What to do when your tenant goes into administration?

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1. When your tenant goes into administration there are likely to be rent arrears. However the moratorium on bringing proceedings makes it difficult for the landlord to take steps to protect their position. The moratorium is set out in para 43 of Schedule B1 of the Insolvency Act 1986:

> ***Moratorium on other legal process***
> *43(1) This paragraph applies to a company in administration.*
> *(2) No step may be taken to enforce security over the company's property except—*
> *(a)with the consent of the administrator, or*
> *(b)with the permission of the court.*
> *(3) No step may be taken to repossess goods in the company's possession under a hire-purchase agreement except—*
> *(a)with the consent of the administrator, or*
> *(b)with the permission of the court.*
> *(4) A landlord may not exercise a right of forfeiture by peaceable re-entry in relation to premises let to the company except—*
> *(a)with the consent of the administrator, or*
> *(b)with the permission of the court.*
> *(5) In Scotland, a landlord may not exercise a right of irritancy in relation to premises let to the company except—*
> *(a)with the consent of the administrator, or*
> *(b)with the permission of the court.*
> *(6) No legal process (including legal proceedings, execution, distress and diligence) may be instituted or continued against the company or property of the company except—*
> *(a)with the consent of the administrator, or*
> *(b)with the permission of the court.*
> *(6A) An administrative receiver of the company may not be appointed.*
> *(7) Where the court gives permission for a transaction under this paragraph it may impose a condition on or a requirement in connection with the transaction.*
> *(8) In this paragraph "landlord" includes a person to whom rent is payable.*

2. This of course prevents a landlord from bringing forfeiture proceedings, or pursuing rent claims without the permission of the court or the consent of the administrator. It goes without saying that it is highly unlikely that the administrator is going to provide his/her consent to a landlord commencing proceedings against them.

How are liabilities under a lease treated in an administration?

3. The starting point is that sums due under agreements made before a company goes into administration – even where payments continue to fall due after administration – are unsecured claims which are provable in the administration.

Insolvency Rules 1986 rr 12.3 and 13.12

4. Rule 13.12 of the Insolvency Rules 1986 defines ***debt*** for the purpose of liquidations and administrations as:

(a) any debt or liability to which the company is subject … at the date on which the company went into liquidation;
(b) any debt or liability to which the company may become subject after that date by reason of any obligation incurred before that date; ...

5. Since a lease is an obligation which will have been entered into before the date of the administration, liabilities under it are provable debts in the administration.

Rent falling due before the administration = provable debt in the administration, rule 13.12(a).
Rent falling due after the administration = provable debt in the administration, rule 13.12(b).

6. However despite these provisions rent falling due after the administration WILL be recoverable as an expense of the administration when
- the company occupies the property post administration for the company's purposes
- the property is retained by the administrator in order to preserve and realise the assets of the company

This is an application of the principle set out in the case of *In re Lundy Granite Co; Ex p Heavan (1871) LR 6 Ch App 462.* In *Lundy Granite* James L.J. stated at p. 466:

"But in some cases between the landlord and the company, if the company for its own purposes, and with a view to the realisation of the property to better advantage, remains in possession of the estate, which the lessor is therefore not able to obtain possession of, common sense and ordinary justice require the court to see that the landlord receives the full value of the property. He must have the same rights as any other creditor, and if the company choose to keep the estates for their own purposes, they ought to pay the full value to the landlord, as they ought to pay any other person for anything else, and the court ought to take care that he receives it."

7. Recent cases have clarified exactly when rent will be due as an administration expense. In *Re Atlantic Computers* there was a suggestion that it was a matter of discretion whether rent was paid. However in the House of Lords case of *In re Toshoku Finance UK plc [2002] 1 WLR 671* Lord Hoffman confirmed that where *Lundy Granite* applies it is not a matter of discretion whether they are administration expenses but a question of law.

8. In *Toshoku* the company was in liquidation, not administration (and the question was whether corporation tax was an expense of the liquidation) but in his reasoning Lord Hoffman stated that in his view rent would be a liquidation expense under rule 4.218(a) where it was an expense incurred in ***preserving, realising or getting in the assets of the company.***

9. Since *Toshuku* the principles applicable to the payment of rent have been considered in two cases *Goldacre* and *Luminar Lava Ignite.*

10. In *Goldacre (Offices) Ltd v Nortel Networks UK Ltd (in administration) [2010] Ch 455* the question was whether the administrators were entitled to pay a pro rata rent to reflect the fact that they were only occupying only a small part of the premises, and to pay only for the period of their occupation, HHJ C Purle QC (sitting in the High Court) held:

- future rent was an administration expense where administrators made use of or retained possession of leasehold premises for the benefit of the administration

- following *Toshuku* he was of the view that rent was an administration expense under the Insolvency Rules, r. 2.27(1)(a), but if that was not right it would in any event be an expense under r. 2.27(1)(f)

- that the question of whether rent was an administration expense was a question of law not a matter of discretion

- that the liabilities payable as administration expenses would be any liability falling due under the lease while the administrator made use of the premises

- where rent is payable in advance it is payable in full even if the administrator subsequently vacates the premises during the rental period

- if the administrator occupies any part of the premises the rent for the whole is payable without apportionment

- once the administrator vacates the property liabilities under the lease cease to be administration expenses.

11. *Goldacre* was followed by *Leisure (Norwich) II Ltd v Luminar Lava Ignite Ltd (In administration) [2012] EWHC 951 (Ch)* where HHJ Pelling QC (sitting in the High Court) held

- where rent fell due in advance before the administration no payment is due for the administrator's subsequent occupation of the property during that rental period

- an administrator's refusal to consent to forfeiture did not make rent falling due before administration an administration expense

- rent falling due in advance during the administration was payable as an administration expense and was due in full even if the administrator gave permission to forfeit shortly after the rent day

12. Both of these decisions rely upon the fact that it is not possible to apportion rent payable in advance; the Apportionment Act 1870 only applies to rents payable in arrear. As a result of these decisions a company is now likely to choose to go into administration shortly after a rent day – this will effectively give the administrator a period when it can use the premises without becoming liable to pay rent as an expense of the administration.

13. This happened in the Game Group Administration – a quarter's rent was due in advance on 25th March 2012 under the company's numerous leases, and the administrators were appointed on 26th March 2012. Game Group had a number of landlords that were unhappy with this position both in respect of rent and service charges, this in turn meant that the administrators wanted the comfort of the Court's directions on what was or was not an administration expense, leading to the decision in *Jervis v Pillar Denton Ltd [2013] EWHC 2171 (Ch).* N Lavender QC followed the decisions in *Goldacre* and *Luminar* which he held were binding on him. However he was

satisfied that there are reasonable prospects of a successful appeal and granted permission to appeal to the Court of Appeal. The appeal is due to be heard in February 2014.

14. The point that will be argued on the appeal is that the *Lundy Granite* principle ***deems*** rent an administration expense based on the use of the premises and as a matter of 'common sense and ordinary justice'. Given that the rent is being 'treated' as incurred by the administrator it will be argued that the Court could properly deem the relevant administration expense as being an apportioned rent to reflect the period of actual use by the administrators rather than being constrained to reflect the contractual provisions of the lease, such an approach would be more in keeping with the basis on which the administrator's liability arises – being use of the property – and the fact that liability ceases when the administrator stops using the premises.

15. The most recent case to consider what is or is not an administration expense is the Supreme Court decision in *Re Nortel GmbH (in admin) & Ors [2013] UKSC 52.* This litigation related to the administrations of the Nortel and related companies and Lehman Brothers and related companies. The case concerned statutory liabilities arising under pensions legislation; after the appointment of the administrators the Pensions Regulator had investigated the companies and served Financial Support Directions (FSD) and Contribution Notices (CN) on the target companies. These required the target companies to provide financial support for the occupation pension scheme of employees of a service company in the same group. The question was whether these statutory liabilities were administration expenses or debts provable in the administration. The liabilities arose as a result of a state of affairs existing prior to the administration – the Supreme Court analysed the liabilities as related to an obligation incurred before the administration and so held that they were debts provable in the administration and not administration expenses.

16. In reaching that decision the Supreme Court overruled 2 cases on legal costs in which it had been decided that awards of costs made after the commencement of a liquidation but in respect of proceedings pre-dating the liquidation were liquidation expenses. (Decisions which Briggs J and the Court of Appeal had felt constrained to follow).

17. Liabilities under a lease are contractual rather than statutory liabilities so much of the reasoning of the Supreme Court is not of assistance. Additionally the decision focused on what amounts to a provable debt. However Lord Neuberger went on to consider what is an administration expense, although discussing liability for rates rather than rent. He approved the statement of principle that rates became an expense of a liquidation because ...*the liquidator remained in rateable occupation of the property in question,* and characterised such liabilities as amounting to administration expenses because they are referable to ...*an act or decision taken by or on behalf of the administrator or any act or decision taken during the administration.*

18. These observations leave open the possibility of a successful appeal in *Game Group,* although Lord Neuberger's characterisation of rates as a charge that arises from 'day to day' (at para 103) may suggest that he would treat rents payable in advance differently,.

In summary:

19. In order for rent to be payable as an administration expense the administrator must be
    - occupying any part of the property, or
    - using the property for the purpose of carrying on business, or
    - keeping property in order to sell it or do the best he can with it

    It does not apply where the administrators
    - are not using the premises and 'thinking about what to do' *In re ABC Coupler and Engineering Co Ltd (No 3) [1970] 1 WLR 702*

    Where the administrator occupies/uses the property any sums that fall due under the lease will be payable as administration expenses, including the full amount of sums payable in advance, however liability ceases when occupation/use stops.

Forfeiture

20. Returning to a landlord's right to forfeit – when is the Court going to give permission to a landlord to exercise it? The principles applicable are set out in *Re Atlantic Computer Systems plc [1992] Ch 505,* these were applied in *Sunberry Properties Ltd v Innovate Logistics Ltd (in administration) [2008] EWCA Civ 1321* (although in that case the landlord sought permission to claim a mandatory injunction to prevent occupation in breach of covenant rather than forfeiture).

21. The Court has to balance the interests of the company's creditors and the purposes of the administration with the interests of the landlord. Factors to be considered are:

    - whether occupation of the property is necessary to facilitate the purpose of the administration,
    - the period the administration is expected to take, the end result sought and the likelihood of that outcome,
    - a comparison of the financial loss to the landlord of being prevented from exercising its proprietary rights with the financial loss to the creditors if permission is granted,
    - any money paid or proposed to be paid by the administrators to the landlord ,
    - how the landlord's proprietary interests are being affected and whether that is in a way which is strictly limited and unavoidable,
    - whether it is inequitable for the landlord to be prevented from exercising its proprietary rights,

    Additionally the burden of establishing that permission should be granted is on the landlord.

22. Where substantially greater losses would be incurred by the creditors as a result of the grant of permission, out of all proportion with the benefit to the landlord, permission is likely to be refused. In contrast where the exercise of proprietary rights will not interfere with the purposes of the administration then permission should usually be given.

23. It is also clear from the House of Lords decision in *Toshoku* that the Court will consider whether

the right is being used to seek to recover pre-administration or post-administration liabilities, and will bear in mind the following factors:

- although a landlord may be entitled to rent as an administration expense it does not follow that it is entitled to immediate payment – where assets may not meet other administration expenses ranking equally or in priority may mean that an administrator should properly delay payment
- the Court will be more inclined to permit the landlord to exercise proprietary rights to recover post-administration liabilities.

23. Practically this will probably mean that if your tenant has gone into administration shortly after a rent quarter day the landlord is going to have to wait until the next rent day before it can complain that the administrator is not fairly balancing its rights with the objectives of the administration. Additionally if the landlord is then offered payment for the use and occupation of the premises, the court can see that there will be a real benefit to the general creditors if the landlord is prevented from exercising its proprietary rights, and the state of affairs is going to be temporary, it is unlikely that a court would grant permission.

22. Where a pre-pack administration has been arranged and the landlord is dissatisfied with the financial standing of a proposed assigned *Leisure (Norwich) II Ltd v Luminar Lava Ignite Ltd (In administration) [2012] EWHC 951 (Ch)* illustrates the steps that should be taken to protect the landlord's position, and the risks to administrators of unreasonably refusing consent to the brining of forfeiture proceedings.

23. In that case the landlord had found alternative occupiers with a good rental covenant who would be prepared to pay a premium to take an assignment of the lease, the administrators pressed ahead with trying to impose a Newco on the landlord without offering reasonable terms for the Newco's occupation, they failed to address in correspondence the landlord's concerns about the financial standing of Newco. Ultimately the negotiations with the Newco to take over the business of Luminar Lava Ignite failed and shortly before the hearing of the permission application the administrators consented to the forfeiture of the lease, the Court ordered that the administrators pay the costs of the application for permission to forfeit and observed that the delay by the administrators in failing to consent had occasioned unfair and disproportionate pressure on the landlord to agree to the less favourable and unacceptable terms from the Newco.

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Operation of Break Clauses

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Introduction

1. Break clauses are often of vital importance to tenants. They provide a means to escape the onerous obligations of a lease that may well have seemed like a good idea at the time. Most break clauses are exercisable only at a particular date and in a particular manner. Rolling break clauses are not unknown, but are deeply unpopular with landlords, who may lose a valuable tenant at any time.

2. This paper attempts to provide a practical guide to the most common pitfalls encountered in this area. Tenants often attempt to operate break clauses at the last minute, at a time when they are in breach of one or more covenants in the lease and when they have taken no steps to remove themselves and their property from the building. The extreme urgency with which advice is often needed makes this an exciting but challenging area of practice.

The Lease

3. Sight of the lease is vitally important. The lease itself will set out who may exercise the clause, the time for service of notice, the circumstances in which the break clause may be exercised and the conditions that must be complied with, if any. Leases are construed strictly, which means that there is little or no room for error.

4. It is always worth checking that there is a valid break clause that is exercisable by the tenant rather than the landlord or the parties jointly.

Service of Notices

5. Where the tenant has already served the notice, it will be important to see a copy of the notice and to know when and how it was transmitted to the landlord.

6. The lease may require the notice to be in a particular form. In that case, the notice must comply with the requirements of the lease.

7. The notice does not need to refer to the break clause expressly, but it must be clear that it is intended to operate the break. The test in *Mannai v. Eagle Star* [1997] A.C. 749 applies to notices exercising a break clause. Thus, if it would not have misled a reasonable recipient, it will achieve what it intended, rather than what it said. Errors in dates have been corrected by construction, but only where the meaning of the notice was obvious.

8. The notice will always have to be properly served. Great care should be taken to ensure that the tenant has correctly served the notice. Section 196 of the Law of Property Act 1925 may have been incorporated into the lease. Alternatively, the lease may specify the method of service. Where the lease sets out a method of service, there may be scope for argument as to whether that method is the only available method or is merely a permissible method. Aside from method of service, it is important to ensure that the correct person has been served and in particular whether any agent has authority to accept service.

Compliance With Conditions

9. The lease is, again, vitally important in ascertaining what covenants, if any, need to be complied with and to what degree. Often, the break clause will be conditional on the performance of covenants or the payment of all sums due under the lease. A lease may set the bar lower, by specifying that there be no substantial breach or material breach. Alternatively, the lease may require that the tenant shall have reasonably complied with the covenants or to have undertaken to pay damages for breach. In the absence of any limiting words, strict compliance is required.

10. There is a further question as to when the condition must be complied with. It may be the date of the notice, the date of the break, both or neither. The lease may be silent, in which case difficult questions of interpretation may have to be considered.

Payment of Rent and Other Sums

11. Rent in commercial leases is usually payable quarterly in advance. Where the tenant seeks to exercise the break clause before the end of the quarter, all of that quarter's rent must be paid. There may be an express term as to the recovery of rent relating to the period after the operation of the break clause. In *Marks & Spencer v. BNP Paribas Securities Services Trust Co (Jersey)* [2013] EWHC 1279 (Ch), it was found that there was an implied term to permit recovery of rent relating to the period after the break clause had taken effect. It was also held that in the absence of that implied term, there would have been no remedy in restitution.

12. In addition to the rent, there may be other sums due. The problematic one is service charge, particularly if it is the subject of a dispute. Some of the uncertainty is alleviated in modern leases where service charge has to be paid in advance on account. Where service charge is payable on demand, which is more common in older leases, then any demand should be paid. If necessary that can be done under protest, so as to ensure that the condition is complied with but the dispute is preserved.

13. Caution should also be exercised to ensure that there are no other sums outstanding, particularly interest on late payments of rent or service charge. Those sums due may have escaped the notice of the landlord, only to resurface later.

Vacant Possession

14. Break clauses are often conditional on giving up vacant possession. The state of the property must be such that the landlord is able to take and enjoy immediate possession. That means that the tenant must remove its staff and its chattels from the property. It must also ensure that any contractors are off the premises. It is important to remember that the tenant may have added to the premises by way of fixture. Unless and until the fixture is severed from the building, it is in fact part of the premises of which possession must be given and can safely be left.

15. Other chattels are more risky. The obligation to give up vacant possession will be breached if the remnants substantially interfere with or prevent the enjoyment of the right of possession of a substantial part of the property.

16. Ideally, the keys should be returned. It is possible to dispense with return of the keys if there has been an unambiguous yielding up of possession.

Checklist

1. Is there a break clause?
2. Who may exercise it?
3. When can it be exercised?

4. Has a notice been served?
5. If not, when must it be served?
6. On whom must it be served?
7. How must it be served?

8. Are there conditions as to compliance with covenants?
9. Is compliance absolute or limited?
10. When must compliance take place?

11. Has the rent been paid?
12. Is there any service charge outstanding?
13. Are there any other sums due, such as interest on late payments?

14. Have all items been removed from the property?
15. If not, can anything be abandoned on the basis that it is a fixture?
16. If there are workmen on site, are they aware that they must be out, too?