

Landlords lose out as Court sheds light on the payment of rent during administration

Over the last 18 months we have seen an increasing number of insolvencies in the retail/consumer products sector. Whilst reduced consumer spending and over-leverage have undoubtedly contributed to such demise, a further factor in most of these cases has been an increasingly unmanageable rent burden.

Against that background, the recent decisions of first instance in *Goldacre* and *Luminar* have considered the question of whether and, if so, when, rent should be payable as a priority expense following a tenant's administration.

Why is it so important?

When a company is in administration, the fees, costs and expenses of its administrator will be paid on a priority basis. Broadly speaking, such fees, costs and expenses are payable out of the company's assets (other than those secured by a fixed charge) in priority to all other claims.

In addition to having an impact on secured creditor recoveries, the answer to this question has very real and practical implications for insolvency practitioners. An insolvency practitioner considering an administration appointment will want to be certain at the outset that there is sufficient funding available to achieve the purpose of the administration and, importantly, cover his own remuneration and costs.

The good old days?

Prior to the decision in *Goldacre*, it was generally accepted that the payment of rent on properties used during the administration was not an absolute requirement and that a balance would need to be achieved between the interests of the landlord and the interests of the creditors as a whole. In broad terms, provided the administrator could demonstrate that continued use of the premises was evidently to the benefit of the administration, and the administrators paid what they could towards the rental payments, the tenant would typically be entitled to remain in occupation.

This "discretionary" approach was in contrast to the position on the winding up of a tenant company, where a liquidator would be obliged to pay rent as a priority expense for the period

Key issues

- Rent payable in advance before insolvency is commenced is an unsecured debt – landlords wait in line
- Rent due after the insolvency is commenced is payable as an expense – landlords at the front of the queue - ranking after only those with fixed security

during which the insolvent tenant continued to occupy and use the rented property.

Too good to last?

In *Goldacre*, however, the court moved away significantly from past practice, deciding that as the administration expense rules were so

akin to the liquidation rules, there should be no distinction in approach to the payment of rent in an administration and the payment of rent in a liquidation and as such, rental payments in an administration are mandatory expenses payable in full.

In short (see below for more detail), *Goldacre* and *Luminar*, whilst not without their critics, have established that:

- if an administrator is in office *on* a quarterly rent payment date (where rent is payable in advance), the full quarter's rent will be payable as a priority expense, regardless of whether the tenant company uses the property for the whole of that quarter; but
- if an administrator enters office after the quarterly rent payment date where such rent remains unpaid, only rent falling due on a future rent payment date on which the insolvent tenant remains in occupation of the property will be payable as a priority expense.

Nortel administrators first to experience shift in culture and Court's approach

Turning to the specifics of the *Goldacre* decision, prior to its entry into administration, Nortel had entered into two long leases with the landlord, *Goldacre*. The administrators of Nortel continued to use small parts of the premises demised by the leases and the rest of the premises were sub-let. The High Court was asked to consider whether

rent that had become due and payable, and rent falling due for payment thereafter, was payable as an expense of the administration.

The Court held that rent is an expense of the administration and, similar to the law relating to liquidation, the use of a leasehold premises following administration must be on the terms and conditions contained in the lease. Any rent that falls payable during the administration is therefore, following the decision in *Goldacre*, payable in full (subject to any administration expense with higher priority) even if rental payments are paid in advance. For example, if the rent that became payable was to be paid quarterly in advance and it was likely that the tenant in administration would vacate the premises before the end of that quarter, payment for the full quarter's rent would still need to be paid. It was also held that the administrator, despite only using part of the premises, was liable for rent on the whole of the premises demised by the lease.

The decision in *Goldacre* has received mixed reviews from commentators and practitioners alike. It has been said that the *Goldacre* decision effectively elevates the claims of landlords above other creditors to whom the company became indebted prior to the administration albeit that the landlord has a continuing relationship with the tenant following insolvency which potentially increases the landlord's exposure whilst restricting the scope of its remedies. Despite the well argued reasons against the decision in *Goldacre*, the High Court in *Luminar* has recently lent support to *Goldacre*.

Luminar case sheds light on expenses debate

In this case, the High Court held that where rent was payable in advance and fell due prior to liquidation or administration, it was provable (i.e. it was a simple unsecured debt) but it was not payable as an expense. As such, the landlord in this case was not entitled to rent falling due for payment from its insolvent tenant prior to the commencement of administration as an administration expense. The judge concluded that where the administrator is appointed on or before the rent due date, *Goldacre* applies – all the rent for the quarter is payable as an expense, regardless of whether the administrator ceases to retain the property during the rent period. However, where the administrator is appointed after the rent due date, nothing is due to be paid as an expense; that rent is merely an unsecured debt which is provable in the administration.

Timing is critical

In addition to lending support to the decision in *Goldacre*, *Luminar* serves as an illustration of how timing is crucial in the context of the administration expense regime. The clear message from this case from the insolvency practitioner's perspective is that it is advisable to be appointed *after* the rent due date to avoid the liability ranking as an expense and, where possible, cease retention of property prior to the next quarter day. From the landlord's perspective, this decision illustrates that in some cases the ability to manipulate the timing of appointment may leave them worse off.

It should be noted that *Goldacre* and *Luminar* are decisions of first instance and we expect to hear more on this topic in due course. In particular:

- we are aware that various professional bodies are lobbying for further legislation to bring clarity to the whole area of administration expenses; and
- whether there will be a continuance of the practice which has developed whereby administrators will take an appointment after the quarter date and will seek written confirmation from landlords that only rent payable in respect of the period after such appointment will be treated as an administration expense remains to be seen.

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