

**ADMINISTRATIONS – BALANCING THE INTERESTS OF LANDLORDS AND  
CREDITORS IN ‘PRE-PACK’ ADMINISTRATIONS**

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**Introduction**

- 1.1 One of the effects of the ‘credit crunch’ has been the overwhelming number of companies which have gone into administration in the course of the past year. According to statistics provided by The Insolvency Service, some 2,792 companies had gone into administration by the end of the third quarter of 2008 and the numbers for the third quarter of 2008 were more than 50% up on the numbers for the equivalent quarter of 2007. With companies such as Woolworths and MFI now going into administration in ‘the eye of the storm’, the impact of administrations is being felt through society in a variety of ways.
  
- 1.2 The issues discussed in this paper concern a commercial ‘victim’ of administrations that we don’t read about in the national press but whose interests are very much the concern of property litigators around the country at the moment. This ‘victim’ is the unfortunate commercial landlord who finds himself in the position of discovering that his tenant has gone into administration and worse still, then discovers that the administrator has allowed

an unwanted third party into occupation. This occupier may be a third party who the landlord would never have wished to have occupying his property. More importantly, the landlord may have been careful to ensure when he let the property that he only did so on terms which protected him from the risk of ever having his property occupied by such an occupier. The occupation of the third party may be a clear breach of the terms of the tenant's lease. What can the landlord do?

### **'Pre-Pack' Administrations**

- 2.1 It is likely that the occupier may have gone into possession of the premises as a result of a 'pre-pack' administration. A 'pre-pack' administration is one which might be described as a 'fait accompli' administration (the legality and propriety of which has not yet been fully tested in the courts). In a 'pre-pack' administration, a company is placed into administration and the business is sold shortly after the appointment of the administrator. Often, the insolvency practitioner, the directors and the bank will have obtained valuations, agreed a sales price and drafted contracts to enable the business to be sold immediately after appointment. The company has had the chance to prepare itself to enter administration and to sell the more successful elements of the business to a new company ("Newco") or to an existing company.
- 2.2 This is a process which is intended to protect the more successful parts of a failing company for the benefit of creditors. The struggling parts of the business are retained in "Oldco", which unsurprisingly is then made the subject of liquidation very soon thereafter. The 'pre-pack' avoids the failing business being marketed at a time when it has become vulnerable by virtue of the label of 'in administration'. It also avoids the uncertainty and the fate of a downward spiral, which so often befalls a company in administration.
- 2.3 For those 'Newcos' who acquire assets of the company in administration, it is frequently desirable for them to carry on the former operations of the tenant in the latter's premises. There may be many commercial reasons for this. However, by virtue of the 'pre-pack'

nature of the administration, no application for consent to an assignment/parting with possession may have been made in relation to their occupation. It is in this manner that the landlord of the premises may suddenly find that he has an occupier in his premises, to whose presence he has never agreed. He may have had no prior warning of the situation and even if he had, there would have been little he could do about it.

### **The Obstacle of the Statutory Moratorium**

3.1 There is no doubt that the presence of an unlawful occupier on a landlord's premises would ordinarily entitle the landlord to seek to forfeit the lease or seek an order for immediate termination of such occupational licence as had been granted, in accordance with the principles most recently applied in *Tesco v Crestfort* [2005] 37 EG 148<sup>1</sup>.

3.2 However, there are two provisions in Paragraph 43 of Schedule B1 to the Insolvency Act 1986 which place an obstacle in the way of these remedies. In relation to forfeiture, paragraph (4) provides:-

*“(4) A landlord may not exercise a right of forfeiture by peaceable re-entry in relation to premises let to the company except—*

*(a) with the consent of the administrator, or*

*(b) with the permission of the court.”*

In relation to other forms of legal proceedings, paragraph (6) provides:-

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<sup>1</sup>In *Esso Petroleum Co Ltd v Kingswood Motors (Addlestone) Ltd* [1974] QB 142, *Hemingway Securities Ltd v Dunraven* [1995] 1 EGLR Bridge J and *Tesco v Crestfort* [2005] EWHC 805, the fact that a landlord is prima facie entitled to an injunction in such circumstances has been emphasised. In *Esso Petroleum Co Ltd v Kingswood Motors (Addlestone) Ltd* [1974] QB 142 Bridge J (as he then was) was faced with a similar situation where a solus tie in a lease had been broken and the defendants argued that it was too late for the court to intervene. Bridge J dismissed this argument, even on an interlocutory application and said at p156H: *“I am asked to enforce the personal liability incurred by a tortfeasor to undo the consequences of his tort which could have been restrained before it was committed. In a proper case, I ask myself: what reason can there be in principle why the tortfeasor should not be ordered to undo that which he has done?”* Bridge J then went on to grant a mandatory injunction, which he did on the basis that the defendants there had been stealing a march on the plaintiffs.

*"No legal process (including legal proceedings, execution, distress and due diligence) may be instituted or continued against the company or property of the company except-*

*(a) with the consent of the administrator*

*(b) with the permission of the court."*

- 3.3 As a result of the statutory moratorium imposed by these provisions, the landlord will usually be obliged to apply to the court for permission to commence his proposed proceedings. The question then is how does the Court exercise its discretion in such circumstances.

### **The Easy Case**

- 4.1 There is one situation in which it seems that permission is very likely to be refused and where the interests of the creditors will generally be preferred to the proprietary interests of the landlord. This is in the situation where the administration is an interim and temporary regime designed to give the company a breathing space whilst proposals are put to creditors.

- 4.2 In this type of case, the statutory moratorium is undoubtedly imposed on the creditors of the company in order to assist the administrator in his attempts to achieve the statutory purpose for which he was appointed. *"[The statutory provisions] are couched in procedural terms and are designed to prevent creditors from depriving the administrator of the possession of property which may be required by him for the purpose of the administration"*: per Millett J in *Re Olympia & York Canary Wharf Limited* [1993] BCLC 453 at 457f.

### **The Pre-Pack Situation**

- 5.1 In those situations where there is a 'pre-pack' administration, however, the proposed proceedings do not deprive the administrator of the possession of property which may be required by him for the purpose of the administration. The relevant business has been

sold on ‘day one’ and there is no ongoing business of the company to be continued by the administrators and protected by the moratorium.

- 5.2 Whilst it may be in the interests of the creditors for the company to be able to dispose of its assets in the most beneficial manner by use of a ‘pre pack’ administration, what about the interests of the landlord? After all, it has never been the law that an administrator has been clothed with the right to breach the terms of a contract<sup>2</sup>. Furthermore, if the primary purpose of the statutory moratorium on proceedings is intended to protect the company from *creditors* seeking to enforce their claims<sup>3</sup> why should it prevent the enforcement of proprietary rights primarily against a solvent third party who has unlawfully been let into occupation.

### **The guidance provided by *Innovate Logistics Ltd (in administration) v Sunberry Properties Ltd***

- 6.1 In *Re Atlantic Computer Systems plc* [1992] 2 WLR 367, the Court of Appeal had set out various principles in relation to applications for leave to commence proceedings against companies in administration. However, the question of how these principles should be applied in relation to a landlord faced with an unwanted occupier in his property was the subject of very recent judicial consideration by the Court of Appeal in *Innovate Logistics Ltd (in administration) v Sunberry Properties Ltd* [2008] EWCA Civ 1261 (18<sup>th</sup> November 2008).

- 6.2 In the *Sunberry* case, the respondent was the landlord and the appellant was the tenant under a lease which contained a covenant against assignment or parting with possession

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<sup>2</sup> See *Astor Chemical Ltd v Syntec* [1990] BCC 97, followed by Scott J. in *Re P&C and R&T (Stockport) Ltd* [1991] BCLC 366 at p.374c: “...an administration order does not constitute an authority for the administrators to break the company’s contracts. There is no power of disclaimer such as is available to liquidators...”

<sup>3</sup> per Robert Walker L.J. in *Environment Agency v Clark* [2000] BCC 653 (CA) at para 52

of occupation. After the appellant went into administration, it entered into an agreement to sell its frozen food warehousing and distribution business as a going concern. The appellant granted the purchaser a six-month occupational licence of the premises. The purchaser gave notice to the administrator to terminate the licence in October 2008.

6.3 On an application by the landlord for permission, under paragraph 43(6) of Schedule B1 to the Insolvency Act 1986, to bring proceedings for a mandatory order for immediate termination of the licence on the grounds that it had been granted in breach of the covenant, the Court of Appeal held that although leave to bring proceedings would normally be given to a landlord to exercise its proprietary rights if this was unlikely to impede the statutory purpose of the administration, the court nevertheless had to balance the legitimate interests of the landlord against those of the company's other creditors. It was therefore appropriate to apply the factors set out in *Re Atlantic Computer Systems plc*. As one of the main purposes of the administration was a continuation of the collection of the book debts, it was essential for the purchaser to occupy the property and thereby take over and perform the appellant's contracts by storing and distributing the goods of the customers, many of whom owed money to the appellant.

6.3 The Court of Appeal took the approach that the mandatory injunction sought by the landlord would, if granted, terminate the ability of the purchaser to do that and would mean that it was not possible to use the premises for the purposes of the administration. Moreover, both the appellant and the respondent would benefit from a continuation of the purchaser's occupation of the property since the appellant did not have the funds to pay the rent.

## **The *Re Atlantic* Principles**

7.1 Turning then to the principles which are required to be considered for the purposes of the balancing exercise under the principles referred to in *Re Atlantic Computer Systems plc* and *Sunberry*, some of the most relevant can be summarised as follows:-

7.1.1 It is for the person who seeks permission to make out the case for him to be given permission.

7.1.2 The prohibition applies where this would assist in the achievement of the purpose which the administration order was made.

7.1.3 If granting permission to protect the proprietary rights of the person seeking permission would not impede the achievement of the purpose of the administration, then permission should normally be given.

7.1.4 In other cases, the court carries out a balancing exercise, balancing the legitimate interests of the person seeking permission and the legitimate interests of the other creditors of the company.

7.1.5 In carrying out the balancing exercise great importance or weight is normally to be given to the proprietary interests of the person seeking permission.

7.1.6 Thus it will normally be a sufficient ground for the grant of permission if significant loss would be caused by the refusal to grant permission. For this purpose, loss comprises loss which is not even financial.

7.1.7 The factors to be considered are not exhaustive. For example, conduct of the administrators may be a material consideration.

**What 'rent' can the landlord expect to receive?**

- 8.1 It was argued in the *Sunberry* case that it would be wrong in principle for a tenant company in administration to benefit from the occupation of a property for the benefit of past creditors at the expense of the tenant's landlord and on terms other than terms requiring full payment of the rent contractually due: see *Thomas v Ken Thomas Ltd* [2006] EWCA Civ 1504 [2007] Bus LR 429 at para 34 per Neuberger L.J. The latter case was a case concerning a CVA but it was argued that the same principle applied to administrations. If the landlord's property was to be used for the benefit of other creditors the contractual rent relating to the period of use ought to be paid in full, since it is wrong to sacrifice the interests of a landlord for the general good (or for the good of a solvent third party occupier). On the other hand, the administrators argued that they could not afford the full monthly rent but could only afford to pay over the monthly licence fees which were being paid by the occupier.
- 8.2 The Court of Appeal held that Sunberry did not have an absolute legal entitlement to be paid contractual rent and interest as an administration expense. It held instead that the Court had a wide discretion exercisable according to the circumstances of the case. On the facts of the instant case, it took account of the fact that the third party occupier did not want to take an assignment of the lease, the fact that the tenant company did not wish to continue trading and the fact that, but for the licence to the third party occupier, the tenant company would be unable to pay Sunberry anything in respect of the property. It therefore ordered the administrators to pay over to Sunberry just the monthly payments of the licence fee which the occupier was required to pay, together with any interest which had been earned. Subject to that, however, the Court of Appeal held that Sunberry was merely an unsecured creditor of the tenant with respect to the rent falling due after the administration order was made.

## **Conclusion**

- 9.1 The *Sunberry* case is a decision which strongly favours the interests of the creditors of a company in administration rather than the proprietary interests of a landlord. However, no general statements of principle really emerge from the case. Each case will be very 'fact sensitive'. In each case, it will be incumbent upon the administrators to establish

that there is some reason why the continued occupation of the 'Newco' is in the interests of the general body of creditors. If there is evidence of this, then it is likely that permission will be refused to a landlord who wishes to commence proceedings with respect to the unlawful occupation.

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