

Commercial Leases and the Credit Crunch: Part Two

In a second article on the impact of the recession on the commercial property market, Gerard Small, Commercial Property Partner at John McKee & Son Solicitors, considers the position of the landlord in a number of recent cases before the courts where the tenant has become insolvent.



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Tenant in administration

There has been much media focus in recent months on the use of company administrations, in particular, so called "pre-pack" arrangements. Administrations have been lauded as a means of rescuing the business of a company as a going concern and achieving a better result for the creditors overall than a liquidation. Some commentators, though, are sceptical about such claims, pointing to cases where the existing unsuccessful management have been able to buy the best bits of the company's business from the administrator free from its debts, leaving unsecured creditors with only a fraction of what they are owed from the sale proceeds. Whether or not such criticisms are justified, the use of administrations is on the increase and this has implications for many commercial landlords.

The effect of an administration is to impose a moratorium or stop on legal proceedings e.g. for recovery of rent or forfeiture of the lease. The only exceptions to this are where the administrator or the Court consents to such action. The administrator may have little incentive to give such consent, arguing that the lease is needed for the purposes of the administration. The administrator may be mindful of the fact that would-be purchasers of the business of the company may have difficulty procuring the landlord's consent to the assignment of the lease to it because they have little or no track record and may in those circumstances be grateful of the opportunity to occupy the premises for a period rent-free and without the risk of forfeiture.

There are numerous Court decisions where consent to forfeit in administration has been refused but one recent English case, *Metro Nominees (Wandsworth) (No. 1) Limited v K Rayment*, is notable as an example where such consent was given to the landlord. In this instance, the administrator of the tenant company entered into an agreement for the sale of the undertaking and assets of the tenant to a new company for a nominal sum of £1.00. The administrator then proceeded to allow the new company into occupation and then sought the landlord's consent to assignment. The landlord sought leave to forfeit the lease and this was granted on the basis that the object of the administration had been achieved. The administrator had received the sum of £1.00 for the existing lease and the other assets of the company and this was all it was ever going to be paid. Forfeiture of the lease would no longer impact on the tenant company, its creditors and administrators, as their interest in it had ceased.

In another case, *Innovate Logistics Limited v Sunberry Properties Limited* the English Court of Appeal overturned a decision of the lower court allowing the landlord to take action for breach of covenant. The administrator had agreed with the proposed purchaser of the business that it could go into occupation of the premises as agent of the administrator on a temporary basis in order to collect the outstanding debts of the tenant company in administration. The Court of Appeal decision turned on the fact that the purposes of the administration (including the collection

of the outstanding debts) were still continuing and to allow the landlord to take action would interfere with those purposes. Furthermore, the new company was paying the passing rent under the lease during its period of temporary occupation which was a higher rent than the landlord could have commanded on any new letting, so there was no loss of rent to the landlord during this temporary period.

Even where landlords cannot pursue the recovery of rent during the administration, will they be left to compete with other creditors for a dividend of a few pence in the pound at the end of the administration? If such rent due for any period of the administration is an 'expense of the administration', it will be paid in full in priority to the claims of other creditors. A concession was made in the *Innovate* case that this is in the discretion of the Court, but there is a view based on other case law that in fact what is an expense is a matter of law and that rent may well be an expense of the administration. This remains to be tested by the courts.

Tenant in liquidation

If a corporate tenant of commercial property goes into liquidation, it is open to the liquidator to disclaim the lease. The disclaimer brings to an end the rights, interest and liabilities of the insolvent tenant in the lease concerned, but does not affect the rights and liabilities of anyone else. This includes guarantors so that the landlord of commercial premises whose tenant has gone into liquidation can still pursue guarantors of the tenant's obligations under the lease for rent

for which they could otherwise have pursued the tenant. Even if the liquidator had not disclaimed the lease, the landlord would probably only have recovered a fraction of the rent through the liquidation. In contrast, whether or not the lease is disclaimed by the liquidator, the landlord has the option of pursuing the guarantor for the tenant's liability in full.

It should be noted that the effect of any variation of a lease, no matter how small, for example varying slightly the description of the demised premises, has the effect of discharging any guarantor.

In the current climate guarantees of the tenant's obligations are more important than ever and landlords of commercial properties should be seeking clear and effective guarantee provision from financially strong guarantors.

Conclusion

The present difficult market place in commercial lettings is fraught with pitfalls for the unwary. Independent legal advice is vital for the protection of both landlords and tenants before, during and after entering into a commercial lease.

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