A new Lease of life

Cecily Crampin & Tricia Hemans investigate reviving disclaimed property

IN BRIEF

- One of the effects of the COVID-19 distancing measures and their impact on the economy is an increase in cases of insolvency.
- Attempts to disclaim onerous property will no doubt become increasingly common.
- The law on disclaimer, and, in light of *Leon v Attorney General,* who has standing to apply for a vesting order to bring disclaimed property back to economic life.

Sadly, one of the likely effects of the COVID-19 precautions, and their impact on the economy, is an increase in insolvency, despite the government's intended relief under the Corporate Insolvency and Governance Act 2020. A particular issue will be businesses unable to pay rent due under commercial leases. In the eyes of insolvency practitioners, leases will be onerous property ripe for disclaimer. Similarly, companies on the brink of dissolution may choose to leave property to go *bona vacantia*, with the risk of eventual Crown disclaimer. This article reviews the law on disclaimer, and, with reference to *Leon v Attorney General* [2019] EWCA Civ 2047 decided in November 2019, discusses who has standing to apply for a vesting order to bring disclaimed property back to economic life.

Power to disclaim

The power to disclaim onerous property can be found in three different pieces of legislation, for three different situations. The statutory provisions are similar for all three. The first two sets of statutory provisions are in the Insolvency Act 1986 (IA 1986). First, ss 178–182 of IA 1986 deals with disclaimer by a liquidator, on the winding up of a company in England and Wales. Second is ss 315–321 of IA 1986 which deal with disclaimer by a trustee in bankruptcy on individual insolvency. Finally, ss 1012 to 1023 of the Companies Act 2006 (CA 2006) deal with the vesting of a dissolved company's property *bona vacantia* in the Crown and the Crown's power to disclaim.

Disclaimer by a liquidator

A liquidator has power to disclaim onerous property by the giving of a prescribed notice under s 178 of IA 1986. He may do so notwithstanding that he has taken possession of it, tried to sell it, or otherwise exercised rights of ownership over it. However, notice cannot be given if a person interested in the property has applied to the liquidator asking for a decision on disclaimer, and a period of 28 days, or longer as ordered by the court, has elapsed without notice being given.

Property is considered onerous if it imposes continuing financial obligations detrimental to the creditors so that it gives rise to prospective liabilities without a reciprocal benefit. What is critical is that continued 'performance of future obligations will prejudice the liquidator's obligation to realise the company property and pay a dividend to creditors within a reasonable time' (see: *In re SSSL Realisations* (2002) Ltd [2006] Ch 610 at [36] and [42]). Thus a lease with a high rent may be onerous and open to disclaimer. The effect of disclaimer, under s 178(4), is to determine 'the rights, interests and liabilities of the company' in the property disclaimed.

Disclaimer by a trustee in bankruptcy

In bankruptcy, under s 315 of IA 1986, the power to disclaim is in like words, with a like category of onerous property, and with a similar prohibition on disclaimer if an application to the trustee by a person interested has been made and no decision by the trustee made in the statutory time period. Moreover, notice of disclaimer may not be given for after acquired property or certain personal property of the bankrupt, without leave of the court.

Crown disclaimer

The power of the Crown to disclaim under CA 2006 is a little different; the property need not be onerous. Property of a dissolved company vests in the Crown (or the Duchy of Lancaster or Duke of Cornwall, depending

on its location) *bona vacantia* on dissolution, unless it is held by that company on trust for another.

Often, the Crown is unaware of the property until someone seeks to determine ownership. The Crown will have no liabilities unless it has taken possession, and is entitled to disclaim by notice under s 1013 of the 2006 Act. If a person interested in the property applies to the Crown, it has at least 12 months to give a notice of disclaimer. The effect of disclaimer is that the property is deemed not to have vested in the Crown, and disclaimer terminates, from the date of disclaimer, the rights, interests and liabilities of the company in the property disclaimed (see s 1015(1), CA 2006).

Effect of disclaimer on third parties

For each of the three types of disclaimer explored above, the effect is to end rights, interests and liabilities in the disclaimed property of the company (in liquidation, or Crown disclaimer) or the trustee (in bankruptcy). That is, after all, the purpose of disclaimer. However, what is most interesting about disclaimer, legally, is the effect on third parties interested in the disclaimed property.

In each of the three disclaimer regimes, it is express that the effect of disclaimer on third party rights is limited. Thus for liquidation, a disclaimer 'does not, except so far as necessary for the purpose of releasing the company from any liability, affect the rights or liabilities of any other person' (see: s 178(4)(b) of IA 1986 and the like provision for bankruptcy under s 315(3) of IA 1986, and Crown disclaimer under s 1015(2) of CA 2006). Thus, in *Scmlla Properties Ltd v Gesso Properties (BVI) Ltd* [1995] BCC 793, post disclaimer, the mortgage and the mortgagee's power of sale continued. The lender's sale revived the disclaimed property on its vesting in the new owner.

Similarly, the limit on the effect of disclaimer on a third party means that a sub-tenant of a company which had held under a disclaimed lease is entitled to remain in possession during the underlease's term. It used to be the case that the lease was destroyed on disclaimer, and with no privity between the landlord and the sub-tenant there was no direct entitlement to enforce covenants (see: *Re A E Realisations (1985) Ltd* [1988] 1 WLR 200, [1987] 3 All ER 83). That was an unsatisfactory and insecure position. Now, statute prevents a lease ending until notice has been served on all underlessees and mortgagees, and the 14 days for a vesting order application has passed. Vesting orders are useful for sub-tenants wishing to regularise the position, or mortgagees wishing to preserve property they are not yet ready to sell.

Vesting orders

In liquidation, s 181 of IA 1986 allows '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' to apply to the court for a vesting order of the disclaimed property. The court may make a vesting order, vesting the disclaimed property in 'a person entitled to it', or a trustee for that person, or in a person subject to a liability where it would be just to do so for the purpose of compensating that person subject to the liability. The court will make an order on such terms as it thinks fit, thus reviving the disclaimed property. In bankruptcy, the like provision is s 320 of IA 1986, and for Crown disclaimer, s 1017 of the 2006 Act.

On a vesting order application, the court will not make a vesting order in favour of an underlessee or mortgagee save on terms making that person subject to the same liabilities and obligations as the company pre the winding up, or as if the lease had been assigned to the applicant at the date of the winding up (see s 182 of IA 1986). Each set of provisions ends the interest of a lender or an underlessee if they do not take a vesting order. Thus on an application, the court will usually aim to vest in whichever party will protect the most interests, for example, vesting in a lender or underlessee, or vesting the lease in an underlessee but subject to the mortgage. The effect of vesting in the landlord would be to end the lesser interests (see: *Re ITM Corp Ltd* [1997] BCC 554).

> *"In the eyes of insolvency practitioners, leases will be onerous property ripe for disclaimer"*

Who is entitled?

It is straightforward that an underlessee or a mortgagee, with their clear property interest, has standing to apply for a vesting order. The category of other people so entitled has proved less clear. A recent case has explored this issue. In *Leon v Attorney General*, there was disclaimer of a long lease of a flat under the Companies Act 2006. By the time of the disclaimer, the lease was owned by a company, controlled by Mr Leon, and was subject to a mortgage granted by the company, with Mr Leon named as co-mortgagor. The company was dissolved and the lease vested in the Crown, which disclaimed it. Mr Leon applied successfully for a vesting order, on the basis that he had an interest in the disclaimed lease as co-mortgagor, or likewise had a liability not discharged by the disclaimer. That order was set aside on a first appeal from the Master to a High Court judge, with vesting instead in the mortgagee who would account for the proceeds of sale to whoever was next entitled. Mr Leon appealed.

In relation to the second limb, consideration was given to whether under s 1017(2)(b) of CA 2006 it would be just to make a vesting order of the lease in favour of the co-mortgagor to compensate him for loss caused by the Crown's disclaimer. However, in this case, the value of the lease far outweighed the liability under the mortgage. A vesting order in favour of the mortgagee would give Mr Leon protection as regards his liability since the security could be recouped by it on sale.

The key question before the Court of Appeal, was whether, under s 1017(2)(a) of CA 2006, Mr Leon was 'entitled to' the disclaimed property, an issue the Master had not addressed. A judge, asked to make a vesting order, must decide not just whether the person claims an interest, but whether 'the interest claimed … entitle[s] him to the property' in the circumstances of the case (see para [23]). Thus where there are competing interests, such as Mr Leon and the mortgagee, the court will have to choose between them, deciding who is entitled.

Mr Leon was not a co-owner of the lease; he was a person liable on the mortgage only. Nor did he have an interest in the equity of redemption, since that was the company's. He had an interest in having the mortgage redeemed, but the lease, once the mortgage had been paid off, would not vest in him. Thus Mr Leon did not have an interest which entitled him to the disclaimed lease.

Comment

This decision suggests that something close to a property interest is necessary to qualify for a vesting order under the first limb. The principles outlined will no doubt have application beyond CA 2006 into the realm of the similar provisions under IA 1986. Given the likely increase in insolvency and disclaimers of onerous property in the coming months, the *Leon* decision provides timely and welcome guidance on the court's approach to the question of entitlement when seeking a vesting order in relation to disclaimed property. NLJ

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