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Review

Corporate Strategy & Finance

Landlords and administrators: a shift in the balance of power?

No administrator will be surprised to hear that he has to pay rent when occupying the premises of the company in administration. However he will be surprised by some of the other statements made by the High Court in *Goldacre (Offices) Limited v Nortel Networks UK Limited (In administration) [2009] EWHC 3389 (Ch)*.

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RENT AS AN ADMINISTRATION EXPENSE

The High Court was asked to determine whether administrators who had been using, and paying rent in respect of, a small part of premises leased to a company for the benefit of the administration, were liable to pay future rent under the lease as it fell due as an expense of the administration. The judge held that:

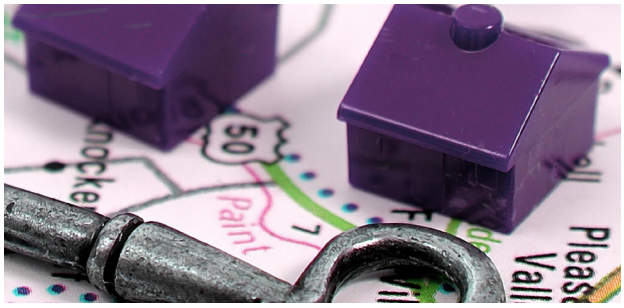
- Where an administrator uses any part of the premises for the purpose of the administration then he is liable to pay rent as it falls due as an administration expense under either r.2.67(a) or (f) Insolvency Rules 1986. This is a mandatory not a discretionary expense.
- Where a quarter's rent becomes due it is payable in full, in advance and there is no apportionment of this amount if the administrator vacates the premises during that quarter. This liability will continue until the administrator fully vacates the entire premises.
- Rent must be paid in respect of the entire premises, even if the administrators only occupy a very small part of the premises and other parts are sublet or unoccupied.
- The priority of payment as an administration expense is not limited to rent, but will extend to all liabilities arising under the lease during the period that the administrator can be said to be using the premises for the purposes of the administration. This could include claims for dilapidations on redelivery of the premises.
- Where there is a 'sufficiency of … realisable assets' to meet the claim of landlords 'administrators … have no justification for acting otherwise' than to pay the rent as an administration expense as they go along.

THE ISSUES FOR ADMINISTRATORS

The decision is a considerable change from the commercial approach widely taken by administrators, who customarily negotiate a pro rata payment with landlords for the period they anticipate they will need the premises.

In his judgment, which he acknowledges was produced more quickly than he would have liked, the judge has left administrators with a number of uncertainties that need to be fully considered and clarified.

- **"Retain or use any part of the premises"**: when can the administrators be truly said to have vacated the premises? The common practice of simply abandoning the premises and writing to the landlord to advise that the premises are no longer required for the purposes of the administration may no longer be sufficient to bring the rent liability to an end, if any of the company's property remains on site.Tthe judge drew parallels with the 2007 decision Re Trident Fashions plc which concluded that rates in respect of premises occupied by administrators are an expense of an administration. Statute has since provided an exception to liability for rates in respect of unoccupied premises. S 65(5) Local Government (Finance) Act 1988 provides that a hereditament that is not in use will be treated as unoccupied if it is only being used for the storage of plant, machinery or equipment used when the premises were last in use or which are intended for use on the premises. Could a similar exception be argued in the case of rent liability?



- Is the administrator to be considered as retaining the premises from appointment if he does nothing immediately to divest himself of the premises?
- Can the administrator enter the premises to remove the company's property without being regarded as being in occupation?
- Would leaving third party property on the premises be regarded as retaining use of the premises?

- **"Any liability incurred while the lease is being enjoyed or retained for the benefit of the [insolvency procedure] is payable in full as a[n] … expense"**: whilst the administrator should be able to ensure that pre-appointment liabilities and arrears accrued under the lease are treated as unsecured claims and do not attach to him on continuing the lease, it may be very difficult (time-consuming and expensive) to quantify these claims, particularly with regard to dilapidations where there is a covenant to redeliver the premises in good repair at the end of the lease. Administrators will also be concerned by the potential open-ended nature of "any liability" in respect of the premises, which the judge does not limit to rent.

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- Whilst the judge recognises that if the full amount of realisations is uncertain the landlord may have to wait to see if his claim can be satisfied in full and that there may be other claims also having priority, he does not make it clear who determines the sufficiency of the realisations and, in such circumstances, how they are to be applied. If it is determined that there are sufficient realisations to pay the landlord's claims as they fall due (bearing in mind that these amounts may be significantly higher than the old rent provision calculations), must the administrator pay those first or can he select other claims or use the funds to trade the business in administration instead?
- **Pre-packs and business sales:** administrators need to be aware that when granting a licence to occupy to a purchaser of the business they are still using the premises for the purposes of the administration and therefore remain liable for the rent and other expenses under the lease. Particular consideration will need to be given as to who they grant any licence to, for how long and on what terms. The licensee must comply with all the terms of the lease and indemnify the administrators for any breaches. It may be much more difficult to find buyers who are willing, and able, to pay a much more substantial rent commitment in advance in place of the common weekly licence fee in mitigation of this risk. This may have a negative impact on the recovery for creditors and the whole rescue culture.

WHAT CAN THE ADMINISTRATOR DO IN RESPONSE?

The effect of the decision is a considerable shift in the negotiating power between the landlord and the administrator, which is already being explored in current transactions. It would seem that there are a number of further actions for an administrator to consider before, or immediately upon, appointment.

- **Due diligence –** the administrator must ascertain the full extent of the company's property commitments and accrued liabilities under the leases. He must also consider what his needs for any of those premises are likely to be and for how long. With any premises that he needs to keep on, it may be prudent to consider preparing a schedule of dilapidations up to the date of appointment to limit liability for repairs.
  - Sub-tenants – it is not clear from this case whether the administrators were being held liable to pay the full rent where there were sub-tenants of part of the premises who were paying their rent. The landlord should not be able to make a double recovery of rent, so administrators should ascertain whether any part of the premises are sub-let, the rent payable by the tenants and ensure that these payments are maintained in order that the administrators are only liable for the difference. Administrators may wish to rely (in their negotiations with landlords) on the decision of the Court of *Appeal Sunberry v Innovate Logistics* (2009) that they are only liable to pay the landlords the amount they receive in respect of any licence to occupy the premises that is granted.

- **Moratorium –** the moratorium created by serving notice of an intention to appoint an administrator may be a valuable period in which the administrator can take some key steps:
  - Negotiate with the landlord. Whilst landlords will now feel that they have more bargaining power, where administrators do not anticipate retaining premises over any quarter rent payment date they may be able to negotiate a pro rata payment.
  - Advise the company to clear pre-appointment all premises that the administrators know will not be used during the administration.
  - Consider a company voluntary arrangement instead of administration. The use of CVA for distressed retail businesses is becoming increasingly popular as a rescue option where it may be possible to compromise the landlord's claim.
- **Timing of the appointment –** this case concerned the administrator's liability for rent that fell due after appointment. It could be argued that an administrator who only uses the premises between rent payment dates and for a period shorter than the full rental period should not attract liability for the full quarter's rent.
- **Give notice of non-occupation to the landlord on the date of appointment** in respect of all premises that have been vacated and cleared of all property.
- **Consider putting companies into liquidation** before any rent payment date and disclaim the leases. Although, in the opinion of the judge "administrations may come to resemble liquidations" there is no equivalent right for administrators to disclaim leases.

FOR FURTHER INFORMATION

Whilst this is only a first instance decision, it would appear that it is not going to be appealed and therefore administrators need to plan carefully, before they are appointed, how they are going to deal with landlords who perceive they now have an enhanced entitlement to rent in respect of premises used by administrators in the conduct of the administration. If you have any questions concerning negotiations with landlords and the lease liabilities of distressed companies, please speak to your usual Hammonds' contact or:

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