

LEASES

Variation of Leases and Discharge of Guarantor AVC Property Development Co Ltd v Joyful Grace Trading Ltd Court of Appeal [2017] HKCU 1515

Summary

A landlord succeeded in overturning on appeal the finding of the High Court that a lease guarantee had been discharged by a variation of the lease.

The case highlights the risk for landlords in agreeing a variation of a lease without consent from a guarantor.

Facts

This note is only concerned with the guarantor's obligations. The relevant facts of the case are:

- AVC Property Development Co Ltd, a landlord, had rented a shop in Wanchai to a tenant, the 1st defendant.
- A guarantee was signed by a director of the tenant company on 20 August 2012. The guarantor was the 2nd defendant.
- It was originally envisaged that the tenancy would commence on 20 August 2012 but there was some delay due to works being carried out. The tenancy agreement was not dated until 12 September 2012.
- The tenancy agreement provided:
 - "Term: For the term of TWO (2) YEARS fixed lease (sic) commencing on the 1st day of September 2012...."
 - "If for whatever reason the Landlord fails to deliver up vacant possession of the Premises on or before 1st September 2012 ('the Lease Commencement Date'), the Landlord shall be entitled to postpone the delivery of possession to a later date to be designated by the Landlord..... Upon such postponement, the Lease Commencement Date and all relevant dates of the Term shall be

automatically postponed accordingly." (Variation)

- Rent Free Period: The Tenant will be granted a rent free period of one (1) month starting from 1st September 2012 to 30th September 2012 (both days inclusive).
- The term eventually started on 11 September 2012.
- The tenant defaulted on the rent and the landlord sought possession and claimed rent, interest and mesne profits from both defendants.
- The guarantor's defence was that the Variation was a material alteration.
- The landlord, however, claimed that the Variation was manifestly immaterial and incapable of prejudicing the guarantor.
- The judge accepted the defence and held against the landlord who appealed to the Court of Appeal.

Legal principles

The established law is clear: a guarantee is discharged when an amendment can potentially cause prejudice or increase the risk borne by the guarantor. The threshold is high - all that is needed is the potential for prejudice whether or not the guarantor is so prejudiced.

Decision

The court allowed the appeal on liability:

- The High Court judge had construed the reference in the Variation to "all relevant dates of the Term" as only referring to the commencement and end dates of the tenancy, but not the rent free period.

- The Court of Appeal construed the Variation language against the context and factual matrix. It considered that the postponement of the commencement date was to accommodate the landlord in not having the shop ready as anticipated and that it was highly unlikely that the tenant would accept that it would lose part of its rent free period as a result.
- Accordingly, on a proper construction, the Variation provided that the rent free period would be postponed as well. As such there could not be any possible prejudice to the guarantor.

Comments

- If there is a variation, landlords should consider closely the effect upon guarantors and, if there is the slightest potential of prejudice, obtain the guarantor's consent.
- The case had two other points of note:
 - The tenancy agreement provided that interest was payable at 3% per month as liquidated damages rather than as a penalty. The High Court held that this was in fact a penalty. This was overturned on appeal but only because it had not been pleaded and the judge could not raise the issue himself. Landlords should consider carefully the effect of very high rates of interest (36% per cent pa in the current case). Such rates might not serve a legitimate business interest and be seen as extravagant, exorbitant or unconscionable (or a genuine pre-estimate of loss, the test still referred to by the Court of Appeal) (see our article "Penalty Clauses Revised by the US Supreme Court").
 - The landlord had not shown the pre-conditions for default interest had arisen. It was its burden to do so and this should have been in its pleadings. Accordingly, only the usual pre-judgment interest at 1% above prime was payable on much of the debt.

Corporate real estate and leasing advice forms one of the core elements of Cordells' practice. For full details of these services please see our website: www.cordells.com.hk

Legal Notices

This Note does not constitute legal advice and you should not take, or refrain from taking, any action as a result of it. No responsibility can be taken for losses arising out of any such action or inaction. Always seek advice from a solicitor in respect of any legal issue which you may have.

Copyright

All rights reserved Copyright ©2017 Cordells. No part of these notes may be reproduced in any form by any means without the written permission of Cordells.