LEASES AND INSOLVENCY

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In this paper, I summarise some recent changes affecting the remedies available to a landlord of commercial premises if his tenant becomes insolvent, and review some issues which can arise on disclaimer of a lease.

1 THE INSOLVENCY ACT 2000

Commencement

- Royal assent 30 November 2000
- Ss. 14, 16 in force 30 November 2000: s.16(2)
- Ss.5-13, 15(1), Sch 4, Sch 5 (part) in force 2 April 2001: SI 2001/766
- S.1 and para 4 of Sch 1, as far as is necessary to give effect to paragraphs 5 and 45(1), (2), (3) and (5) in Sch A1: 11th May 2001: SI 2001/1751
- Remainder to come in force on a day to be appointed

Moratorium for small companies proposing CVA

- S.1 and Sch 1 (not yet in force) insert a new Sch A1 into the Insolvency Act 1986 (IA 1986). Under the new Sch A1, "eligible" companies in financial difficulty intending to propose a company voluntary arrangement (CVA) may obtain a moratorium to give the management time to put a rescue plan to creditors. This mirrors the position for individual voluntary arrangements (IVA) under ss.252 – 255 IA 1986 under which an interim order can be obtained.

- Eligible companies are essentially small companies - must satisfy at least 2 of the following: turnover - not more than £2.8 million; balance sheet total - not more than £1.4 million; number of employees - not more than 50

- While the moratorium applies no proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property except with the leave of the court and subject to such terms as the court may impose, and no landlord or other person to whom rent is payable may exercise any right of forfeiture by peaceable re-entry in relation to premises let to the company in respect of a failure by the company to comply with any term or condition of its tenancy of such premises, except with the leave of the court and subject to such terms as the court may impose: IA 1986 Sch A1 para 12

Restriction on distress and forfeiture by peaceable re-entry in the case of IVAs

- S.3 and Sch 3 (not yet in force) amend the IVA provisions of the IA 1986. Sch 3 para.s 2 and 4 make amendments to s.252 and 254 that extend the effect of the moratorium imposed by an interim order to distress and forfeiture by peaceable re-entry – see below

Restriction on forfeiture by peaceable re-entry in case of company in administration

- S.9 (in force from 2 April 2001: SI 2001/766) amends ss. 10 and 11 IA 1986 which impose a moratorium on actions by creditors during an application for an administration order and after an order is made. Distress is already outlawed, and the amendments outlaw forfeiture by peaceable re-entry, except with the consent of the administrator or leave of the court. See below.

Other provisions

- S.2 and Sch 2: amendments made to CVA procedures. Provision is made here and in relation to IVAs to deal with the case of the unknown creditor, and to prevent provisions in floating charges for crystallisation on a moratorium coming into effect

- S.4: extension of scope of "insolvency practitioner" to include CVA and IVA nominees, and provision for new mode of approving insolvency practitioners

- Ss. 5 - 8: changes to the procedures for disqualifying directors

- Ss.10 and 11 alter the procedures for prosecuting delinquent officers and members of a company and the use of information given under compulsion in subsequent criminal proceedings

- S.12 allows the value of a deceased insolvent's interest in jointly-owned property which passes to another joint owner on death by survivorship to be recoverable for the benefit of the insolvent's estate

- S.13 confers a power to make rules or regulations concerning the investment of funds held in the Insolvency Services Account on behalf of bankruptcy estates, and the payment of interest on such funds; and

- S.14 confers a power to make regulations to give effect to the model law on cross-border insolvency

2 PEACEABLE RE-ENTRY DURING INSOLVENCY

Administration

- The leave of the court or consent of the administrator will be required for forfeiture by proceedings once an application for an administration order has been made, or an administration order has been made, under IA s.10 or 11, which provide that:

  "… no steps may be taken to enforce any security over the company's property, or to repossess goods in the company's possession under any hire-purchase agreement, except with the leave of the court and subject to such terms as the court may impose; and no other proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property except with the leave of the court and subject to such terms as aforesaid"

- There was judicial disagreement at first instance as to whether that prevented forfeiture by peaceable re-entry. Peaceable re-entry was held by Harman J to be enforcement of security or a "legal process" in the case of administration: *Exchange Travel Agency Limited v Triton Property Trust Plc* [1991] 2 EGLR 50. However, in *Re Lomax Leisure* [2000] Ch 502, Neuberger J disagreed. He referred to a number of later cases in which forfeiture by peaceable re-entry had been held not to be "legal process". He held that a landlord's right to forfeit a lease for non-payment of rent or breach of covenant could not be described as 'security over the company's property'. He followed the Court of Appeal's decision in *Ezekiel v Orakpo* [1977] QB 260 that a landlord's claim to forfeit was not a "remedy against the property or person of the debtor in respect of the debt" nor "any action or other legal proceedings" for the purposes of s.7(1) of the Bankruptcy Act 1914. Rather, the action was in the nature of an action in trespass. The same decision had earlier been reached by Ferris J in *Essex Furniture plc v National Provident Institution* [2001] L & TR 3. Therefore peaceable re-entry during administration was possible until s.9 of the IA 2000 came into force on 2 April 2001.

- It is therefore clear now, at first instance level, that leave is not needed for peaceable re-entry during administration. However, since 2 April 2001, when s.9 of the Insolvency Act 2000 came into force (SI 2001/766) peaceable re-entry during administration has not been

possible, except where the petition for the administration order had already been presented before that date (SI 2001/766 art 3).

Voluntary liquidation

- No leave is required for court proceedings, but an application may be made to court to stay proceedings under IA 1986 ss.112 (liquidator, contributor or creditor may apply to court to determine any question arising in the winding up of a company, or to exercise any power which the court might exercise if the company were being wound up by the court) and s.126 (power of court in compulsory winding up to stay or restrain any action or proceeding against the company)

- No bar on forfeiture by peaceable re-entry

Compulsory liquidation

- Leave will be required for forfeiture by proceedings: IA s.130(2):

  "...when a winding up order has been made or a provisional liquidator has been appointed no action or proceeding shall be proceeded with or commenced against the company or its property except with the leave of the court ..."

  The court has power to make a possession order on summons in the liquidation which is enforceable against a third party: *Re Blue Jeans Sales* [1979] 1 WLR 362; *Re Brompton Securities Ltd* (1988) 4 BCC 189.

- In the light of *Re Lomax Leisure* and *Ezekiel v Orakpo* (see above) and the cases on bankruptcy and interim orders referred to below it seems probable that s.130(2) does not apply to forfeiture by peaceable re-entry.

- The IA 2000 does not amend s.130(2) and so forfeiture by peaceable re-entry during compulsory liquidation will not be affected.

Bankruptcy

- Presentation of a bankruptcy petition does not affect a landlord's right to forfeit, although the court can stay any action under IA 1986 s.285(1):

  "At any time when proceedings on a bankruptcy petition are pending or an individual has been adjudged bankrupt the court may stay any action, execution or other legal process against the property or person of the debtor or, as the case may be, of the bankrupt".

- Once an order has been made, leave of the court is required for certain proceedings: IA s.285(3):

  "After the making of a bankruptcy order no person who is a creditor of the bankrupt in respect of a debt provable in the bankruptcy shall –

  (a) have any remedy against the property or person of the bankrupt in respect of that debt, or

  (b) before the discharge of the bankrupt, commence any action or other legal proceeding against the bankrupt except with the leave of the court ...".

- In *Ezekiel v Orakpo* (above) the Court of Appeal considered the previous provision, s.7(1) of the Bankruptcy Act 1914, which read:

  "On the making of a receiving order an unofficial receiver shall be thereby constituted receiver of the property of the debtor, and thereafter, except as directed by this Act, no creditor to whom the debtor is indebted in respect of any debt provable in bankruptcy shall have any remedy against the property or person of the debtor in respect of the debt, or shall commence any action or other legal proceedings, unless with the leave of the court and on such terms as the court may impose."

  The Court held that an action claiming possession on the basis of forfeiture for non-payment of rent did not fall within that sub-section. That decision was followed in *In re Lomax* in relation to administration under the IA 1986, and it seems probable that it applies to s.258(3) IA 1986.

- In *Razzaaq v Pala* [1997] 1 WLR 1337, Lightman J held that peaceable re-entry does not fall within s.258(3), following *Ezekiel*. He correctly recorded that *Ezekiel* had decided that the right of re-entry, whether exercised by service of a writ claiming possession or by peaceable entry, does not constitute a remedy against the property or person of the bankrupt. The reasoning is that the exercise of the right of forfeiture does not remedy any preceding breach of covenant: it merely prevents its recurrence and affords relief to the landlord from being saddled with a defaulting tenant. However, curiously, he went on to say: "If this is so, it is anomalous that under section 285(3) a landlord requires the leave of the court before he can commence proceedings for forfeiture, but is immune from any restraint on exercising his right of peaceable re-entry. This is the more so when\b 55\b0 regard is had to the disfavour with which the law looks upon peaceable re-entry ... But that is not a sufficient basis on which I am free to give the word "remedy" a wider meaning than afforded in *Ezekiel v Orakpo* supra." The suggestion there that leave is needed for forfeiture proceedings is contrary to *Ezekiel*, where the forfeiture was by action, and inconsistent with Lightman J's own statement that enforcing a right of re-entry is not a remedy against the property or person of the bankrupt, however it is enforced.

- The IA 2000 will not affect the position in bankruptcy

Receivership

There is no bar on forfeiture by action or peaceable re-entry

Voluntary arrangements

- There is no bar on forfeiture in the case of a proposal for a CVA. However, once s.1 of the IA 2000 comes into force, a small company may obtain a moratorium during which forfeiture will only be possible with leave

- In the case of a proposal for an IVAs, where an interim order under s.252 is made, then while it is in force:

  "(a) no bankruptcy petition relating to the debtor may be presented or proceeded with, and

(b) no other proceedings, and no execution or other legal process, may be commenced or continued against the debtor or his property except with the leave of the court..."

- That does not prevent forfeiture by peaceable re-entry: *Re a Debtor No 13A/IO/95* [1995] 1 WLR 1127. It may well not prevent forfeiture by action either, as in the case of bankruptcy. However, once s.3 of the IA 2000 comes into force, forfeiture during the currency of an interim order will only be possible with leave

- The effect of a CVA or IVA on a landlord's right to forfeit remains controversial. See below.

3 RENT DEPOSITS

Rent deposits are normally taken as a safeguard against the tenant's insolvency, but until recently there was no authority on the effect of such insolvency on a landlord's rights. The matter came to be considered in *Re Greenport Ltd (in liquidation)* Chancery Division – Hazel Williamson QC (sitting as a Deputy High Court Judge) 1 December 2000; NLO case number 2001221802.

In that case, a lease was granted with an ancillary rent deposit deed, requiring the tenant to pay a deposit of £26,750 into an account of the landlord as security against a failure of the tenant to perform its obligations. Clause 1 of the deed included within a definition of "default" a determination of the lease before expiry of the term by the disclaimer of any liquidator. Clause 3.2 of the deed gave the landlord the right to use the deposit to satisfy any claim as a result of default by the tenant prior to the return of the balance of the deposit. Clause 4.2 of the deed expressed the deposit as being charged as "...security for the performance of the Tenant's obligations..." Clause 5.1 of the deed entitled the landlord to appropriate arrears of rent from the deposit account. Two cheques in respect of rent totalling £9,010 were dishonoured in February 2000. On 17 March 2000, Greenway was placed in creditors' voluntary liquidation and a liquidator was appointed. On 25 March 2000, a further instalment of £13,785 rent became due and was not paid. On 6 April 2000, the liquidator disclaimed the lease. The liquidator sought to recover the deposit. The landlord refused to

return the deposit in full and successfully argued that it was entitled to deduct from it by way of set-off the £22,975 owing in arrears of rent.

The landlord conceded that the charge in clause 4.2 of the deed was void for want of registration. The liquidator argued that clause 5.1 had no further independent effect to grant the landlord any right over the deposit, but was a mere mechanism by which the charge under clause 4.2 was given effect. Alternatively, the liquidator contended, if clause 5.1 did have independent effect, r 4.90 of the Insolvency Rules 1986 prevented any set-off because there was no mutuality between the proprietary claim for the return of the deposit and the personal debt of rent owed to the landlord. That rule provides that, where, before the company goes into liquidation there have been mutual credits, mutual debts or other mutual dealings between the company and any creditor of the company proving or claiming to prove for a debt in the liquidation, there is to be a statutory set off. In the absence of mutuality, the landlord was not entitled to set off the rent against his obligation to account for the deposit.

Hazel Williamson QC rejected those arguments. She held that the landlord could deduct the arrears of rent:

- In order to determine whether clause 5.1 had independent effect it was necessary to look at the other terms in the deed. Clause 3.2 of the deed was significant and when read in the context of the definition of "default" had a wide contractual effect independent of the charge within clause 4.2.

- That effect was not affected by the doctrine of set-off because, as a matter of contract, Gateway was only obliged by the terms of the deed to return the balance of the deposit after deduction of what was owed to it**.**

- If the matter were analysed as a trust, it would not be considered a bare trust as the deposit was required to be treated according to the terms of the deed.

- On a proper analysis, however, although described as a "trust", the effect of the deed was to create a further charge to that within clause 4.2. The effect of the contractual terms was that a sum of the tenant's money was held by the landlord subject to a right to return only the balance after the relevant sums which the landlord could claim from the tenant at the end of the lease have been deducted. This was a charge, even though not called such.

- Notwithstanding that the charge under clause 4.2 was conceded to be void for want of registration, the further charge was not void. In order for a charge to be required to be registered, it was necessary for it to fall within s 396(1) of the Companies Act 1985. Section 396(1)(e), "a charge on book debts of the company", was the only possible category into which the charge might fall. A right of a tenant to recover a balance in a deposit account was clearly not a "book debt". In those circumstances the charge did not require registration and validly allowed Gateway to recover arrears of rent. It seems clear from that decision that the landlord's concession that the charge under clause 4.2 was void for non-registration should not have been made.

The moral of that decision is that:

- a rent deposit is likely to be treated as a charge, however it is worded

- registration is probably not necessary, but there is nothing to lose by attempting to register

- provided the rent deposit deed is properly worded, it should enable the landlord to draw on the deposit for rent falling due after the tenant's liquidation

The terms of the rent deposit deed in that case did not attempt to give the landlord a right to the deposit on disclaimer. It is arguable that a liquidator/trustee in bankruptcy cannot disclaim a lease while retaining the right to the rent deposit. There are cases where the Courts have held that if a lease is disclaimed, ancillary rights go with the lease.

- In *Ex P. Allen In re Fussell* (1882) 20 Ch D 341, (trustee lost chattels in a leasehold factory when the lease was disclaimed)

- *Re Morrish ex p. Hart Dyke* (1882) 22 Ch D 410 (right to compensation at expiry of lease went on disclaimer)

- *Pearce v Bastable's Trustee in Bankruptcy* [1901] 2 KB 518 (contract for sale of leasehold property could not be disclaimed separately from the lease; although a contract to sell can be disclaimed without affecting a contract to buy: *Re Gough*

(1927) LJ Ch 239; *MEPC plc v Scottish Amicable* (1994) 67 P & CR 314 (disclaimer of licence to assign took lease with it); but see *Capital Prime Properties plc v Worthgate Ltd* [2000] 1 BCLC 647 (where a vendor had declared a trust of the property for the contracting purchaser, the disclaimer of the contract did not destroy the equitable interest of the purchaser who was entitled to be registered as proprietor)

Other points to bear in mind in relation to a rent deposit are as follows:

- The rent deposit deed can reserve a right to forfeit the lease if the tenant defaults in his obligations under the Deed e.g. to top up the deposit if the landlord has to draw on it (and query whether s.146 LPA 1925 then applies – forfeiture would not be "for a breach of any covenant or condition in the lease", but for a breach of a covenant in a separate deed).

- It is uncertain whether drawing down on a rent deposit for an unpaid instalment of rent would be treated as a waiver of the right to forfeit for accrued once and for all breaches of covenant committed prior to the rent day known to the landlord.

- It is likely that no draw down may take place pending an application for an administration order or once such an order has been made without leave: ss.10, 11 IA 1986 (see above). Such a draw down is probably a step “to enforce any security over the company’s property”; the deposit is vested in the landlord at law but only as security, so that the tenant retains the equity of redemption which makes the deposit in equity the company’s property

4 TRANSACTIONS AT AN UNDERVALUE

There have been a number of recent decisions on s.423 IA 1986, which allows an aggrieved creditor to obtain an order setting aside transactions at an undervalue effected to defeat creditor’s claims. A landlord might need to invoke s.423 if the tenant had arranged his affairs so as to avoid enforcement of his obligations under the lease. Points to note are:

- In considering whether there has been a transaction at an undervalue, one must look at all the consideration actually provided, even if under a linked agreement: *Phillips v Brewin Dolphin Bell Lawrie* [2001] 1 WLR 143

- In valuing the consideration, one may have regard to events which happened subsequently: *Phillips v Brewin Dolphin Bell Lawrie*

- The giving of security is not a transaction at an undervalue: *Re MC Bacon* [1990] BCLC 324, *National Bank of Kuwait v Menzies* [1994] 2 BCLC 306

- A transaction designed to reduce the claims of one creditor falls within s.423 even if the debtor's overall asset position remains unaffected: *National Westminster Bank plc v Jones* [2002] 1 BCLC 55

- It has been held that the purpose of prejudicing creditors need only be a substantial purpose of the debtor's transaction, not the dominant purpose It is sufficient if it is a purpose and not merely as a consequence, rather than something which was indeed positively intended: *Inland Revenue Commissioners v Hashmi* [2002] EWCA Civ 981. Arden LJ used the example of someone who goes out to walk the dog and post a letter – she has two substantial purposes.

5 VOLUNTARY ARRANGEMENTS

It has been held by the Court of Appeal that a voluntary arrangement can affect a landlord's rights against co-tenants, previous tenants and sureties, but if an arrangement is to have this effect it must be apparent on the true construction of the agreement: *Johnson v Davies* [1999] Ch 117, overruling the earlier decision to the contrary in *RA Securities Ltd v Mercantile Credit Co Ltd* [1995] 3 All ER 581.

A landlord faced with a proposal for an arrangement which has that effect should challenge it as unfairly prejudicial. It is quite legitimate for the arrangement to propose the release of the insolvent tenant from liability to the landlord, co-tenants, previous tenants and sureties, but

there is no reason why the arrangement should also secure the release of solvent co-debtors by a side wind.

It remains unclear whether a voluntary arrangement can affect a landlord's right to forfeit:

- In *Re Naeem* [1990] 1 WLR 48 Hoffmann J said that the arrangement in that case was not intended to affect the landlord's right to forfeit, but only his rights qua creditor. Query if he meant that to apply generally to voluntary arrangements or only on the construction of the particular arrangement in *Re Naeem*.

- In *Doorbar v Alltime Securities* (No 2)[1995] BCLC 513, Knox J held that a right of re-entry was a security, and therefore a voluntary arrangement affecting the landlord's right to recover rent due under a lease did not affect its right to forfeit. When that case went to the Court of Appeal [1996] 1 WLR 456 it was not disputed that the right of re-entry survived unaffected by the arrangement

- In *March Estates v Gunmark* [1996] 2 BCLC 1 Lightman J expressed the opinion, obiter, that a voluntary arrangement could not affect the landlord's right to forfeit the lease if the full rent reserved by the lease is not paid. He said this was implicit in the judgments of Knox J and (in the Court of Appeal) of Peter Gibson LJ in *Doorbar v Alltime Securities Ltd.* He disagreed with the view expressed by Hoffmann J in *Re Naeem* that the right to forfeit was not affected but that the terms on which relief might be granted could be, saying that the tenant would have to pay the rent in full to obtain relief. However, this was because he believed, as Knox J did in *Doorbar* that a landlord's right to forfeit is a security, and s.4(3) and 258(4) IA 1986 prevent a creditors' meeting from approving voluntary arrangements which affect the right of a secured creditor to enforce his security without the creditor's concurrence.

- However, later Lightman J recanted and said that a landlord's right to forfeit is not a security and a landlord is therefore not a secured creditor: *Razzaq v Pala* [1997] 1 WLR 1336, although he did not comment on whether that affected the views he expressed on voluntary arrangements in *Gunmark*.

- It has now been settled at first instance that a right of re-entry is not a "security": *Re Lomax Leisure*. That leaves the question of whether a voluntary arrangement can interfere with a landlord's right to forfeit, and if so, to what extent, at large.

- A landlord would be well advised to insist on clarification of this issue in any proposal and, if the proposal does affect the right to forfeit, to challenge it is unfairly prejudicial.

6 STATUTORY DEMANDS, PETITIONS AND CROSS-CLAIMS

It is worth remembering that a landlord can petition for the winding up of a company tenant if the rent is not paid and there is no bona fide dispute as to the rent being due without first serving a statutory demand, even if the tenant is not insolvent: *Cornhill Insurance plc v Improvement Services Ltd* [1986] BCLC 26. It is, however, an abuse of the process to present a petition against a solvent company when the debt is bona fide disputed and the court will grant an injunction restraining presentation or advertisement of the petition and award indemnity costs: *Re a company (No 0012209 of 1991)* [1992] 1 WLR 352

A recent example of these principles in action is *Re Wanda Modes Ltd* [2002] 1 BCLC 289. There, premises which were let to the tenant company under a periodic tenancy. When the premises fell into disrepair and the landlord failed to carry out repairs, breaching his covenant, the tenant carried out works itself at a cost of some £61,000. A s.25 notice was served and an application for a new tenancy was made under the Landlord and Tenant Act 1954. Following the hearing of preliminary issues in the county court the landlord was awarded costs of £6,517.36 against the tenant on 11 May 2001. When the tenant failed to pay that amount the landlord filed a winding-up petition against the tenant who opposed it on the grounds that it had a cross-claim for damages against the landlord which exceeded the amount of the landlord's debt. Meanwhile in December 2000 the tenant had commenced an action in the county court against the landlord's predecessor in title for damages, including loss of profits, caused by the breach of the repairing covenant, and the landlord was added as second defendant to those proceedings by permission of the county court judge on 22 June 2001.

The landlord contended that the cross-claim ought to be disregarded and the tenant wound up because (i) the tenant's cross-claim was not genuine and serious since it was motivated by the anticipated winding-up petition, as was shown by the fact that the landlord was added as second defendant to the damages claim after the tenant knew that costs, which it would be unable to pay, would be awarded against it in the landlord and tenant proceedings, (ii) the tenant could have litigated the cross-claim before the petition was presented and had not been prevented from doing so, (iii) it had not been shown that the cross-claim if successful would

exceed the amount of the landlord's debt, and (iv) the landlord was likely to have further claims against the tenant in respect of costs and interim rent payable by the tenant while the landlord and tenant proceedings were in progress and those claims would outweigh the cross-claim.

Park J rejected those arguments and dismissed the petition:

- The fact that the tenant's motive for joining the landlord as second defendant to the damages claim was to provide a cross-claim against the anticipated winding-up petition did not mean that the cross-claim was not genuine and serious. On the contrary, it had been shown to be genuine and serious by the fact that there were substantial arguments on both sides as to whether it would succeed or fail. In any event, the court hearing a winding-up petition was not the appropriate forum to determine disputed questions of whether the cross-claim would succeed or fail or disputed issues of whether in fact the cross-claim would exceed the amount of the debt on which the winding-up petition was based, and if the company opposed the winding-up petition, either by disputing the debt or making a cross-claim, and in doing so raised substantial questions of fact or law or both which were genuinely disputed, the court would normally dismiss the petition leaving the disputed issues to be litigated in the normal forum for resolving such disputes.

- Although when deciding whether to exercise or refrain from exercising the power to order a company to be wound up because of the existence of a debt owed to the landlord, the court was required to look at the entire relationship between the parties, including any other claims which the landlord might have against the tenant, the court would only allow a reverse cross-claim to neutralise a cross-claim if the reverse cross-claim was certain to become a definite debt because there was no realistic defence to it. Although the landlord was likely to have further claims against the tenant in respect of costs and interim rent, they were not such as to prevent the court from refraining to order the tenant to be wound up, because the claim for further costs, although certain to become a debt because there was no defence to it, was not likely to be large enough to off-set the tenant's cross-claim and the claim for interim rent was strongly opposed and therefore not certain to become a definite debt.

- A company was not precluded from relying on a cross-claim as a ground for opposing a winding-up petition by the fact that it could reasonably have litigated the cross-claim before the winding-up petition was presented. In principle there was nothing objectionable in a company which had refrained from pursuing a claim which it believed it had against another party, later deciding to pursue the cross-claim if the other party threatened it with winding-up proceedings for non-payment of a debt, since it would be undesirable if companies were penalised for refraining from litigating an issue or if parties were encouraged to litigate possible claims sooner rather than later.

7 DISCLAIMER

THE BASICS

Who can disclaim?

A liquidator (whether in voluntary or compulsory liquidation) or trustee in bankruptcy may disclaim the lease under IA 1986 s.178-9 (insolvency); IA 1986 s.315-317 (bankruptcy). The Crown can disclaim where a lease vests in it as bona vacantia: ss.654, 656 Companies Act 1985.

No-one else can. Not

- an administrative receiver
- a Law of Property Act receiver
- a receiver appointed by the court
- an administrator

- a nominee or supervisor under a voluntary arrangement
- a liquidator of a company holding as joint tenant with another
- a trustee in bankruptcy of one of two joint tenants

Time limit

Normally there is no time limit, but a person interested in the property may impose a 28 day time limit upon the trustee in bankruptcy or liquidator requiring him to elect to disclaim within that time or not at all: IA 1986 ss.316 and 178(5). The procedure is laid down by IR 1986 rr. 4.191 and 6.183. The court has power to extend time, but only in special circumstances such as sickness or the landlord leading the trustee/liquidator to believe that more time will be given: *Re Jones* (1874) 9 Ch App 586. If the trustee fails to disclaim he will be personally liable because the lease vests in him. If liquidator fails to disclaim after notice to elect, when any prudent liquidator would disclaim, the position is unclear. The liquidator is not personally liable: *Graham v Edge* (1888) 20 QBD 683. But may be argued that he has effectively adopted the lease for the benefit of the liquidation and so the rent should be treated as an expense of the liquidation under IR 1986 r.4.218(1)(m): "any necessary disbursements by the liquidator in the course of his administration".

How to disclaim

The liquidator/trustee must file a notice of disclaimer in court with a copy: IR 1986 rr.4.187, 6.178. The court seals and dates the notice and returns it to the trustee/liquidator.

The liquidator/trustee serve a copy of the notice upon

- every person who, to his knowledge, claims under the company/bankrupt as underlessee or mortgagee
- every person who, to his knowledge, claims an interest in the disclaimed property (this will include the landlord)

- every person who, to his knowledge, is under any liability in respect of the disclaimed property, not being a liability discharged by the disclaimer:

IR 1986 rr. 4.188, 6.179

In the case of bankruptcy only, where the lease includes a dwelling house, the trustee must also serve on every person of whom he is aware who is in occupation of or claiming a right to occupy the dwelling house. If the occupier is under 18, service may be effected on a parent or guardian: IR 1986 r.6.179(7).

If the liquidator/trustee later discovers a person with such an interest as would have entitled him to be served, then he must give notice to that person. But compliance with that obligation is not required if the liquidator/trustee is satisfied that the person has already been made aware of the disclaimer and its date or the court dispenses with compliance: IR 1986 rr.4.188(5), 6.179(6)

There is a presumption that a disclaimer is valid and effective unless it is proved that the liquidator/trustee has breached his duties: IR 1986 rr. 4.193, 6.185.

Leave to disclaim

Leave to disclaim was required for liquidators between 1929 and 1986, but is no longer required, and the court will only interfere with the decision to disclaim if the liquidator acts mala fides or his decision is perverse: *Re Hans Place; Cavendish Offices & Houses Investments ltd v Adams* [1992] 2 EGLR 179.

A trustee only needs leave to disclaim in the special situation where he has claimed the lease for the estate under either:

- IA 1986 s.307 (after-acquired property specially claimed by the trustee),

- s.308 (personal property of bankrupt which would normally be excluded from his estate which is specially claimed by the trustee as exceeding reasonable replacement value) or

- 308A (assured, protected or secure tenancies which would not normally vest in the trustee but which the trustee has specially claimed).

The procedure for obtaining leave is laid down by IR 1986 r.6.182.

Timing of disclaimer

A notice of disclaimer terminates a lease 14 days after notice is given to underlessees and mortgagees (and in the case of bankruptcy, residential occupiers) of whom the liquidator/trustee is aware unless within that time an application for a vesting order is made, in which case it does not take effect until the Court directs that it is to take effect.

IA 1986 s.179(1) provides:

> "The disclaimer under section 178 of any property of a leasehold nature does not take effect unless a copy of the disclaimer has been served (so far as the liquidator is aware of their addresses) on every person claiming under the company as underlessee or mortgagee and either-
>
> (a) no application under section 181 below is made with respect to that property before the end of 14 days beginning with the day on which the last notice served under this sub-section was served; or
>
> (b) where such an application has been made, the Court directs that the disclaimer shall take effect."

S.317 is to the like effect in the case of disclaimer by a trustee in bankruptcy. Under s.318, the disclaimer by a trustee in bankruptcy of any property in a dwelling house does not take effect unless a copy of the disclaimer has been served (so far as the trustee is aware of their addresses) on every person in occupation of or claiming a right to occupy the dwelling house and either no application for a vesting order is made with respect to the property before the end of the period of 14 days beginning with the day on which the last notice served under this section was served, or where such an application has been made, the court directs that the disclaimer is to take effect.

Effect of disclaimer

The effect is described by IA 1986 ss. 178 and 315 - a disclaimer:

"... operates so as to determine from the date of the disclaimer, the rights, interests and liabilities of [the company] [the bankrupt] in or in respect of the property disclaimed; but does not, except so far as is necessary for the purpose of releasing [the company] [the bankrupt] from liability, affect the rights or liabilities of any other person".

It has been held that, once a lease has been disclaimed, the disclaimer is not undone even if the bankruptcy or winding up order is reversed: *Re Hyams* (1923) 93 LJ Ch 184.

A trustee is wholly released by disclaimer, except perhaps from breaches of the lease he personally committed: *Schofield v Hincks* (1888) 58 LJQB 147.

Vesting orders

Under IA 1986 ss. 181 and 320, any person who "claims an interest in the disclaimed property" or any person "who is under any liability in respect of the disclaimed property, not being a liability discharged by the disclaimer", may apply to the court for an order vesting the "disclaimed property" in either:

- a person entitled to it, or a trustee for such a person, or

- a person under any liability in respect of the disclaimed property, or a trustee for such a person. In this case, the court is not to make a vesting order except where it appears to the court that it would be just to do so for the purpose of compensating the person subject to the liability in respect of the disclaimer.

In bankruptcy only, where the disclaimed property is property in a dwelling house, any person who at the time when the bankruptcy petition was presented was in occupation of or entitled to occupy the dwelling house can also apply for a vesting order (IA 1986 s.320(3)(c)).

A vesting order need not be completed by conveyance, assignment or transfer.

The liquidator or trustee may require any person who it appears to him may claim an interest to declare within 14 days whether he does. Failure to comply entitles the liquidator/trustee to assume that there is no such interest: IR 1986 rr.4.192, 6.184.

An application for a vesting order must be made within 3 months of the applicant becoming aware of the disclaimer, or of his receiving notice of it, whichever is the earlier: IR 1986 rr.4.194(2), 6.186(2).

Terms of vesting orders

The court may not make a vesting order except on terms making the person in whom the disclaimed lease is vested either:

(a) subject to the same liabilities and obligations as the bankrupt was subject to under the lease on the day the bankruptcy petition was presented, or

(b) if the court thinks fit, subject to the same liabilities and obligations as that person would be subject to if the lease had been assigned to him on that day,

ss.182(1), 321(1).

The court can make a vesting order relating to only part of any property comprised in a lease, in which case those requirements apply as if the lease comprised only the property to which the order relates: ss. 182(2), 321(2).

Where s.182(1) or s.321(1) apply, and no person is willing to accept a vesting order on the terms required by those subsections, the court may vest the estate or interest of the company/bankrupt in the property in any person who is liable (whether personally or in a representative capacity and whether alone or jointly with the company/bankrupt) to perform the lessee's covenants in the lease: ss.182(3, 321(3). The court may in that case vest that estate and interest in such a person freed and discharged from all estates, incumbrances and interests created by the company/bankrupt.

Where s.182(1) or s.321(1) apply, and a person declines to accept a vesting order, that person shall be excluded from all interest in the property.

Proof for injury caused by disclaimer

Any person sustaining loss or damage in consequence of disclaimer is entitled to prove for the loss or damage: IA 1986 ss.178(6), 315(5) and *Christopher Moran Holdings v Bairstow* [2000] 2 AC 172

Contractual obligations on sureties to take up new lease after disclaimer

Surety covenants commonly include an obligation on the surety to take up a new lease if the landlord so requires after disclaimer.

DISCLAIMER ANALYSED: *HINDCASTLE V BARBARA ATTENBOROUGH ASSOCIATES* [1997] AC 70

Stacey v Hill

On Friday 1 March 1901, the Court of Appeal gave unreserved judgments in the case of *Stacey v Hill* [1901] 1 KB 660. Mr. Stacey had granted a lease of a shop in Sheffield to Mr. Chapman at a yearly rent of ,280. Mr. Stacey was concerned about whether Mr. Chapman could, in fact, pay the rent. So he took a guarantee from Mr. Hill. A year later, Mr. Chapman was adjudicated bankrupt and a trustee of his estate was appointed. The trustee disclaimed the lease. Hill paid the rent up to the date of the disclaimer, but denied any further liability. The Court of Appeal held that the lease ended with, and Hill was released by the disclaimer.

The decision was faithfully followed at first instance (see e.g. *Re No 1 London Ltd* [1991] BCLC 501), although distinguished in the case of a lease which had been assigned, and where the disclaimer was by the liquidator's assignee. In that case, the lease did not end and the original tenant remained liable: *Warnford Investments Ltd v Duckworth* [1979] Ch 127. However, the logic of *Stacey v Hill* was applied to the surety of the asignee, who, it was held, was released by the disclaimer of the lease by the assignee's liquidator: *Murphy v Sawyer-Hoare* [1993] 2 EGLR 61.

Hindcastle

The decision in *Stacey v Hill* stood in England and Wales (although not followed in Ireland : see *Maurice Tempany v. Royal Liver Trustees Ltd* [1984] BCLC 568) until 1996, when it was overruled by the House of Lords in *Hindcastle*.

In that case, L granted T a lease of office premises for a term of 20 years from 1983. In 1987 the lease was assigned by T to A1, pursuant to a licence to assign which contained a covenant on the part of A with L to pay the rent and to observe and perform the covenants in the lease for the remainder of the term of years. S joined in the licence to assign as surety in order to guarantee the performance of the obligations undertaken by A1 for 10 years from the date of the lease. In 1989,

A1 assigned the lease with consent to A2, a company which in 1992 went into voluntary liquidation. The liquidator disclaimed the lease. L sued T, A1 and S for the rent, and recovered. Lord Nicholls gave the leading speech. He analysed the effect of disclaimer as follows

Third party rights to be affected as little as possible (pp.86-87)

"Disclaimer will, inevitably, have an adverse impact on others: those with whom the contracts were made, and those who have rights and liabilities in respect of the property. The rights and obligations of these other persons are to be affected as little as possible. They are to be affected only to the extent necessary to achieve the primary object: the release of the company from all liability. Those who are prejudiced by the loss of their rights are entitled to prove in the winding up of the company as though they were creditors."

Disclaimer: where only a landlord and tenant are involved (p.87)

"The simplest case is of a landlord and an insolvent tenant. No third parties are involved. Disclaimer operates to determine all the tenant's obligations under the tenant's covenants, and all his rights under the landlord's covenants. In order to determine these rights and obligations it is necessary, in the nature of things, that the landlord's obligations and rights, which are the reverse side of the tenant's rights and obligations, must also be determined. If the tenant's liabilities to the landlord are to be extinguished, of necessity so also must be the landlord's rights against the tenant. The one cannot be achieved without the other. Disclaimer also operates to determine the tenant's interest in the property, namely the lease, Determination of a leasehold estate has the affect of accelerating the reversion expectant upon the determination of that estate. The leasehold estate ceases to exist."

Guarantors and original tenants: statutory deeming (pp.87-89)

In other cases, where third parties are involved, the position is different. The disclaimer does end the lease. However, the statute takes effect as a deeming provision so far as other persons' preserved rights and obligations are concerned. Lord Nicholls explained the position as follows:

"The statute provides that a disclaimer operates to determine the interest of the tenant in the disclaimed property but not so as to affect the rights or liabilities of any other person. Thus when the lease is disclaimed it is determined and the reversion accelerated but the rights and liabilities of others, such as guarantors and original tenants, are to remain as though the lease had continued and not been determined. In this way the determination of the lease is not permitted to affect the rights or liabilities of other persons ...If a vesting order is made, the court order operates by virtue of the statute to vest the lease in the person named on the terms fixed by the court. That the lease may have ceased to exist meanwhile is neither here nor there. If necessary, there will be a statutory recreation. If no vesting order is made and the landlord takes possession, the liabilities of other persons to pay the rent and perform the tenant's covenants will come to an end as far as the future is concerned. If the landlord acts in this way, he is no longer merely the involuntary recipient of a disclaimed lease. By his own act of taking possession he has demonstrated that he regards the lease as ended for all purposes. His conduct is inconsistent with there being a continuing liability on others to perform the tenant covenants in the lease. He cannot have possession of the property and, at the same time, claim rent for the property from others.

The result is not without artificiality. Unless a vesting order is made, after disclaimer there will be no subsisting lease, and the property will be vacant and empty. But if the landlord enters upon his own property, he will thereby end all future claims against the original tenant and any guarantor, not just claims in respect of the shortfall between the lease rent and the current rental value of the property. It must be recognised, however, that awkwardness is inherent in the statutory operation: extinguishing ("determining") the lease so far as the bankrupt is concerned, but leaving others' rights and liabilities in respect of the same lease affected no more than necessary to achieve the primary purpose."

Sub-tenants and mortgagees (p.89)

Lord Nicholls' comments on the position of a sub-tenant or mortgagee were necessarily *obiter*, as no issue as to the position of any such person arose in *Hindcastle*. He dealt with the position shortly, as follows:

"In order to free the tenant from liability, it is necessary to extinguish the landlord's rights against the tenant and also the subtenant's rights against the tenant. The tenant's interest in the property is determined, but not so as to affect the interest of the subtenant. Determination of the subtenant's interest in the property is not necessary to free the tenant from liability. Hence the subtenant's interest continues. No deeming is necessary to produce this result. Here the deeming relates to the terms on which the subtenant's proprietary interest continues. His interest continues unaffected by the determination of the tenant's interest. Accordingly the subtenant holds his estate on the same terms, and subject to the same rights and obligations, as would be applicable if the tenant's interest had continued. If he pays the rent and performs the tenant covenants in the disclaimed lease, the landlord cannot eject him. If he does not, the landlord can distrain upon his goods for the rent reserved by the disclaimed lease or bring forfeiture proceedings. In practice, matters are likely to be brought to a head by one of the parties making an application for a vesting order."

SURETIES

The effect of *Hindcastle*

After *Hindcastle*, a surety under a lease, or licence to assign, will remain liable to a landlord as surety unless

- the surety would have been released even if the lease had not been disclaimed
- the landlord takes possession of the premises, so terminating the statutory fiction
- the landlord requires the surety to take up a new lease, in which case the new lease will replace the fiction that the old lease continues in existence

Release even if the lease had not been disclaimed

The surety is entitled to raise any defence which would have been open to him if the lease had not been disclaimed. The variety and efficacy of such defences is outside the scope of this lecture. Possibilities include the following.

Failure to serve notice under s.17 of the Landlord and Tenant (Covenants) Act 1995

Under s.17, a landlord must serve notice of fixed charges such as rent on the guarantor of performance by a former tenant within 6 months. Query if a guarantee of the liability of "the tenant", defined to include successors in title, is within s.17(3)

Variations of the lease leading to a deemed surrender and re-grant

See *Jones v. Bridgman* (1878) 39 LT 500; *Re Savile Settled Estates* [1931] 2 Ch. 210, *Baker v Merckel* [1960] 1 QB 657, but for the limitations on this see *Friends Provident Life Office v BRB* [1995] 2 EGLR 55 and *Childers Trustees v Anker* [1996] 1 EGLR 1

Variation of the obligations of the tenant potentially prejudicial to the surety

See *Holme v Brunskill* (1877) 3 QBD 495, *West Horndon Industrial Park v Phoenix Timber Group* [1995] 1 EGLR 77, *Howard de Walden Estates ltd v Pasta Place ltd* [1995] 1 EGLR 79.

However, many surety clauses contract out of this rule: BM *Samuels Finance Group plc v Beechmanor ltd* (1994) 67 P & CR 263, and even if it does apply the variation must potentially prejudice the surety: *Metropolitan Properties Co (Regis) v Bartholomew* [1996] 1 EGLR 82

Landlord who takes possession

In *Hindcastle*, Lord Nicholls said that, if no vesting order is made and the landlord takes possession, the liabilities of other persons to pay the rent and perform the tenant's covenants will come to an end as far as the future is concerned. If the landlord acts in this way, he is no longer merely the involuntary recipient of a disclaimed lease. By his own act of taking possession he has demonstrated that he regards the lease as ended for all purposes.

This will probably not apply if the landlord merely takes possession to safeguard the premises against squatters. In the absence of disclaimer, it has been held that a landlord may deal with the premises in a variety of ways without being treated as terminating the lease by accepting a surrender or forfeiting. He may:

- attempt to re-let: *Oastler v. Henderson* (1877) 2 QBD 575

- secure the premises against intruders: *Relvok Properties v. Dixon* (1972) 25 P. & C.R. 1

- take possession proceedings against squatters: *McDougalls Catering Foods v BSE Trading* [1997] 2 EGLR 65 (although query if this can be correct)

The same approach was applied in the case of disclaimer in *Cromwell Developments Ltd v Godfrey* [1998] 2 EGLR 62; 78 P & CR 197. There, the dispute was between the original tenants of two suites of offices and the landlords. In May 1984 both leases were assigned to CBL. In February 1987 CBL was dissolved under s 652 of the Companies Act 1985 and the leases became vested in the Crown as bona vacantia. The fact of dissolution was not communicated to the landlords and they were found in the court below to have been unaware of these events. In April 1993 the leases were disclaimed by the Treasury Solicitor. Until September 1990 the landlords continued to receive rents under the leases paid by a second company, CBTS also based in the building. After September 1990 arrears accrued which, with damages for dilapidations, formed the subject of the dispute. Judgment obtained against the surety of both companies were unsatisfied and the landlords sued the original tenants. The Court of Appeal held in favour of the landlords. The landlords had absolutely no knowledge of CBL's dissolution and made no distinction between CBL and CBTS as regarded payment of rent. The lease did not come to an end in February 1987 by reason of the dissolution of CBL. An act relied on as constituting the final and positive act of forfeiture had to be accompanied by an intention to forfeit, something which was clearly absent in this case. The landlords effected no act which was inconsistent with the continued existence of the original leases and did not permit CBTS to enter or remain in possession as a tenant.

A landlord is under no obligation to take possession: *Bhogal v Cheema* [1998] 2 EGLR 50

Landlord serving notice requiring new lease to be taken up

If the obligation is to take up a new lease if the lease is disclaimed by the liquidator of the tenant, there will be no obligation if the disclaimer is by the Crown on the lease vesting in the Crown on the dissolution of the tenant: *Re Yarmarine (IW) ltd* [1992] BCLC 276

Once the landlord has served notice on the surety requiring him to take up a new lease, an equitable lease comes into existence under which the surety is liable to pay the rent: *Re a Company no 792 of 1992 ex p Tredegar Enterprises ltd* [1992] 2 EGLR 39.

Service of such a notice does not release the guarantor or his estate from liability under the guarantee: *Basch v Stekel* [2001] L&TR 1. Once the new lease is granted, then the fiction of the old lease will end. Until then, the surety is liable under the lease and/or the equitable lease created by the service of the notice

SUB-TENANTS AND MORTGAGEES

Forfeiture and distress

The landlord retains the rights he would have had, but for the disclaimer. These include the right of distress for rent and to forfeit (although query who he makes the defendant in forfeiture proceedings).

Putting sub-tenant/mortgagee to election

The landlord can make an application that the lease be vested in any sub-tenant or mortgagee, so putting them to their election to either take a vesting order or to be barred from all interest in the property: *In re Cock, ex p Shilson* (1887) 20 QBD 343, DC, *In re Finley* (1888) 21 QBD 475 CA

Not entitled to vesting order with benefit of sub-lease

The landlord cannot take a vesting order giving him the lease together with the benefit of a sub-lease

In *Re AE Realisations ltd* [1988] 1 WLR 200, a company was granted a lease. A surety joined in the lease and covenanted to take a new lease on disclaimer. Then the company granted an underlease, the underlessee paying a rent deposit of ,25,000. The tenant company went into liquidation and the liquidator disclaimed the lease. The landlord called on the surety to take a new lease. The surety applied for a vesting order of the existing lease, with the intention that on the old lease being vested in the surety, the surety would acquire the benefit of the underlessee's covenants under the underlease and the rent deposit. Vinelott J held that the underlessee had elected not to take any interest in the property and accordingly its interest in

the property had been destroyed. Accordingly, a vesting order would not give the surety the benefit of the underlease or the rent deposit. So no vesting order would be made.

In *Sterling Estates v Pickard* [1997] 2 EGLR 33, ITM held a headlease of business premises from the plaintiff freeholder for a term of 25 years. P held underleases of three floors of the premises. In January 1992 P allowed S into occupation of the three floors, and S paid rent first to ITM, and then, pursuant to a notice under the Law of Distress Amendment Act 1908, to the freeholder. ITM refused consent to the assignment of the underleases to S, and no assignment took place. In September 1995 ITM was ordered to be compulsorily wound up, and in March 1996 the liquidator disclaimed the headlease. Neither P or S sought a vesting order in relation to the headlease, and made plain that if put to an election by the freeholder, they would elect to be excluded from all interest in the property. Following an application by the freeholder, in October 1996 the registrar ordered that the headlease be vested with the freeholder with the benefit of the existing underleases. P and S appealed against that decision, and Michael Crystal QC, sitting as a deputy High Court judge, allowed the appeal. The court had no jurisdiction to vest the lease in the landlord with the benefit of the underleases.

Query if the same is true of the original tenant.

Nominee

A subtenant or mortgagee cannot escape liability on vesting by assigning the sublease or mortgage to a nominee. In *Re Smith ex p Hepburn* (1890) 25 QBD 536, the trustee in bankruptcy of the tenant disclaimed the lease, which had been mortgaged by sub-demise. The day before the application for leave to disclaim was heard, the mortgagee assigned the mortgage debt and the security to a nominee of small means, who was to hold the debt and security in trust for the mortgagee and deal with it as the mortgagee might direct. The Court of Appeal held that the mortgagee and not the nominee was the person entitled to take a vesting order.

Terms of vesting in subtenant or mortgagee

In *In re Walker ex p Mills* (1895) 64 LJQB 783, Williams J said that, normally, a vesting order should make the applicant liable for all burdens both past and future to which the bankrupt was subject. However, he held that he would make an order that the mortgagee would only be treated as an assignee unless the landlord agreed to take a surrender on 6 months notice if all terms had been complied with.

In *In re Carter & Ellis* [1905] 1 KB 735, 7 leases of 7 houses were granted and immediately mortgaged by sub-demise. Shortly afterwards the tenants became bankrupt and the lease was disclaimed. The Court of Appeal held that the property should be vested in the mortgagees subject only to the same liabilities and obligations as if the leases had been assigned to them at the date of the bankruptcy petition.

In *In re Holmes* [1908] 2 KB 812 DC: Bigham and Jelf JJ considered an application for a vesting order including property not the subject of any sub-lease. There, a tenant of land mortgaged by sub-demise 4 plots to 4 different mortgagees and left one plot unmortgaged. He became bankrupt and the trustee disclaimed the lease. The mortgagees appointed a trustee of their interests under the mortgages and applied for a vesting order in respect of the whole, including the unmortgaged part, which was granted. The court held that it could and would make a vesting order by way of compensation giving the applicant something he was not previously entitled to.

S.6 Law of Distress (Amendment) Act 1908

S.6 provides:

"In cases where the rent of the immediate tenant of the superior landlord is in arrear it shall be lawful for such superior landlord to serve upon any under tenant or lodger a notice (by registered post addressed to such under tenant or lodger upon the premises) stating the amount of such arrears of rent, and requiring all future payments of rent, whether the same has already accrued due or not, by such under tenant or lodger to be made direct to the superior landlord giving such notice until such arrears shall have been duly paid, and such notice shall operate to transfer to the superior landlord the right to recover, receive, and give a discharge for such rent."

The right takes priority over the right of a receiver to receive rents, unless (perhaps) there has been an assignment of the right to receive the rents to the chargee: *Rhodes v Allied Dunbar Pension Services Ltd* [1989] 1 WLR 800

It is not clear whether s.6 continues to apply where the headlease is disclaimed, and the landlord has not put the sub-tenant to his election whether to take a vesting order.

Mortgagees' power to sell without taking a vesting order

Where a charge by way of legal mortgage is granted over a lease the mortgagee is given the same protection, powers and remedies as if a sub-lease less by one day than the term of the lease had been granted: s.87(1)(b) Law of Property Act 1925. The mortgagee has a statutory power of sale: s.101.

The issue arises whether, following *Hindcastle*, the mortgage is destroyed by the disclaimer or whether the mortgagee can exercise his power of sale, and if so, whether the lease re-created in the hands of the purchaser?

SCMLLA Properties v. Gesso Properties [1995] BCC 794 suggests the mortgagee can still sell. That case concerned a block of flats. The freehold was held by G and charged to RTB. G went into liquidation and the liquidator disclaimed the freehold. About 6 months later, RTB sold the freehold to GPB, who was registered as proprietor of it. The majority of the tenants of the flats claimed that they were entitled to the right of first refusal under Part I of the

Landlord and Tenant Act 1987 and nominated SCMLLA to act on their behalf in acquiring the freehold from GPB. The essential issue in the case was whether the property was Crown land, to which the 1987 Act did not apply. GPB argued that on disclaimer the freehold had escheated to the Crown, so that the property was Crown land. One of the issues was whether the freehold was validly vested in GPB. Mr Burnton said he was reluctant to allow the point to be taken, but he did nonetheless deal with it. First, he commented on an argument that the power of sale had not in fact arisen because there had been no notice of default. Then he said: "It is clear that if the power of sale had arisen and been exercised, the freehold was validly vested in the Defendant ... In such circumstances, the freehold must be regarded as reviving"

Does a contracting purchaser or option holder have the right to seek a vesting order?

The problem here can be illustrated best by an example:

> T is the tenant under a commercial lease. The mortgagee appoints receivers, who enter into a contract for the sale of the lease and the business carried on there to P, conditional on the landlord's licence to assign being granted. An application for licence to assign is made, but L refuses consent. T's receivers apply for a declaration that consent has been unreasonably withheld. In the meantime, T goes into liquidation and the liquidator disclaims the lease. L then applies for an order that unless the mortgagee takes a vesting order, it should be barred from all interest in the lease. At the same time, P applies for a vesting order. Who wins?

In *Lloyds Bank SF Nominees v Aladdin* [1996] 1 BCLC 720, the Court of Appeal held that a contracting purchaser of a lease was not a "person who claims an interest in the disclaimed property" for the purposes of s.181(2) Insolvency Act 1986. It seems that counsel for the applicant did not contend that he had any interest of a proprietary nature: see p.721i. Instead, the argument was that he had a financial interest in the lease, having paid ,54,000 for the prospect of an assignment and having been allowed into possession. He relied on a statement by Gavin Lightman QC (as he then was in *Re Vedmay* [1994] 1 EGLR 74 that "interest": "extends to any financial interest in the subsistence or otherwise of the lease and includes in particular any interest that would be adversely affected by the disclaimer". But the Court of Appeal rejected that argument, holding that an "interest" had to be an interest in the property.

It is not clear why counsel for the applicant in that case did not contend that the applicant had a proprietary interest, namely a contract for the sale of the lease. The following are well established principles:

- where there is an unconditional contract for sale of land where the purchaser will be entitled to specific performance the purchaser has a proprietary interest in the land and indeed is treated in equity as the owner of the land: see *Lysaght v Edwards* (1876) 2 Ch D 499, 506;

- an option creates an immediate interest in land as soon as it is granted, even before it is exercised: see *London & SW Railway. v Gomm* (1882) 20 Ch D 562, 581, *First National Securities v Chiltern DC* [1975] 1 WLR 1075.;

- where there is a contract for the sale of a lease conditional on the landlord's consent being given, and the landlord refuses his consent, despite the best endeavours of the parties to persuade him, either vendor or purchaser is entitled to rescind and neither commits a breach of contract in refusing to proceed with the contract: see *Shires v Brock* (1977) 247 EG 127;

- a contract for the assignment of a lease which is conditional on landlord's consent being given is an immediately binding contract for sale. The requirement of landlord's consent is treated as a term of the contract, and not as a condition precedent to the existence of a contract: *Property & Bloodstock v Emerton* [1968] Ch 94.

Accordingly, there is at the very least scope for a respectable argument that P should be treated as having an interest in the property, at least if it is shown that the landlord's consent is being unreasonably withheld. Otherwise, the landlord could take advantage of his wrongful refusal to grant consent to obtain the property for himself.

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