possession by reason of entering into these arrangements.

(5) There is a long line of authorities, now well established, dealing with breaches of the covenant against parting with or sharing possession. For example, *Stening v Abraham* [1931] 1 Ch. 470 decided that a licence to erect an advertisement on the wall of the premises did not constitute parting with possession of the wall. *Lam Kee Ying* ([1975] A.C. 257) held that the transfer to a newly formed company of the partnership business being conducted on the premises was a parting with possession. In *Akici* allowing a third party into occupation to carry on business from the premises was a sharing of possession. This stream of cases is consistent with the notion that a leasehold covenant against parting with or sharing possession is concerned with the question of whether the tenant has allowed another into physical occupation with the intention of relinquishing his own exclusive possession of the premises to that other. Consistency demands that this case be approached in that light and in that light there has been no breach of the covenant.

33. It is, of course, correct, as Mr Nugee concedes, that for some purposes "possession" has a meaning that extends beyond its core meaning and includes receipt of rents and

profits of the land or the right to receive them. The crucial question here is whether New Liberty receives the rents or has the right to receive them.

34. The judge found clause 2 of the Virtual Assignment to be compelling because it expressed the intention of the parties as being “to pass” to New Liberty “all of the economic benefits” so that “any monies from the undertenants ... shall belong to” New Liberty. So he held the effect of the arrangement was that New Liberty was to deal with the property as NatWest would otherwise have been expected to do but no longer had the right to do. That, in his judgment, amounted to a parting with or sharing of possession.
35. Whilst that expression of intention informs the agreement, one still has to consider how it was to be achieved. The mechanism is provided by clause 4 which irrevocably appoints New Liberty to be NatWest’s agent, to act on its behalf and in its name in all dealings connected with the properties, those dealings including collecting and getting in all rent due under the underlease. Thus, when it collects the rent and when it receives the rent it does so under and by virtue of the express terms of the arrangement as agent of NatWest and in NatWest’s name, not in its own name. When New Liberty knocks on the undertenant’s door it may be able to say, “You must pay me the rent *on behalf of* your landlord”, but it cannot say, “You must pay me the rent because you *owe me* the rent.” At the moment of receiving the rent, New Liberty held it for NatWest. Thereafter and perhaps even *eo instanti* it changes its character by virtue of clause 8 for it then becomes money received to the account of New Liberty. The passage of that scintilla of time remains crucial. The appointment of New Liberty as agent and the grant of the Power of Attorney to it seem to me to be such integral and essential elements of the scheme that the agency cannot be discounted and swept aside. The appointment of an agent cannot itself amount to a parting with the right to receive the rents even though NatWest forfeits the rents the moment after receipt. This is a purely contractual arrangement between NatWest and New Liberty and it does not result in a transfer to New Liberty of the right to receive rents and profits in the sense envisaged by the definition in section 205 of the 1925 Act. In my judgment Mr Nugee is right to test the matter by asking who would be able to sue Mercers if it refused to pay the rent. The answer is obvious. NatWest would have to sue because it is the party to the underlease entitled to receive the rent and any action brought by New Liberty in its name would be defeated. The fact that NatWest are to all intents and purposes never likely to be able to refuse to give consent to their name being used is nothing to the point.
36. The appointment of managing agents to collect rent for NatWest would not put NatWest in breach of the covenant against parting with possession nor could it be argued that if the managing agent were to keep 10% of the rent, that would be a sharing of possession.
37. Accordingly, I conclude that New Liberty does not, when it collects rent as agent of NatWest, receive that rent itself in the sense of putting it into possession of the demised premises. Nor, prior to collection, does it have the right to receive rent in that sense.
38. Mr Nugee also makes the point that even if the effect of the Virtual Assignment was to transfer to New Liberty the right to receive the rent, the consequence was not to put

New Liberty “in possession” of the premises but merely to pass to it a chose in action separate from the land.

39. The point here is that a landlord may assign the right to receive the rent without assigning the reversion: *Kataria v Safeland Plc* [1998] 1 E.G.L.R. 39. Such an assignment treats the rent as a chose in action and the assignee acquires no interest in the reversion. The assignee can recover the rent as a debt but cannot forfeit for non-payment of rent or distrain for rent, those rights being an incident of the reversion which does not pass to the assignee: see *Kataria*. I agree with Mr Nugee: even an express assignment of the rent by itself would not amount to sharing or parting with possession of the demised premises.

Conclusion on the first issue

40. In my judgment Mr Nugee is correct. NatWest did not, by entering into this Virtual Assignment share possession or part with possession of the demised premises or any part thereof. Unless, therefore, the judgment can be supported for reasons argued in the respondent’s notice, I would allow this appeal.

The respondent’s notice: the first question is the Virtual Assignment a declaration of trust with regard to the property or the lease?

41. The judge ruled against New Liberty, holding that the relationship between it and NatWest was founded in contract rather than in equity. It was not a bare trust because under a bare trust the trustee’s sole duties to the beneficiary are not only to allow him to enjoy the trust property but also to obey any direction the beneficiary may give as to how the trust property should be disposed of by putting an end to the trust, (in accordance with the rule in *Saunders v Vautier* (1841) Cr & Ph 240, affirming 4 Beav 115). This is not something available to New Liberty under the terms of the Virtual Assignment. With some hesitation the judge held that there was no breach of the prohibition in the lease against declaring any trust of the property or the lease.
42. Mr Gavaghan submits the judge erred. He submits that the effect of the voluntary assignment was that NatWest held the bare legal title in the leasehold estate on behalf of New Liberty. All the economic benefits and burdens of the lease passed and all that was left with NatWest was the legal title. The absence of words such as “declaration of trust” were not determinative and the label the parties put on the document or transaction was likewise not determinative of its proper legal characterisation. One must look to the substance, not the form. The judge was wrong to base his conclusion that no bare trust was created because of a concern about the rule in *Saunders v Vautier*.
43. The voluntary assignment does bear some resemblance to a trust in so far as the underlease is vested in NatWest but New Liberty enjoys the economic benefits that flow from it. By itself that is not enough. One must also explore the manner in which the relationship between the parties was created in order to determine whether the arrangements bear the hallmark of a trust which in essence is, as the House of Lords restated in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] A.C. 669, the existence of an obligation binding on the conscience of the person vested with the legal ownership. Jessel M.R. explained the principle thus in *Richards v Delbridge* (1874) L.R. 18 Eq 11, 14:

“The principle is a very simple one. A man may transfer his property, without valuable consideration in two ways: he may either do such acts as amount in law to a conveyance or assignment of the property, and thus completely divest himself of the legal ownership, in which case the person who by those acts acquires the property takes it beneficially, or on trust as the case may be; or the legal owner of the property may, by one or other of the modes recognised as amounting to a valid declaration of trust, constitute himself a trustee, and, without an actual transfer of the legal title, may so deal with the property as to deprive himself of its beneficial ownership, and declare that he will hold it from that time forward on trust for the other person. It is true he need not use the words, “I declare myself trustee”, but he must do something which is equivalent to it, and use expressions which have that meaning, for, however anxious the court may be to carry out a man’s intentions, it is not at liberty to construe the words otherwise than according to their proper meaning.”

44. Here the proper meaning and cornerstone of the arrangement is agency: New Liberty is appointed the agent of NatWest in relation to the property. New Liberty take not only the benefits but also assume the responsibility for managing the property. If it were a trust in the full sense rather than simply a bare trust, the fiduciary obligations would have been owed *to* New Liberty, not *by* New Liberty.
45. On Mr Gavaghan’s analysis, this is a bare trust of the kind described in *Snell’s Equity* 31st edition, paragraph 19-11:

“A bare (or simple) trust is one in which the property is vested in one person on trust for another, the nature of the trust imposing no active duties or powers of management on the trustees. ... In such a case T’s sole duty is to B to enjoy the property and to obey any direction he may give as to how the property should be disposed of.”

He notes that New Liberty is given the right to negotiate and complete all assignments of the Lease (see clause 4.1.9) and that assignments include the assignment of the property by NatWest to New Liberty. Hence it is submitted that the rule in *Saunders v Vautier* applies because the beneficiary is entitled to wind up the trust and require the trustee to assign to him the subject matter of the trust. A bare trustee, or a trustee who is being directed to deal with a lease at the direction of those entitled under the rule in *Saunders v Vautier*, cannot be compelled to act in a way which would put him in breach of his obligations to the landlord under that lease. There are parallels in that context with the qualified trusteeship which arises on the sale of land, where the vendor is sometimes said to become a trustee for the purchaser as from the date of the contract (with the property correspondingly being at the purchaser’s risk). The trusteeship in the case of vendor and purchaser depends on the availability of specific performance: *Howard v Miller* [1915] A.C. 318 at 326. Specific performance would not be granted of the assignment of a lease in the face of opposition from the landlord if that would result in a breach of covenant and a risk of forfeiture.

46. Similarly, NatWest could not be compelled to assign the Lease to New Liberty when to do so would put it in breach of covenant under the terms of the Lease, exposing it to a claim for damages. New Liberty does not have the right to put an end to the alleged “trust” by calling for a transfer of the legal title because the assignment cannot take place without the consent of the landlord and even though NatWest are obliged to co-operate in connection with any assignment, NatWest cannot compel Clarence House to agree to the assignment. The point is made clear by reference to clause 3 of the Virtual Assignment. New Liberty is obliged, among other matters, to observe the covenants in the Lease. It could not, without breach of that provision, compel NatWest to assign the Lease to it. Accordingly, as between New Liberty and NatWest, there is no present right to call for an assignment and there is therefore no bare trust.
47. It was with some hesitation that the judge reached the conclusion that there was no breach of the prohibition in the Lease against declaring any trust of the Property or the lease. I am satisfied there is no trust. I recognise that Virtual Assignments are strange new beasts in the forest; that one must circle around them suspiciously and cautiously; but the moment one gets close and has a good sniff, the overwhelming smell is of contract, not trust. Although the judge would not for a moment have expressed himself in such an inelegant way, so lacking jurisprudential precision, this was the central finding on this point and he was correct in that conclusion.

The second issue in the respondent’s notice: has there been a breach of the prohibition on assignment?

48. The lease requires the landlord’s consent before the tenant can assign and the respondent contends that assignment covers both a legal and an equitable assignment and that the voluntary assignment was in effect an equitable assignment of the lease.
49. Central to this issue is the proper construction of the words “not to assign, transfer, charge or underlet the whole of the demised premises ... without obtaining the previous consent in writing of the landlord ...”. The issue is whether or not the words should be interpreted as if the word “legally” had been inserted before the word “assign”. The general rule is established by *Gentle v Faulkner* [1900] 2 Q.B. 267, 276 where Romer L.J. held:

“... It seems to me to be clear that a covenant in a lease against assigning the demised premises, in the absence of any context showing that the covenant is to have an extended meaning, covers only a legal assignment. The covenant against assignment is, therefore, not broken by anything short of a legal assignment. In my opinion such a covenant is not broken by the lessee executing a declaration of trust of the demised premises.”

50. Mr Gavaghan points out that the many non-alienation provisions in this Lease include the prohibition against entering into a declaration of trust, the underlying commercial reason for which, he submits, is to ensure that the person with the economic interest in the Lease remains the tenant, not some third party who does not have the landlord’s consent. Likewise the prohibition against entering into a transfer of the lease suggests that it is the act of passing the benefit of the lease to someone else rather than the

formal step of registration which shows the underlying intention. Likewise the restriction on charging shows the extent of the landlord's control. Hence the submission is that in the context of the lease as a whole the commercially sensible meaning of the word "assign" is not restricted simply to legal assignments but to assignments generally.

51. I do not accept those submissions. As Neuberger L.J. made plain in paragraph [24] of his judgment in *Akici* (see [30] above), "It is desirable that the courts are as consistent as they properly can be when construing standard phrases in standard contracts". This is a standard phrase in a standard context and it has been settled since *Gentle v Faulkner* that "assignment" means a legal assignment unless the context compels a different construction. There is nothing in the context here that requires that wider meaning to be given to the well-known phrase. Clause 30 of the lease dealing with alienation sets out in ten sub-clauses precisely what acts must not be done and it seems to me impossible to conclude that if the draughtsman had in mind a bar on equitable assignment he would not have included that. As the judge correctly held:

"The fact that the alienation provisions in the lease restrict several, specified forms of alienation leads me to the conclusion that the parties intended that only those forms of alienation should fall foul of the alienation restrictions: the express inclusion of several excludes the implication of other forms of alienation."

52. In my judgment the judge was correct for the reasons he gave. Further I agree with the submissions advanced by Mr Nugee that there has not been an assignment of the lease to New Liberty because there is no contractual obligation on NatWest to assign the Lease to it. New Liberty has, at most, the power to call for an assignment or to effect an assignment as agent of NatWest. Unless and until such an assignment is called for or made, there is no assignment, whether legal or equitable. In any event, any assignment is conditional on the Landlord's consent; no consent is forthcoming from the Respondent who has always shown the greatest reluctance to accept New Liberty and there is, therefore, no possibility of New Liberty obtaining an order for specific performance of the obligation (if there is one) to assign.

The third ground of the respondent's notice: was there an underletting of the premises?

53. The respondent submits that although the Virtual Assignment is not drafted as an underlease, its substantive effect is the same. That submission was rejected by the judge who held:

"13. Neither in form nor in substance did the Virtual Assignment amount to an underletting. Perhaps the most formidable objection to treating it as such is the fact that it neither reserves nor purports to reserve, any reversion to the defendant."

54. In my judgment the judge was correct. An underlease is the demise of the property for a term which creates a new inferior estate and constitutes the relationship of landlord and tenant between the parties. That is wholly absent from this arrangement. Put very simply, there is no privity of estate.

Conclusion

55. None of the grounds advanced by the respondent in the respondent's notice succeeds. The judge was correct to decide as he did. His error lay only in his conclusions that NatWest had either parted with possession or at least shared or permitted the sharing of the property with New Liberty. I would therefore allow NatWest's appeal, set the judge's order aside and dismiss the claim.

Lord Justice Jacob:

56. I agree.

Mr Justice Warren:

57. I also agree.