Insolvency and Corporate Tenants

1. This seminar is intended for junior property litigators. It presupposes a knowledge of the law of landlord and tenant, but not of insolvency law. It is aimed at those who did not, until recently, do a significant amount of insolvency work, but are now beginning to find themselves needing to consider the threat of, and consequences of, tenant insolvency on a more regular basis.

2. The modern insolvency law system was enacted in the Insolvency Act 1986 following the recommendations for the reform of insolvency law made in the report of the Cork Committee in 1982. Further substantial structural changes were made by the Enterprise Act 2002 and the Insolvency Act 2000.

3. The rules which govern respectively the insolvency of individuals and of corporations are of course distinct. And within the personal and corporate insolvency regimes, there are a number of distinct procedures which can apply, each of which needs to be considered separately. In this seminar we consider only corporate insolvency, and consider some of the issues which the relevant procedures raise for landlords.

4. Under the pre-1986 Act system, there were two forms of insolvency procedure, receivership and winding up. Two more were added in 1986: the company voluntary arrangement; and administration. Also, the new concept of the administrative receiver was introduced, although no such receiver can be appointed under any

"qualifying floating charge" which was created after 15 September 2003, when the Enterprise Act 2002 came into force. No doubt this terminology is already familiar, but as this seminar does not presuppose any knowledge of insolvency law, we shall briefly outline the nature of each procedure before considering the main impact it has on a landlord. However, we shall not give any consideration here to receivership, as since the coming into force of the Enterprise Act 2002, administrative receivership will be of diminishing importance.

Winding up

5. The winding up, or liquidation, of a company is the process which leads to its death. The actual death of the company is called its dissolution. The process of winding up involves taking the affairs of the company out of the hands of the directors, and instead giving control of the company to a liquidator. The company ceases to be the beneficial owner of its assets, and a trust of those assets arises in favour of the company's creditors. The liquidator's job is to realise those assets so that he can, so far as possible, pay the company's debts and liability before giving whatever is left over to the company's members. He is best described as an agent of the company[1], and does not incur personal liability for what he does on the company's behalf.

6. There are two kinds of winding up, voluntary and compulsory.

Voluntary winding up

7. Voluntary winding up, as the name suggests, is a process initiated by those who control the company, by a resolution in a general meeting. It can take place without the intervention of the Court. As soon as the winding up commences the company must cease to carry on its business except so far as may be required for its beneficial

[1] *Re Anglo-Moravian Hungarian Junction Rly Co* (1875) 1 Ch D 130.

winding up, but the company remains in existence until dissolved (section 87). The liquidator is normally appointed at the meeting which resolves on the winding up.

8. There is no statutory restriction on a creditor proceeding against a company in voluntary liquidation. Nevertheless, the Court has the jurisdiction, on the application of the liquidator or any contributory or creditor, to exercise any of the powers available to the Court in a compulsory liquidation (section 112 of the 1986 Act). Accordingly, a landlord seeking to enforce against a tenant in voluntary liquidation may find itself faced with an application for an injunction to restrain or stay those proceedings. Section 112(2) provides that, on such an application, the Court may do what it thinks will be "just and beneficial".

Compulsory winding up

9. Compulsory winding up, on the other hand, is initiated by the presentation of a winding up petition, which is then heard by the Court. The petition states the ground on which a winding-up order is sought, the available grounds being those set out in section 122(1) of the 1986 Act.

10. Those grounds include that the company is unable to pay its debts. The nature of this inability is defined in section 123, which is where provision is made for the notorious "statutory demand": one way a company counts as being unable to pay its debts is if it has been served with a written demand in a prescribed form demanding payment of a debt and it fails within 3 weeks to do so (section 123(1)(a)). Another way is for it to be "proved to the satisfaction of the court that the company is unable to pay its debts as they fall due" (subsection 123(1)(e)).

11. Other grounds include: that the Court is of the opinion that it is just and equitable that the company should be wound up; and that at the time at which a moratorium for the

company under section 1A comes to an end (on which see below), no voluntary arrangement has effect. Generally compulsory winding up takes place against the wishes of those who control the company, and most winding up petitions are presented by creditors on the ground that the company is unable to pay its debts.

12. When the Court hears the winding-up petition, it may make an order winding up the company (section 125(1)). If it does so, the winding up of the company by the Court is normally deemed to commence at the time of the presentation of the petition (section 129), and generally the Official Receiver becomes the liquidator until a meeting of creditors is summoned to choose a liquidator in his place.

13. The presentation of a winding-up petition does not halt or prevent proceedings against the company, although there is a jurisdiction for the Court, on the application of the company or any creditor or contributory, to stay any action or proceedings against the company (section 126). When a winding-up order has been made, or a provisional liquidator appointed, there is a general freeze on action or proceedings "against the company or its property or any contributory of the company, in respect of any debt of the company, except by leave of the court, and subject to such terms as the court may impose" (section 130(2)). In exercising this discretion, the Court is concerned to avoid one creditor getting an advantage over another in the same class.

14. Both an action for rent arrears, and distress, require permission under this statutory jurisdiction. Distress against a company in compulsory liquidation is void without the consent of the Court (paragraph 128(1)[2]). However, normally a landlord whose

[2] Despite the wording of section 128(1) appearing to make distress void without qualification, it seems clear that that consent under 130(2) will validate it (see *The Constellation* [1966] 1 WLR 272).

tenant was in arrears at the commencement of the winding up must prove in the liquidation, and will not be allowed to sue for arrears or distrain.[3]

15. A landlord should also note that if he has distrained on the goods of the company in the period of 3 months ending with the date of the winding up order, those goods are charged for the benefit of the company with the preferential debts of the company if the company's remaining property is insufficient for meeting those debts (section 176(2)).

16. The situation is different with regard to rent falling due after the commencement of winding up. Although while the company in liquidation remains the tenant, it remains liable for the rent which continues to fall due, this is unlikely to be of much comfort to the landlord if he cannot sue or distrain for the arrears, and has to prove for his arrears like any other creditor. However, if the liquidator actively retains possession of the demised premises, for the benefit of the insolvent company's creditors, then the Court has may exercise its discretion to order the liquidator to pay the ongoing rent as if[4] it were an expense of the liquidation.[5] This is so, notwithstanding that the ongoing rent is not strictly an expense of the liquidation, as it is a liability arising out of a pre-liquidation contract.[6]

17. A landlord will generally be entitled to commence (or continue) forfeiture proceedings against a company being wound up.[7] However, permission is still required, as with other legal process. Accordingly, as orders for forfeiture and relief against forfeiture can be made by the winding-up Court, it makes sense for a landlord

[3] See *Woodfall* 16.217.1(a)(1).
[4] See *In Re Toshoku Finance UK plc* [2002] 1 WLR 671, per Lord Hoffmann at para. 27.
[5] *Re ABC Coupler and Engineering Co Ltd (No. 3)* [1970] 1 WLR 702.
[6] *In Re Toshoku Finance UK plc* [2002] 1 WLR 671, per Lord Hoffmann at para. 25.
[7] See *Bailey & Groves Corporate Insolvency* (3rd ed) paragraph 22.18, citing *Re Strand Hotels Co* [1868] WN 2.

to ask for possession at the same time as applying for permission.[8] This is often referred to as a *Blue Jeans* order, after the case in which this jurisdiction was established, *Re Blue Jeans Sales Ltd* [1979] 1 WLR 362.

18. Although the company's property, including any lease, remains vested in it upon the commencement of winding up, the liquidator has the option to disclaim any onerous property including tenancies, under section 178 of the 1986 Act. Subsection 178(4) provides that such a disclaimer operates so as to determine the rights and liabilities of the company in respect of the disclaimed property, as from the date of disclaimer, but "does not, except so far as is necessary for the purpose of releasing the company from any liability, affect the rights or liabilities of any other person". A landlord whose tenant disclaims is left to prove for damages in the liquidation (subsection 178(6)).

19. The effects of disclaimer under this section were authoritatively described by the House of Lords in *Hindcastle Ltd v Barbara Attenborough Associates Ltd* [1997] AC 70. As explained by Lord Nicholls (with whom the other four Law Lords agreed) at 87 following:

> *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.*
>
> *I turn next to consider the application of these provisions to the principal types of landlord and tenant situations. I do so initially without reference to the decided cases.*
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> *Disclaimer: (1) where only a landlord and tenant are involved*
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> *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*

[8] *General Share and Trust Co v Wetley Brick and Pottery Co* (1882) 20 Ch D 260; *Re Blue Jeans Sales Ltd* [1979] 1 WLR 362; *Re Brompton Securities Ltd (No. 2)* [1988] BCLC 616, 4 BCC 436.

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. I can see no reason to question that this is the effect of disclaimer when the only parties involved are the landlord and the tenant.

Disclaimer: (2) where others have liabilities in respect of the lease

Thus far I have addressed the case where, apart from the insolvent tenant, the only person involved is the landlord. In such a case there is no scope for any rights or liabilities to be preserved by paragraph (b) of section 178(4). In order to achieve the statutory objective of releasing the insolvent from liability, it is necessary to determine all the rights of the landlord.

The matter stands differently where the landlord has the benefit of covenants from a guarantor. In this situation the liabilities of the insolvent tenant to the landlord are ended, but not so as to affect the obligations ofthe guarantor to the landlord. That is the effect of paragraph (b) of section 178(4). Similarly, where the insolvent tenant is an assignee and the landlord has the benefit of the covenants of the original tenant: the original tenant's obligations to the landlord are not affected.

Also ended is the obligation of the insolvent tenant to indemnify the guarantor but, here again, not so as to affect the mutual rights and obligations of the landlord and the guarantor. Termination of the liabilities of the insolvent does not carry with it any legal necessity to determine the guarantor's obligations to the landlord. The right of recourse of the guarantor against the insolvent can be effectually determined without, at the same time, releasing the guarantor from his liability to the landlord. His liability to the landlord can survive extinguishment of his right of recourse. Similar considerations apply to the liabilities of the original tenant where the insolvent tenant is an assignee.

20. However the liability of the surety will be determined if the landlord re-takes possession of the premises, so this must not be done if the landlord wants to pursue the surety.

21. Where a lease has been disclaimed any person who claims an interest in it, or who has any liability in respect of it, may apply to have it vested in him (section 181, 182). The Court may make a vesting order on such terms as it thinks fit, and such an order takes effect without needing to be completed by conveyance assignment or transfer. Accordingly, the landlord may find himself with a new tenant following a disclaimer. In practice, he may be content with this result, as the new tenant will have the same liabilities as the company had (section 182(1)).

22. The landlord can make an application under section 182 asking for the lease to be vested in a sub-tenant. This puts the sub-tenant to his election as to whether he will accept a vesting order (182(4)). The landlord himself is not entitled to apply to have the lease vested in himself in order to take the benefit of underleases, as those other interests must first have been cleared away through the use of the statutory machinery.[9] This appears to be the effect of subsection 182(4), which provides that where a sublessee or mortgagee declines to accept a vesting order, he is excluded from all interest in the property.

23. The damages to which a landlord is entitled in the liquidation under subsection 178(6) are to be assessed in the same way as damages for breach of a contract which has been wrongfully terminated.[10] As decided by the House of Lords in *Christopher Moran Holdings Ltd v Bairstow* [2000] 2 AC 172, at 180 (Hobhouse) and 186 (Millett), in assessing damages, allowance must be made for accelerated receipt of the future rent.

[9] *Sterling Estates v Pickard UK* [1997] 2 EGLR 33; *Re ITM Corpn Ltd, Sterling Estates Ltd v Pickard UK* [1997] 2 BCLC 389, [1997] BCC 554.

[10] These are damages, not a claim for a debt payable at a future time: the future rent will *not* become payable, as the lease has been disclaimed (*Christopher Moran Holdings Ltd v Bairstow* [2000] 2 AC 172, at 180 (Hobhouse) and 186 (Millett)).

24. At the conclusion of the winding up, following a final meeting of the company or the creditors, the registrar of companies is notified, and, following registration, the company is dissolved 3 months later (sections 201 (voluntary) and 205 (otherwise)). When a company is dissolved, any property it holds is deemed to be *bona vacantia* and vests in the Crown (or Duchy of Lancaster or Cornwall).[11] Obviously, if a lease has been disclaimed prior to dissolution by the liquidator, this provision will have no effect on it. However, once a lease has vested in the Crown, it may still be disclaimed. The effects of such a post-dissolution disclaimer are the same as a disclaimer by a liquidator under section 178 of the 1986 Act, as discussed above, and it is as if the lease never vested in the Crown. If the landlord wishes to, he can put the Treasury Solicitor to his election regarding whether to disclaim, in which case a decision must be made within 3 months.[12]

Administration

25. In contrast to winding up, the administration procedure is intended not to lead to the death of the company, but rather, if possible, to its rescue. It has been described judicially as a "breathing space" for the company.[13] Administration procedure was substantially altered by the Enterprise Act 2002, and the new procedure is contained in the new Schedule B1 to the 1986 Act (given effect to by the new section 8). Since those changes, administration is now a much more versatile and attractive alternative, and as the significance of administrative receivership steadily diminishes[14], will become more important still to companies which aspire to rescue. However, as discussed below, administration procedure is also frequently used where no rescue of the tenant company is envisaged.

[11] Companies Act 1986 section 654(1); Companies Act 2006 section 1012(1).
[12] Companies Act 1986 section 657(2) as amended; Companies Act 2006 section 1015-1019.
[13] *Re Atlantic Computer Systems plc* [1992] Ch 505 at 528.
[14] By virtue of the restrictions imposed on administrative receivership by the Enterprise Act 2002.

26. A company is "in administration" while an administrator is appointed (paragraph 1(2)(a) of the new Schedule). The concept "administrator" is defined broadly in paragraph 1 of Schedule B1 as "a person appointed under this Schedule to manage the company's affairs, business and property", and in this definition "affairs" is interpreted widely[15]. He is an agent of the company (paragraph 69).

27. Administration commences with the appointment of an administrator under Schedule B1, which can be done by an order of the Court, but also by the Company or its directors or the holder of a floating charge (paragraph 2 of the Schedule). The criteria which must be met for an administrator to be appointed depend upon which mechanism he is appointed under. Where an application is made for the appointment of an administrator, the Court may make an administration order only if it is satisfied that the company is or is likely to become unable to pay its debts, and that the administration order is reasonably likely to achieve the purpose of administration (paragraph 11). For an administrator to be appointed by the company or the directors, a notice of intention must first be given to certain others and filed at Court accompanied by a statutory declaration that the company is or is likely to become unable to pay its debts (paragraphs 26 and 27). And an administrator can only be appointed pursuant to a floating charge if that charge has become enforceable by a relevant default (paragraph 16).

28. It is expressly provided (in paragraph 3 of Schedule B1) that an administrator must perform his functions with the primary objective of rescuing the company as a going concern. Next in the hierarchy of objectives is achieving a better result for the company's creditors as a whole than would be likely if the company were being wound up (without first being in administration). The administrator can only adopt this second objective if he thinks that it is not reasonably practical to achieve the

[15] *Denny v Yeldon* [1995] 3 All ER 624 at 627; and *Polly Peck International plc v Henry* [1999] BCLC 407.

primary objective of rescuing the company, or that this second objective would achieve a better result for the company's creditors as a whole. Ranking below these two in the administrator's statutory hierarchy is the third objective of realising property in order to make a distribution to one or more secured or preferential creditors. He can only retreat to this third objective if he thinks that it is not reasonably practical to achieve either of the other two, and he does not unnecessarily harm the interests of the creditors as a whole.

29. The importance attached to this hierarchy of objectives is reinforced by the fact that within eight weeks of his appointment the administrator must make a statement setting out proposals for achieving the purpose of administration, and if applicable, explaining why he thinks the primary or secondary objectives cannot be achieved (paragraph 49 of Schedule B1). However, in practice the administrator will frequently be intending to sell the company's business as a going concern, and then liquidate the company. Sometimes this is all worked out in advance, in what is known as a pre-pack administration. In such cases, no rescue of the company (as opposed to its business) is ever a genuine objective, and the administrator will presumably explain this in his statement, when he says why the primary objective cannot be achieved.

30. A proposed administration impacts on creditors in two stages. When administration is imminent, an interim moratorium is imposed on insolvency proceedings and other legal process (paragraph 44). And when a company is in administration, this moratorium is extended so that creditors' rights are generally frozen (paragraphs 42 and 43). This had a direct impact on the landlord of a company in administration, as paragraph 43 provides that without the consent of the administrator or the permission of the Court, a landlord may not exercise a right of forfeiture by peaceable re-entry in relation to premises let to the company, and that no legal process, which includes any

legal proceedings, execution or distress, may be instituted or continued against the company.

31. Therefore the fundamental question for a landlord faced with a tenant which is about to or has already gone into administration will often be whether he will get permission from the Court (or administrator) to proceed against it. He may want to proceed against the company for non-payment of rent, and seek possession, or he may seek leave to pursue the tenant for breaches of other covenant, such as a covenant against alienation. The guidance given by the Court of Appeal in *Re Atlantic Computer Systems plc* [1992] Ch 505 (on the similarly worded section 11(3)(d) of the pre-amendment Act) explains the balancing act which the Court (and administrator) must carry out in deciding whether to give permission to exercise existing proprietary rights against a company in administration.

(1) It is in every case for the person who seeks leave to make out a case for him to be given leave.

(2) The prohibition in section 11(3)(c) and (d) is intended to assist the company, under the management of the administrator, to achieve the purpose for which the administration order was made. If granting leave to a lessor of land or the hirer of goods (a "lessor") to exercise his proprietary rights and repossess his land or goods is unlikely to impede the achievement of that purpose, leave should normally be given.

(3) In other cases when a lessor seeks possession the court has to carry out a balancing exercise, balancing the legitimate interests of the lessor and the legitimate interests of the other creditors of the company: seeper Peter Gibson J. in Royal Trust Bank v. Buchler [1989] B.C.L.C. 130, 135. The metaphor employed here, for want of a better, is that of scales and weights. Lord Wilberforce adverted to the limitations of this metaphor in Science Research Council v. Nassé [1980] A.C. 1028, 1067. It must be kept in mind that the exercise under section 11 is not a mechanical one; each case calls for an exercise in judicial judgment, in which the court seeks to give effect to the purpose of the statutory provisions, having regard to the parties' interests and all the circumstances of the case. As already noted, the purpose of the prohibition is to enable or assist the company to achieve the object for which the administration order was made. The purpose of the power to give leave is to enable the court to relax the prohibition where it would be inequitable for the prohibition to apply.

(4) In carrying out the balancing exercise great importance, or weight, is normally to be given to the proprietary interests of the lessor. Sir Nicolas Browne-Wilkinson V.-C. observed in Bristol Airport Plc. v. Powdrill [1990] Ch. 744, 767D-E that, so far as possible, the administration procedure should not be used to prejudice those who were secured creditors when the administration order was made in lieu of a winding up order. The same is true regarding the proprietary interests of a lessor. The underlying principle here is that an administration for the benefit of unsecured creditors should not be conducted at the expense of those who have proprietary rights which they are seeking to exercise, save to the extent that this may be unavoidable and even then this will usually be acceptable only to a strictly limited extent.

(5) Thus it will normally be a sufficient ground for the grant of leave if significant loss would be caused to the lessor by a refusal. For this purpose loss comprises any kind of financial loss, direct or indirect, including loss by reason of delay, and may extend to loss which is not financial. But if substantially greater loss would be caused to others by the grant of leave, or loss which is out of all proportion to the benefit which leave would confer on the lessor, that may outweigh the loss to the lessor caused by a refusal. Our formulation was criticised in the course of the argument, and we certainly do not claim for it the status of a rule in those terms. At present we say only that it appears to us the nearest we can get to a formulation of what Parliament had in mind.

(6) In assessing these respective losses the court will have regard to matters such as: the financial position of the company, its ability to pay the rental arrears and the continuing rentals, the administrator's proposals, the period for which the administration order has already been in force and is expected to remain in force, the effect on the administration if leave were given, the effect on the applicant if leave were refused, the end result sought to be achieved by the administration, the prospects of that result being achieved, and the history of the administration so far.

(7) In considering these matters it will often be necessary to assess how probable the suggested consequences are. Thus if loss to the applicant is virtually certain if leave is refused, and loss to others a remote possibility if leave is granted, that will be a powerful factor in favour of granting leave.

(8) This is not an exhaustive list. For example, the conduct of the parties may also be a material consideration in a particular case, as it was in the Bristol Airport case. There leave was refused on the ground that the applicants had accepted benefits under the administration, and had only sought to enforce their security at a later stage: indeed, they had only acquired their security as a result of the operations of the administrators. It behoves a lessor to make his position clear to the administrator at the outset of the administration and, if it should become necessary, to apply to the court promptly.

(9) The above considerations may be relevant not only to the decision whether leave should be granted or refused, but also to a decision to impose terms if leave is granted.

(10) The above considerations will also apply to a decision on whether to impose terms as a condition for refusing leave. Section 11(3)(c)and (d) makes no provision for terms being imposed if leave is refused, but the court has power to achieve that result. It may do so directly, by giving directions to the administrator: for instance, under section 17, or in response to an application by the administrator under section 14(3), or in exercise of its control over an administrator as an officer of the court. Or it may do so indirectly, by ordering that the applicant shall have leave unless the administrator is prepared to take this or that step in the conduct of the administration. Cases where leave is refused but terms are imposed can be expected to arise frequently. For example, the permanent loss to a lessor flowing from his inability to recover his property will normally be small if the administrator is required to pay the current rent. In most cases this should be possible, since if the administration order has been rightly made the business should generally be sufficiently viable to hold down current outgoings. Such a term may therefore be a normal term to impose.

(11) The above observations are directed at a case such as the present where a lessor of land or the owner of goods is seeking to repossess his land or goods because of non-payment of rentals. A broadly similar approach will be applicable on many applications to enforce a security: for instance, an application by a mortgagee for possession of land. On such applications an important consideration will often be whether the applicant is fully secured. If he is, delay in enforcement is likely to be less prejudicial than in cases where his security is insufficient.

(12) In some cases there will be a dispute over the existence, validity or nature of the security which the applicant is seeking leave to enforce. It is not for the court on the leave application to seek to adjudicate upon that issue, unless (as in the present case, on the fixed or floating charge point) the issue raises a short point of law which it is convenient to determine without further ado. Otherwise the court needs to be satisfied only that the applicant has a seriously arguable case.

32. In *Metro Nominees (Wandsworth) (No. 1) Ltd v Rayment* [2008] BCC 40 a landlord sought permission to exercise a right of re-entry against a company in administration. Judge Norris QC, sitting in the Birmingham County Court, applied the guidance in *Atlantic Computers*, and decided on the facts that leave should be given to the landlord to forfeit. The dominant factor in favour of granting leave appears to have

been that the unsecured creditors' interests would be largely unaffected by giving permission to forfeit [25]. Shortly after the company had entered administration, a sale of its undertaking and assets to a new company had been agreed, which included the agreement for the sale of the lease in question for £1 [5]. The judge was particularly unimpressed by the fact that "the administrators were really acting as front men for" the new company, and that the unsecured creditors' only interest in the outcome of "the landlord and tenant battle" was in receiving that £1 [36].

33. The question of the extent to which the administrators may actually be acting for the benefit of those to whom the business of the company is sold can seem particularly pressing in the context of what are known as "pre-pack" administrations. As is explained in the commentary to Schedule B1 in *Sealy & Milman's Annotated Guide to the Insolvency Legislation 2008/2009* (11th ed) at page 521:

> *In a pre-pack, the insolvency practitioner who, it is intended, is to become the administrator is involved in planning in advance an arrangement under which the business of the company is to be sold immediately after his appointment, bypassing the statutory procedure of a creditors' meeting, and without any direction from the court. The pre-pack is most appropriate where the insolvency is such that there will be no surplus available for distribution to the company's unsecured creditors and the proposed sale is likely to be advantageous by comparison with what might be yielded if all the statutory formalities were followed.*

34. Although a pre-pack may frequently be used where the appointment of the administrator is effected without the assistance of the Court, one was endorsed by the Court in *DKLL Solicitors v HM Revenue and Customs* [2007] BCC 908. Nevertheless, as the *Metro Nominees* case illustrates, depending upon how the administrator approaches his role, and in particular on the precise nature of his relationship with the proposed purchaser, the nature of the deal struck in a pre-pack may well give a landlord legitimate grounds for complaint.

35. In *Innovate Logistics Ltd (In Administration) v Sunberry Properties Ltd* [2008] EWCA Civ 1261 the Court of Appeal recently decided an application for permission to commence proceedings for breach of alienation covenant in the context of a pre-pack administration. In that case a company's frozen foods business was sold to a third party on the same day as an administrator was appointed. As the Court found, the purpose of the administration was to ensure the continuity of the business and the orderly collection of debts. The purchaser (the operator of another cold storage business) did not want to take an assignment of the company's lease, but it was granted a 6 month licence of the relevant premises at a fee which enabled the administrator to continue to pay the rent. However, the landlord complained that this arrangement was a breach of the alienation covenant in the lease of the premises. Because the purpose of the licence was to enable the purchaser to continue trading from the premises so that the administrators could collect the debts the Court decided that the purpose of the administration was not achieved simply by the sale of the business. The company was still to derive substantial benefit from the arrangement, and this required the purchaser temporarily to occupy the premises. The Court held that the intended proceedings would impede the administration and the achievement of its purpose, and that as in the meantime the landlord was still receiving its rent [52], the *Atlantic Computers* balance favoured the company. The Court of Appeal exercised the discretion afresh, and permission was refused.

36. If a landlord inadvertently begins proceedings in breach of the moratorium without having secured the requisite permission, the situation is not necessarily lost. It appears that such proceedings are not a nullity, and that a stay can be sought for the purpose of making an application for leave to proceed.[16] Nevertheless, a breach of

[16] See *Carr v British International Helicopters Ltd* [1993] BCC 855.

the moratorium provisions may give rise to a claim in damages[17], so landlords should try to avoid this predicament in the first place.

37. A landlord can take some comfort that the moratorium does not affect his ability to proceed against anyone else liable on the tenant's covenant, such as a previous tenant or guarantor.

38. An administrator does not have a specific power to disclaim onerous property.[18] Accordingly the issues discussed above in relation to disclaimer do not arise during administration.

39. The appointment of an administrator ceases automatically after one year, unless extended by the Court (paragraph 76), although the appointment can be shorter if the Court so orders on the appointment. It may also end earlier if the administrator considers that the purpose of the administration has been achieved and he either applies to the Court or files the appropriate notice. Further, a creditor can apply to end an administration, but only on the grounds of improper motive on the part of the person who appointed or applied for the appointment of the administrator (paragraph 81). There are also specific provisions for the exit from administration into a creditors voluntary liquidation (paragraph 83), and for the exit into dissolution if it has no assets worth realising (paragraph 85). In the case of an exit into dissolution, the company is deemed to be dissolved three months after the administrator has appropriately notified the registrar of companies. Therefore the issues relating to dissolution, discussed above in relation to winding up, can arise directly upon the end of an administration as well as after a liquidation—and of course a dissolution may well lead to a disclaimer by the Crown.

[17] *Euro Commercial Leasing Ltd v Cartwright & Lewis* [1995] 2 BCLC 618, [1995] BCC 830.
[18] *Re P&C and R&T (Stockport) Ltd* [1991] BCLC 366, [1992] BCC 98

Company Voluntary Arrangements

40. The purpose of both individual and corporate voluntary arrangements is to enable debtors to enter into binding arrangements with creditors without the need for a formal insolvency. The concept of the voluntary arrangement was introduced in the 1986 Act. It has been substantially changed by the Insolvency Act 2000, and also significantly affected by the Enterprise Act 2002.

41. The key feature of the voluntary arrangement is that if an arrangement can be reached with three-quarters in value of the creditors, it is capable of binding the remainder without their consent, provided that the recalcitrant minority does not include more than half in value of the creditors, this time excluding from that calculation those connected with the company (Insolvency Rules 1.19(4) and 1.52(6)).

42. A CVA is initiated by a proposal, normally made by the company's directors,[19] being presented to a creditors' meeting for a vote. Where the requisite majority is in favour, this creates a "statutory contract" which, since the coming into force on 1 January 2003 of the changes made in the Insolvency Act 2000, is capable of binding all those entitled to vote, even those who did not know of the proposal or the meeting (section 5(2) of the 1986 Act as amended; and paragraph 37(2) of Schedule 1A).

43. Accordingly, despite the fact that a CVA is, to a degree, consensual, a landlord may need to be vigilant to ensure that he is not bound into an arrangement the terms of which better suit other categories of creditor. Like others he is entitled under section 6(1) of the 1986 Act to challenge an arrangement not only on the grounds of irregularity, but more significantly on the grounds of unfair prejudice (subsection

[19] A proposal can also be made by an administrator or liquidator where the company is already in administration or liquidation (section 1(3)).

6(1)(a)). The Court's powers on an application made under section 6 include the power to revoke or suspend any decision approving the offending arrangement, and giving directions for the consideration of a revised proposal (subsection 6(4)). As is explained by Lord Neuberger, then LJ, in *Thomas v Ken Thomas* [2006] EWCA Civ 1504 at [34]:

There is no doubt but that the rent, which accrued due but was not paid, before the CVA was proposed in this case, would be expected to be caught, at least in its capacity as a debt, within the CVA. As at present advised, it appears to me that the rent falling due after the CVA should by no means necessarily be expected to be caught by the terms of the CVA, even if it is capable of being so caught (as was held first instance in Re Cancol Ltd (1996) 1 All ER 37). It strikes me that, at least normally, it would seem wrong in principle that a tenant should be able to trade under a CVA for the benefit of its past creditors, at the present and future expense of its landlord. If the tenant is to continue occupying the landlord's property for the purposes of trading under the CVA (and hopefully trading out of the CVA) he should normally, as it currently appears to me, expect to pay the full rent to which the landlord is contractually entitled -- see by analogy, in the administration context, Re Atlantic Computer Systems PLC [1993] Ch 505 542(g)-543(b) and, in a liquidation context, Re ABC Coupler & Engineering Company Ltd (No.3) [1970] 1 WLR 702. Therefore as at present advised, I consider that a CVA should so provide, or if it does not provide, in the absence of special circumstances the landlord may well be entitled to object to the proposals as unreasonable. Certainly, that is how the company and its advisers in the present case appear to have proceeded.

44. Accordingly, while any arrears already in existence at the date of the CVA are likely to be subject to the same arrangement as other existing debts to other kinds of creditors, careful consideration will need to be given to the provisions which the arrangement makes regarding future rent, and if those provisions are unsatisfactory to the landlord, he should consider whether to make a section 6 application. A landlord should turn his mind to this question when the proposal is made, and in any event well before 28 days after the arrangement being approved, as that is the deadline for making an application to the Court under section 6 (subsection 6(3)).

45. If a landlord proposes to advance a claim for future rent (and perhaps also terminal dilapidations) in the context of a proposed CVA, the decision in *Re Newlands (Seaford) Educational Trust* [2007] BCC 195 suggests that he will need to produce detailed evidence in this regard.

46. In *Prudential Assurance Company Ltd v PRG Powerhouse* [2007] EWHC 1002 (Ch) the Court had to consider (amongst other things) whether a landlord was unfairly prejudiced by a CVA. Etherton J set out the legal principles as follows:

> *71. It is common ground that the issue whether a cva unfairly prejudices the interests of a creditor under IA s.6 is to be judged on the information available at the time the cva was approved.*
>
> *72. There is no conceptual difficulty and probably little practical difficulty in showing the presence or absence of "prejudice" for the purposes of IA s.6. Any cva which leaves the creditor in a less advantageous position than before the cva – looking at both the present and the future – will be prejudicial.*
>
> *73. It is the additional need to show that the prejudice is "unfair" which raises difficulty. All the principal cases on the subject were reviewed by Warren J in his valuable judgment in SISU Capital Fund Ltd v Tucker [2005] EWHC 2170 (Ch), [2006] BCC 463. It is not necessary, for the purposes of this judgment, to repeat everything he said or to re-state all the important principles. It is sufficient to concentrate on, and to emphasise, the following particular points.*
>
> *74. It is common ground that there is no single and universal test for judging unfairness in this context. The cases show that it is necessary to consider all the circumstances, including, in particular, the alternatives available and the practical consequences of a decision to confirm or reject the arrangement: Re a debtor (No. 101 of 1999) [2001] 1 BCLC 54 at p.63d (Ferris J), SISU Fund Ltd v Tucker at para [71].*
>
> *75. In broad terms, the cases show that unfairness may be assessed by a comparative analysis from a number of different angles. They include what I would describe as vertical and horizontal comparisons. Vertical comparison is with the position on winding up (or, in the case of individuals, bankruptcy). Horizontal comparison is with other creditors or classes of creditors. In that context, another helpful guide, in the case of a cva, is comparison with the position if, instead of a cva, there had*

> *been a formal scheme of arrangement under CA s.425 (compromise or arrangement between a company and its creditors or members), on which the different classes of creditors would have been required to meet and vote separately.*

47. On the facts he had no hesitation that certain landlords had been unfairly prejudiced who were left in a worse position than without the CVA, as they would lose the value of certain guarantees.

48. It should be noted that it is possible for those making a proposal in relation to a "small company"[20] to seek an interim moratorium[21], although this procedure is rarely used in practice.[22] We shall not consider this topic in this seminar.[23]

49. The effect of an arrangement on a secured creditor is not straightforward.[24] However, it is now clear from the decision of the House of Lords in *Christopher Moran Holdings Ltd v Bairstow* [2000] 2 AC 172 that a landlord's right of re-entry is not a security for these purposes, we shall not consider this topic further.[25] Nevertheless, it appears that the approval of a CVA does not deprive the landlord of the right to

[20] Companies Act 1985 section 247(3); Companies Act 2006 section 382(3).
[21] If at the time such moratorium comes to an end, no arrangement has effect, that is a ground for the presentation of a winding up petition (see above).
[22] See *Bailey & Groves Corporate Insolvency* (3rd ed) paragraph 9.18.
[23] Of particular significance for a landlord is that while a moratorium is in force it is not possible to forfeit by peaceable re-entry, or commence or continue any proceedings, execution or other legal process including levying distress, without the leave of the Court (paragraph 12(1) of Schedule 1A).
[24] See *Bailey & Groves* (3rd ed) paragraph 9.50.
[25] See also *Thomas v Ken Thomas* [2006] EWCA Civ 1504 at [43], where Neuberger LJ said: "… the 1986 Act makes it clear what sort of creditors are to be excluded from the class of creditors who are to be bound by the CVA, namely secure creditors, and, to the extent described in section 4(4), preferential creditors. While it is true that it was, at one time, thought that a landlord with a right to forfeiture was to be treated for these purposes as a secure creditor, that is now seen to be wrong -- see URazzaq v PalaU [1997] 1 WLR 1336 1341(e)-1343(d) and URe Lomax Leisure LtdU [2000] Ch 502 at 510(b)-517(d). It does not seem as if the legislature intended a creditor with a right to forfeit should be treated in a different or better position under a CVA than any other sort of unsecured creditor."

forfeit as such, although this right does not extend to rent which has been "subsumed into the CVA".[26]

50. Whether a surety under a lease is released from liability in relation to rent which is covered by a CVA depends upon the construction of the wording of that CVA.[27] This is to be contrasted with the clarity regarding the situation where a company is in liquidation (and the lease is disclaimed), as set out in the *Hindcastle* case. Thorough consideration was given at first instance regarding whether certain guarantees were indeed released on a CVA in *Prudential Assurance Company Ltd v PRG Powerhouse* [2007] EWHC 1002 (Ch). On the facts they were released, but the difficultly of the exercise is a marked contrast with the situation following disclaimer.

[26] *Thomas v Ken Thomas* [2006] EWCA Civ 1504 at [39] and [45].
[27] *Johnson v Davies* [1999] Ch 117; and see *Woodfall* 16.225.3.