

# INSOLVENCY ISSUES - DISCLAIMER

by

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## INTRODUCTION

1. As all property litigators will know, disclaimer is a procedure available in the liquidation of companies and the bankruptcy of individuals<sup>1</sup> by which the insolvent entity can divest itself of certain continuing obligations.
2. Disclaimer is however a difficult area both in terms of the legal principles and the issues to which they give rise in practice. Although disclaimers will obviously be more common in times of recession, they can arise at any time and it is important to be familiar with them.
3. The purpose of this paper is to provide a refresher on the legal principles together with a more detailed examination of some of the practical issues, particularly in connection with the options facing the various persons – landlords, sureties, former tenants or their sureties, subtenants, mortgagees etc - potentially affected by a disclaimer.

## PRINCIPLES

4. Copies of the relevant provisions of the Insolvency Act 1986 ("IA 1986") and Insolvency Rules 1986 ("IR 1986") are attached.

### **Property which can be disclaimed**

5. Any "onerous property" can be disclaimed. "Onerous property" is defined in terms of (a) any unprofitable contract and (b) any other property of the company which is unsaleable or not readily saleable or is such that it may give rise to a liability to pay money or perform any other onerous act: Insolvency Act 1986 ("IA 1986") ss 178(3), 315(2).

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<sup>1</sup> Disclaimer is not available in other forms of insolvency proceedings such as administration or receivership or CVAs/IVAs (although a similar effect to disclaimer may be achieved under the terms of a CVA/IVA).

6. Examples of “onerous property” include leases (including continuation tenancies under the 1954 Act) as well as agreements for leases and some licences and also onerous contractual obligations (eg in relation to terminal repair) on expiry of leases.

### **Procedure**

7. The procedure for disclaiming is essentially administrative in nature. The liquidator/trustee in bankruptcy (“TIB”) simply files a notice of disclaimer in court in the prescribed form: Insolvency Rules 1986 (“IR 1986”) rr. 4.188(5), 4.193.
8. Within 7 days of the notice being returned to him, the liquidator/TIB must serve a copy of it on so many of the following as he is aware of:
  - (1) where the disclaimed property is of a leasehold nature, any person claiming under the company/bankrupt as underlessee or mortgagee
  - (2) where the disclaimed property is a dwelling house and the disclaimer is made in bankruptcy proceedings, any person occupying or claiming the right to occupy the property
  - (3) in any case
    - (i) any person claiming any interest in the disclaimed property
    - (ii) any person under a liability in respect of the disclaimed property which is not discharged by the disclaimer

See IR 1986, rr 4.188, 6.179.

9. In a case falling within (1) and (2) above, the disclaimer will not take effect until the last of the persons to be served under (1) and (2) above (as the case may be) has been served with the notice of disclaimer and 14 days has then elapsed without an application for a vesting order being made: IA 1986 ss 179, 317-318.
10. Errors or inaccuracies in the notice do not make it void.
11. Failure to serve the notice on persons of whom the liquidator/TIB is unaware will not invalidate the disclaimer: see IR 1986 rr 4.188(5), 6.179(6) which provide a procedure for notice to be given to such persons subsequently. However, failure to serve the notice on persons of whom the liquidator/TIB is aware will (it seems) invalidate the disclaimer: IR 1986 rr 4.193, 6.185.

### **Effect of disclaimer**

12. A disclaimer “operates so as to determine, as from the date of the disclaimer, the rights, interests and liabilities of the *[company/bankrupt]* in or in respect of the property disclaimed”: IA 1986, ss 178(4), 315(3).
13. Where a lease is disclaimed, the effect of the disclaimer as between the landlord and the tenant is therefore that neither party owes the other any further obligation under or in respect of the lease. The tenant loses any right to remain in the premises and the landlord can demand possession (although he may not wish to

because this may affect his rights against others, see further below). The disclaimer will not, however, affect liabilities (eg rent) which have accrued due before the disclaimer, although if the liabilities are those of the tenant they will have to be proved for in the usual way in the winding up or bankruptcy.

14. This relatively straightforward position is, however, complicated by the remainder of the above sections which provide that a disclaimer “does not, except so far as is necessary for the purpose of releasing the [company/bankrupt] from any liability, affect the rights or liabilities of any other person”.
15. The House of Lords (in the well-known case of *Hindcastle Ltd v Barbara Attenborough Associates* [1997] AC 70) described this as a “deeming” provision. As Lord Nicholls put it:

“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”.
16. Whilst this “deeming” provision is easy enough to state in theory, it is far less easy to operate in practice. This was recognized by the House of Lords in *Hindcastle* who referred to the “artificiality” and “awkwardness” of the provision.
17. Consideration is given in the next section to the effect of the provision in relation to various potentially relevant third parties. However, first, it is helpful to clarify the effect of a disclaimer on the liquidator/TIB. A disclaimer has no effect on a liquidator because the company’s property does not vest in liquidator when the company goes into liquidation. However, the position is more complex in the case of a TIB. Because the bankrupt’s property vests in the TIB personally, he becomes liable on the covenants in the lease. By disclaiming, he discharges himself from all personal liability in respect of the property. Moreover, in his case, the disclaimer operates from the date of commencement of his trusteeship (i.e. it is retrospective): IA 1986 s 315(3)(b).

### **Third parties**

18. Potentially relevant third parties include the following:-

- Surety for insolvent tenant
- Original tenant
- Intermediate assignee
- Sureties for original tenant or intermediate assignee
- Subtenant
- Mortgagee

#### *Surety for tenant*

19. In many cases the terms of the guarantee will expressly provide for the landlord’s rights against the surety in the event of a disclaimer. However, where they do not, the position is as follows.

20. The surety will remain liable to the landlord notwithstanding the disclaimer and the consequent ending of the lease as between the landlord and the tenant. The surety cannot say that he is released because the principal debtor (i.e. the tenant) has been released from liability.
21. Furthermore, the surety will also lose his right of indemnity from the tenant. If he were to retain such a right, the disclaimer would not operate effectively to discharge the tenant from all liability in respect of the lease. However, he does have (see below) a right to claim in the winding up/bankruptcy for loss suffered as a consequence of the disclaimer (which would include loss of such right of indemnity).
22. It is important, however, that the landlord does not re-take possession of the property. If he does, this will have the effect of bringing the notional lease to an end and release the surety. By his act of taking possession he demonstrates that he regards the lease as ended for all purposes. His conduct is inconsistent with there being any continuing liability on others to perform the tenant covenants in the lease.

#### *Original tenant*

23. Where the insolvent tenant is not the original tenant, the original tenant will be potentially liable (subject to the Landlord and Tenant (Covenants) Act 1995 ("the 1995 Act")) to the landlord by privity of contract. The question therefore arises as to whether that liability continues following disclaimer of the lease.
24. The clear answer (see *Warnford Investments Ltd v Duckworth* [1979] Ch 127 and *Hindcastle* above) is that such liability does continue. Although the lease disappears as between the landlord and the insolvent tenant, it is deemed to continue in existence so far as the original tenant is concerned and the original tenant will therefore still be liable to the landlord (subject to the 1995 Act) as if no disclaimer had taken place.
25. The original tenant is therefore in the same position as a surety for the insolvent tenant. In addition to being liable to the landlord, he will lose any right of indemnity he might otherwise have against the insolvent tenant (although if he is lucky, he may have a right of indemnity against an intermediate assignee). However, he will be released if the landlord re-takes possession of the property.

#### *Intermediate assignee*

26. Where there is an intermediate assignee between the original tenant and the insolvent tenant and he covenanted directly with the landlord to ensure that the covenants of the lease would be complied with for the term of the lease, he will be in the same position as the original tenant.

#### *Surety for original tenant or intermediate assignee*

27. The same applies to any surety for the original tenant or an intermediate assignee.

### *Subtenant*

28. Rather different considerations apply to a subtenant of the insolvent tenant. In order to free the tenant from liability, it is necessary to extinguish not only 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 that interest is not necessary to free the tenant from liability. The subtenant's interest therefore continues. No deeming is necessary to produce this result. However, deeming is necessary in relation to the terms on which the subtenant's proprietary interest continues. His interest continues unaffected by the determination of the tenant's interest. He 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.
29. Accordingly, if the subtenant pays the rent and performs the tenant covenants in the disclaimed lease, the landlord cannot eject him. However, if he does not, the landlord can either distrain upon his goods for the rent reserved by the disclaimed lease or bring forfeiture proceedings (although in practice matters are likely to be brought to a head by one or other of the parties bringing an application for a vesting order, see further below).

### *Mortgagee*

30. The position of a mortgagee is much the same as that of a subtenant. His interest continues notwithstanding the disclaimer. However, if he wishes to avoid losing his security as a result of forfeiture by the landlord, he will need to pay the rent and perform the tenant covenants in the disclaimed lease.

### **Right to claim for loss suffered as a result of disclaimer**

31. Any person suffering loss or damage as a result of the disclaimer may prove in the winding up or bankruptcy for such loss or damage: IA 1986, ss 178(6), 315(5).
32. The main person who stands to suffer loss or damage as the result of the disclaimer of a lease is the landlord in that he loses his right to claim against the tenant in respect of the period following the disclaimer. His loss, in effect, is the loss of future rents.
33. In principle, the landlord's loss is calculated as the value of the total income stream under the lease (discounted for payment at the date of the disclaimer) on the assumption of no liquidation/bankruptcy, less the value of any income derived from any re-letting which the landlord can (or ought reasonably to) achieve on the open market for the remainder of the term, plus the rates and the cost of any repairs needed to achieve that re-letting: *Christopher Moran Holdings v Bairstow* [1999] 2 WLR 396.
34. The following may also be taken into account in calculating the landlord's loss: (i) any option to terminate early which the tenant may have had; (ii) a void period for re-letting; and (iii) a vesting order (if made) (see IA s 181(5), 320(5)).
35. Another group of persons who may suffer loss or damage as a result of the disclaimer of a lease are the third parties (sureties, original tenants, intermediate

assignees) who remain liable in respect of the lease notwithstanding the disclaimer but lose rights of indemnity against the insolvent tenant as explained above. In principle, they should be entitled to claim for such loss, albeit that there may be difficult issues in valuing their loss

36. Finally, it is possible that a sub-tenant may also suffer loss or damage as a result of the disclaimer of a lease through having to pay out more (in performing the covenants under the disclaimed lease) than he would have had to pay out under his sublease in order to preserve his interest in the premises.

### **Vesting orders**

37. Where a liquidator/TIB has disclaimed onerous property, it is open to any person claiming an interest in the property or being under a liability in respect of the property to apply to court for an order vesting the property in such person or a trustee for such person: IA 1986, ss 181, 320.
38. In the case of leasehold property, it is therefore potentially open to the following persons to apply for a vesting order:
- Original tenants
  - Sureties
  - Intermediate tenants who are liable to the landlord
  - Subtenants
  - Mortgagees
  - Landlord
39. Furthermore, it is specifically provided in bankruptcy cases involving a dwelling house that it is open to any person in occupation or entitled to occupy the property to make an application: IA 1986, s 320(2)(c).
40. It is unclear whether contracting purchasers of a lease can apply. *Lloyds Bank SF Nominees v Aladdin* [1996] 1 BCLC 720 held not but see *Test Valley BC v Minilec Engineering Ltd* [2005] 2 EGLR 113 where equitable assignees were held to have a sufficient proprietary interest to apply for a vesting order.
41. The procedure for applying is laid down in the Insolvency Rules: IR 1986, rr 4.194, 6.186. Note that there is a time limit of 3 months from the date on which the applicant first became aware of the disclaimer. This creates a potential difficulty (see further below) for persons subject to a liability in respect of the property who may be unsure whether they are going to be pursued by the landlord and accordingly whether they might wish to apply for a vesting order.
42. The court has a discretion whether to grant a vesting order and its terms. However, this discretion is subject to certain specific rules and requirements. In particular:-
- (1) The court may not make an order vesting the property (in the case of a winding up) in an underlessee or mortgagee or (in the case of a bankruptcy) in any person except upon terms making that person (a) subject to the same liabilities and obligations as the insolvent tenant was subject to under the lease at the commencement of the winding up/bankruptcy (in which case the

new tenant will be liable for accrued breaches) or (b) if the court thinks fit, subject to the same liabilities and obligations as that person would be subject if the lease had been assigned to him at the commencement of the winding up/bankruptcy (in which case the new tenant will not be liable for accrued breaches): see ss 182(1), 321(1).

- (2) If (in the case of a winding up) an underlessee or mortgagee or (in the case of a bankruptcy) a person declines to accept an order in such terms, such underlessee/mortgagee or person is excluded from all interest in the property: see ss 182(4), 321(4).
  - (3) If (in the case of a winding up) no underlessee or mortgagee or (in the case of a bankruptcy) no person is willing to accept an order in such terms, the court may (subject to (4) below) vest the lease in any person who is liable to perform the lessee's covenants under the lease and may do so freed and discharged from all estates, incumbrances and interests created by the insolvent tenant: see ss 182(3), 321(3).
  - (4) The court may not vest the lease in a person who is under a liability in respect of the disclaimed lease unless it appears to the court that it would be just to do so for the purpose of compensating such person: see ss 181(4), 320(4).
43. The rules and requirements referred to above have the consequence that there is an order of preference among the persons potentially entitled. A subtenant or mortgagee will come first, followed by a surety or former tenant, and finally the landlord: see eg *Re A E Realisations (1985) Ltd* [1987] 3 All ER 83.
  44. They also mean that a landlord cannot obtain a vesting order in his favour unless the prior interests of all other persons have been cleared away: *Re ITM Corp Ltd* [1997] 2 BCLC 389.
  45. It is the court's duty when making a vesting order to ensure that the disclaimer has effect with as little disturbance as possible to the rights and liabilities of third parties. For example, where the court made an order vesting the lease in a mortgagee, it attached terms to ensure that any surplus on sale by the mortgagee would benefit the bankrupt's creditors: *Re Lee (a bankrupt)* (1988) Times, 24 Feb.
  46. The effect of a vesting order is to vest the lease in the person concerned without he need for any further conveyance: IA 1986 ss 181(6), 320(6).
  47. In addition to dealing with the vesting, the order must also contain a direction giving effect to the disclaimer: IR 1986, rr 6.186(7), 4.194(7).
  48. Where an application for a vesting order is made, the court has a discretion (instead of or in addition to any vesting order) to make such order as it thinks fit in respect of any fixtures, tenant's improvements or other matters arising out of the lease: IA 1986, ss 179(2), 317(2).

## **Parts of premises**

49. There are some specific statutory provisions catering for the possibility of a disclaimer or vesting order in relation to part of premises only.
50. S 21 of the Landlord and Tenant (Covenants) Act 1995 provides (although it might have been thought unnecessary to spell this out) that where an insolvent company or bankrupt individual is, as a result of one or more assignments, the tenant of part only of the premises demised by a tenancy, the liquidator/TIB's power to disclaim is exercisable only in relation to the relevant part of the premises.
51. Ss 182(2), 321(2) IA 1986 provide that the court may make a vesting order as to only part of the premises affected by a disclaimed lease. This will mean a vesting of part only of the disclaimed lease and accordingly on terms requiring payment of an apportioned part of the disclaimed lease.

## **Right to put liquidator/TIB to his election whether to disclaim**

52. Any "person interested in the property" may apply in writing to the liquidator/TIB requiring him to decide whether he will disclaim or not and, if he does so, the liquidator/TIB then has 28 days (or such longer period as the court may allow) to decide whether or not to disclaim: IA 1986 ss 178(5), 316(1). If the liquidator/TIB does not disclaim within that period, he loses the right to do so and, in the case of the TIB, is deemed to have affirmed the lease.

## **Disclaimer by Crown**

53. Finally, special provision is made for the possibility of disclaimer by the Crown where property has vested in it as bona vacantia: ss 653 ff Companies Act 1985

## **PRACTICAL ISSUES**

54. It is now helpful to turn to consider some of the practical issues that arise in the context of disclaimer by reference to the various potentially affected persons, namely
  - Surety for insolvent tenant
  - Former tenant or surety for former tenant
  - Subtenant
  - Mortgagee
  - Landlord
55. The person facing the most difficult choices is generally the landlord but it is convenient to consider his position last because among the factors he will want to consider is the position of the other potentially affected persons.

## **Surety for insolvent tenant**

56. Any surety for the insolvent tenant is likely to be the first port of call for the landlord in his attempts to recover his losses following a disclaimer. There is nothing much the surety can do to avoid a claim (assuming a claim has not already been made).

He can only hope that the landlord will prefer to take possession of the premises (which will put an end to any future claim against the surety) or do so mistakenly without realizing the consequences for his right to claim against the surety.

57. If the surety is pursued by the landlord, the only protection available to him (assuming that the guarantee does not itself require the surety to take or give him the right to take a new lease of the premises) is to apply to court for a vesting order in his favour. A surety (unlike former tenants or sureties for former tenants) does not have a right to request an overriding lease under s 19 of the Landlord and Tenant (Covenants) Act 1995 (as to which see further in relation to former tenants and sureties for former tenants below).
58. A surety has clear standing to apply for a vesting order following a disclaimer. Of course, he might not get the vesting order because a subtenant or mortgagee might assert their prior right to a vesting order but he is likely to be happy with this because it will normally be on terms (see above) that the insolvent tenant's liabilities are cleared off and the subtenant or mortgagee assumes responsibility for such liabilities in the future.
59. The only dilemma a surety might face is what to do if he has not yet been pursued by the landlord at the date of the disclaimer. A vesting order must be applied for (see above) within 3 months of the applicant becoming aware of the disclaimer. If the landlord has not yet made a claim against the surety, he may be reluctant to take the step of applying for a vesting order. To do so might invite such a claim in circumstances where the landlord would otherwise have decided to re-take possession or to pursue other parties whereas not to do so is to run the risk of losing the opportunity to obtain a vesting order. In practice, however, the position vis a vis a surety of the insolvent tenant is likely to have become clear long before a disclaimer. This is therefore much more likely to be an issue for former tenants and sureties of former tenants rather than sureties of the insolvent tenant and is therefore considered in more detail below when dealing with the former.

### **Former tenant or surety for former tenant**

60. As discussed above, where the lease has been assigned since its creation, the original tenant, any intermediate assignees who have covenanted directly with the landlord and any sureties of either of the foregoing are potentially liable (subject to the Landlord and Tenant (Covenants) Act 1995) to the landlord. However, they are less obvious targets for the landlord than a surety for insolvent tenant and it may be some time before it becomes known whether they are going to face a claim or not. Also, having disposed of the property, it may be that they are unaware that the current tenant is in financial difficulties and therefore have insufficient warning to be able to form a strategy for dealing with the situation at an early stage.
61. There is little that such former tenants or sureties for former tenants can do to avoid a claim by the landlord other than to lie low and to hope that the landlord will prefer to re-take possession (or take possession without realizing the consequences for his right to claim against them) or will find some easier target to pursue.

62. In the event that they are pursued by the landlord, they have essentially two forms of protection available to them, namely either applying for a vesting order or requesting an overriding lease under s 19 of the Landlord and Tenant (Covenants) Act 1995. At first sight, these might seem to give much the same protection in terms of conferring on them an interest in the property which they can turn to advantage to help defray the liabilities they now face. However, closer analysis indicates that they are not identical.
63. The principles governing vesting orders have been explained above. The principles governing overriding leases under s 19 of the Landlord and Tenant (Covenants) Act 1995 require a little more explanation.
64. A copy of the relevant statutory provisions is attached. In summary, the position is as follows:-
- (1) Where a former tenant or his guarantor has paid in full an amount which he has been duly required to pay to a landlord under s 17 of the 1995 Act, he is entitled to have the landlord grant him an overriding lease of the premises demised by the relevant tenancy.
  - (2) The right is exercised by making a written request to the landlord at the time of making the payment in question or within 12 months after making the payment.
  - (3) Only one overriding lease can be granted. Where two or more requests are made, the first in time takes precedence. If two or more requests are made on the same day, then the following rules apply: former tenants take precedence over guarantors and, as between such classes of persons, the person whose liability commenced first take precedence.
  - (4) The overriding lease is to be for a term equal to the remainder of the term of the relevant tenancy plus 3 days (or the longest period less than 3 days that will not wholly displace the landlord's reversionary interest).
  - (5) The overriding lease is otherwise to be on the same terms as the relevant tenancy, although it is open to the parties to agree modifications if they wish to do so.
  - (6) The person claiming the overriding lease shall be liable for the landlord's reasonable costs of and incidental to the grant of the lease.
65. This right was introduced as part of the wide-ranging changes to the law made under the 1995 Act with a view to improving the position of former tenants or their guarantors who are called upon to make good the defaults of the current tenant. However, so far, relatively little use seems to have been made of the right. Prior to s 19 there was little that former tenants or their guarantors could do other than to claim indemnity against subsequent assignees or the current tenant. They could ultimately push the tenant into winding up/bankruptcy at which point the liquidator/TIB might disclaim the lease with the result that they could then apply for (but might not get) a vesting order. However, there was no certainty that this would happen and it could take some time. The right to an overriding lease would, it was thought, remedy the situation.

66. The effect of an overriding lease has been described by Hazel Williamson (in a recent article (04.02.06) in the Estates Gazette) as “elegant”. “The original tenant reaffirms the contractual obligations that it originally undertook, but in a way that provides it with an interest in the property once again, below the landlord but superior to the defaulting tenant. The landlord’s position remains the same, except that its privity of estate is with the original tenant rather than the current defaulting tenant, and the original tenant has all the powers of the landlord (rather than just a claim to indemnity) to assist its position against the defaulting tenant. Indeed, it can enforce all the covenants in the subject lease, thus controlling the performance of the tenant obligations in that lease. If the lease terms are not performed, the original tenant can, by forfeiture, or by provoking a disclaimer, obtain possession of the property and turn it to account to defray the expenses of the overriding lease”.
67. It is unclear whether an overriding lease under s 19 can be requested after a disclaimer of the relevant tenancy. One would have thought (having regard to the underlying purpose of an overriding lease) that a former tenant or his guarantor ought to be able to obtain such a lease at any time after he has paid the landlord sums claimed under s 17, whether or not the relevant tenancy has been disclaimed in the meantime. However, there is an argument that the landlord is not actually obliged to grant an overriding lease following disclaimer of the relevant tenancy because s 19(7) provides that “the landlord shall not be under any obligation to grant an overriding lease of the demised premises under this section at a time when the relevant tenancy has been determined”. As explained above, the House of Lords in *Hindcastle* held that following disclaimer the lease is determined. This suggests that an overriding lease will not be available following disclaimer. Moreover, it could be said that this makes practical sense having regard to the fact that following disclaimer the former tenant or his guarantor will have a right to apply for a vesting order; an overriding lease is (so the argument would go) no longer necessary.
68. The above issue does not appear to have been considered yet in case law. It is submitted that the better view is that it should be open to the former tenant/his guarantor to request an overriding lease whether or not the relevant tenancy has been determined. However, this certainly cannot be said to be clear cut.
69. Turning to consider the attractions of the two options (i.e a vesting order or an overriding lease), a vesting order will generally be more attractive to a former tenant/guarantor of former tenant who have been called upon to pay the landlord.
- (1) The process of obtaining a vesting order is likely to be relatively cheap and straightforward.
  - (2) No stamp duty land tax will be payable.
  - (3) There is no doubt about the standing of a former tenant/guarantor of former tenant to apply for a vesting order following a disclaimer. Of course, he might not get the vesting order because a subtenant or mortgagee might assert their prior right to a vesting order but he is likely to be happy with this because it will normally be on terms (see above) that the insolvent tenant’s

liabilities are cleared off and the subtenant or mortgagee assumes responsibility for such liabilities in the future.

70. In contrast, an overriding lease has the following drawbacks.
- (1) Before he can claim an overriding lease, the former tenant/guarantor of former tenant must have made payment in full (together with interest) of the sums owing by the insolvent tenant. However, there may be issues as to precisely what is owing which may give rise to problems and delays.
  - (2) A further potential source of problems and delays is the possibility that the parties may desire modifications to the original lease. S 19 of the 1995 Act provides that the terms of the overriding lease should be the same as the original lease but also allows modifications if they are agreed.
  - (3) Stamp duty land tax will be payable and may be substantial in a case where a lease has many years to run.
  - (4) The former tenant/guarantor of former tenant will be required to pay the landlords' (reasonable) legal costs.
  - (5) There is the issue referred to above as to whether a former tenant/guarantor of former tenant is entitled to an overriding lease where the relevant tenancy has been disclaimed.
71. There is, however, a problem for a former tenant/guarantor of former tenant who has not yet been pursued by the landlord at the date of the disclaimer. A vesting order must be applied for (see above) within 3 months of the applicant becoming aware of the disclaimer. If the landlord has not yet made any claim against the former tenant/guarantor of former tenant, he will obviously be reluctant to take the step of applying for a vesting order. To do so might be to invite such a claim in circumstances where the landlord would otherwise have decided to re-take possession or to pursue other parties. However, not to do so is to risk losing the opportunity to obtain a vesting order.
72. The court has a discretion to extend time for making an application for a vesting order (see IA 1986 s 376 and IR 1986 r 4.3) and one would have thought that the court would exercise its discretion to extend time in a case where the original tenant was unsure whether a claim was going to be made against him and applied promptly as soon as a claim is notified to him. However, there can be no guarantee.
73. In practice, the best course is probably for the original tenant to wait and see and to cast himself on the mercy of the court if a claim is made against him. However, it is a strategy not without risks. If the court were not prepared to extend time, the original tenant's only option would be to request an overriding lease from the landlord which is less attractive and may not even be possible for the reasons explained above.
74. The discussion above focuses on the position where a disclaimer has already occurred. However, it is important also to consider the position where the former tenant/guarantor of former tenant is being pursued by the landlord prior to a

disclaimer having taken place and perhaps in circumstances where the current tenant has not yet even gone into winding up/bankruptcy. In such circumstances, the former tenant/guarantor of former tenant cannot apply for a vesting order. His only option is to request an overriding lease. However, the possibility that a disclaimer will take place in the future may mean that he should think about delaying any such request for a while in case a disclaimer takes place and he can then apply for a vesting order.

75. There are of course dangers in doing this including rent will continue to accrue in the meantime; disclaimer may never take place; even if it does take place, the former tenant/guarantor of former tenant only has 12 months to play with between making payment to the landlord and requesting an overriding lease which may not be long enough; and another person with a right to an overriding lease may step in in the meantime and obtain such a lease, thereby shutting the door on the first person obtaining such a lease.
76. Nevertheless, there may be circumstances where it is more attractive to hold back from making an immediate request for an overriding lease in the hope of later being able to obtain a vesting order - eg where disclaimer seems imminent and/or there are no other potentially competing claimants for an overriding lease.

### **Subtenant**

77. A subtenant's reaction to disclaimer of the headlease will generally depend upon whether he wishes to retain his premises or not.
78. If the subtenant wishes to retain his premises, he will have to pay the rent and perform the covenants under the headlease. If he does not do so, it will be open to the landlord to forfeit and re-take possession. However, he will have standing to apply from relief against forfeiture under s 146 LPA 1925 (although not under the court's inherent jurisdiction): *Griffin v Hill* [1987] 1 EGLR 81; *Barclays Bank v Prudential Assurance* [1998] 1 EGLR.

(NB It is unclear what the subtenant must do where the sublease relates to part only of the premises demised by the headlease. The subtenant presumably (by analogy with the provisions referred to above regarding disclaimer and vesting orders in relation to parts of demised premises) only has to perform the covenants insofar as they relate to the premises falling within the sublease which will mean in practice paying only an apportioned part of the rent. However, this could give rise to problems in practice. In particular, what if there is a dispute as to the correct level of the apportioned rent? This is not a problem where the court is making a vesting order because it can determine this at the time it makes the order. However, there is no court involvement where a subtenant is keeping alive his right to remain in the premises by paying the rent and performing the covenants in the headlease.)

79. In practice, the option of paying the rent and performing the covenants under the headlease will normally be only a short-term solution in that the subtenant is likely to end up having to take a vesting order in respect of the disclaimed lease. Either he will himself apply for a vesting order or the landlord will do so which will have the effect of putting him to an election as to whether or not he wishes to take a

vesting order and, if he does not, depriving him of any further interest in the premises.

80. In fact, subtenants seem generally to be unwilling to go to these lengths to retain their premises. This is probably because the rent under the disclaimed lease is generally above the market rent. If it was lower than the market rent, the tenant would not have got into financial difficulty in the first place or, if he had, the lease would have a value which could be realized by the liquidator/bankrupt and therefore would not have been disclaimed.
81. If the subtenant does not wish to retain his premises, he should simply do nothing. The landlord will then be entitled to forfeit and to re-take possession. Of course, the landlord may not do so because of the consequences in terms of his rights against sureties or other parties liable in respect of the lease. If he does not do so, the subtenant will be able in practice to stay in possession without paying rent. (It is unclear precisely what the subtenant's status would be in this situation – trespasser or licensee or other – and whether he would be liable to pay mesne profits and, if so, to whom.)
82. It is important to note that there is nothing the landlord can do after disclaimer to acquire the benefit of the sublease against the wishes of the subtenant. If the subtenant wishes to retain the premises and obtains a vesting order, the landlord will end up getting the benefit of the subtenant's covenant in this way. However, if the subtenant declines to take a vesting order, he will be excluded from any further interest in the premises. If the landlord gets a vesting order in this favour, this will not carry the benefit of the sublease: *Sterling Estates v Pickard UK Ltd* [1997] 2 EGLR.
83. In short, therefore, disclaimer of the lease will provide a subtenant with an opportunity to get out of his sublease if he wishes to do so. The only way for the landlord to obtain the benefit of the sublease is to do a deal with the tenant (or, after commencement of the winding up/bankruptcy, the liquidator/TIB) for a surrender of the lease: see further below when discussing the position of the landlord. Having regard to this, a subtenant who wishes to get out of his sublease will be keen to see a disclaimer take place as quickly as possible so as to reduce the scope for the landlord to consider his position and to try to negotiate a surrender prior to any disclaimer.
84. It may be that this is a case where a notice to the liquidator/TIB to elect whether or not to disclaim will be useful. Such a notice gives the liquidator/TIB a period of only 28 days in which to make up his mind. Moreover it does not have to be served on the landlord so, unless the liquidator/TIB approaches the landlord, the landlord will be unaware of the urgency of any attempt to negotiate a surrender.

## **Mortgagee**

85. The position of a mortgagee is the same as that of a subtenant except that, given that the mortgagee will not be liable under the covenants in the lease, he will not be concerned about trying to get out of the sublease. His only concern will be in retaining the subtenant's interest in the premises either by paying the rent and performing the covenants in the disclaimed headlease (so as to avoid forfeiture by the landlord) or obtaining a vesting order in his favour.

## Landlord

86. Turning finally to the position of the landlord, this is the most complex of all. He landlord has a number of options and must take care in deciding which is the most beneficial for him and in pursuing that option.
87. The landlord will normally be concerned about one or more of the following:-
- (1) Obtaining possession of the property
  - (2) Claiming against third parties liable in respect of the lease
  - (3) Obtaining the benefit of a sublease
  - (4) Maximising the value of his claim in the winding up/bankruptcy
88. These options are considered in turn below. It should be remembered that if no disclaimer has yet actually taken place, the landlord has ability to force the issue by putting the liquidator/TIB to elect within 28 days whether or not to disclaim. The landlord may wish to take advantage of this once he has decided on his strategy.

### *Obtaining possession of the property*

89. The most obvious option for the landlord following disclaimer is to re-take possession of the property and to re-let it. He will obviously not face any resistance from the tenant in so doing and, if no one else is in possession of the property, he will not need any order of the court. However, if there are others in possession of the property or with potential rights to the property (eg subtenants or mortgagees), he will probably need to proceed by way of applying for a vesting order in order to clear off such interests.
90. The landlord must, of course, bear in mind that by obtaining possession of the property he will be putting an end to the following:-
- any claim he might have against third parties (eg sureties or original tenants or intermediate assignees) liable in respect of on-going rent or other obligations under the lease
  - (subject to their right to seek relief from forfeiture) any subtenants' interests in the property.
91. He will therefore need to weigh up carefully the advantages and disadvantages of obtaining possession as against retaining rights against third parties. Relevant factors will include:
- ease of re-letting
  - likely rental on re-letting
  - existence of rights against third parties
  - likely recoveries from third parties on exercise of such rights
  - likely reaction of third parties in terms of seeking vesting orders or overriding lease
  - existence of subleases
  - likelihood of subtenants wishing to pay the rent or to apply for a vesting order
  - size of likely distribution in winding up/bankruptcy.

### *Claiming against third parties liable in respect of lease*

92. Disclaimer does not (as explained above) let such parties (eg a surety or the original tenant or intermediate assignees or sureties for such former tenants) off the hook. They continue to be liable in respect of the lease notwithstanding the disclaimer. Depending upon the circumstances (including those listed above) the landlord may regard claims against such third parties as his highest priority.
93. In order to be able to bring such claims, it is vital that the landlord does not do anything that might be construed as a re-taking of possession. To date, the courts have not proved particularly sympathetic to arguments by third parties trying to establish that landlords should be regarded as having re-taken possession following disclaimers. For example, the court rejected a surety's argument in *Scottish Widows plc v Tripipatkul* [2003] EWHC 1874 the landlord had re-taken possession by putting the property up for sale and describing it in the particulars of sale as "vacant". However, the landlord should nevertheless exercise great caution to make clear at all times that they are not taking possession and regard the lease as continuing as regards all persons other than the insolvent tenant.
94. In addition, in bringing such claims, the landlord must of course take care to comply with the provisions of the Landlord and Tenant (Covenants) Act 1995.
95. There is nothing legally objectionable in a landlord refraining from re-taking possession and re-letting the property and instead claiming payment of continuing rent from a third party liable in respect of the lease. The third party cannot object that the landlord is unreasonably failing to mitigate his losses by not re-taking possession of the property and seeking to re-let it: *Bhogul v Cheema* [1998] 2 EGLR 50.
96. In principle, such a situation could continue for many years. In *Cromwell Developments Ltd v Godfrey* [1998] 2 EGLR 62 it continued (albeit in rather unusual circumstances) for some 10 years following the disclaimer. The court held that the landlord had not done anything to re-take possession of the property and accordingly the liability of the original tenant to pay the rent under the disclaimed lease continued throughout the period.
97. It is also worth noting that the landlord can sell this "notional reversion" with the benefit of the relevant third party covenant: see the *Scottish Widows* case referred to above. Moreover, the third party covenant will be regarded as being annexed to the "notional reversion" so as to pass without the need for an express assignment of the benefit of the covenant (although it would of course be wise to include an express assignment of the benefit of the covenant to put the matter beyond doubt).

### *Obtaining benefit of sublease*

98. There may be cases where, whilst the tenant has become insolvent, there is a valuable sublease in place with a solvent subtenant and at a rent exceeding what could be obtained in the market. In such a case, the landlord may consider (particularly if he has no or limited prospects of making any recoveries from third parties) that his best option is to try to obtain the benefit of such sublease. However, this may not be easy if the subtenant is unwilling to play ball.

99. The landlord will not be able to obtain the benefit of the sublease by re-taking possession. That will immediately bring to an end the subtenant's interest in the property.
100. It might be thought that the way to obtain the benefit of the sublease is to apply for a vesting order in respect of the disclaimed lease. After all, the landlord does (as explained above) have standing as a person interested in the property to apply for a vesting order. Unfortunately, however, he will not be able to obtain a vesting order which gives him the benefit of the disclaimed lease: see *Sterling Estates v Pickard UK Ltd* [1997] 2 EGLR. This is because of the provisions under which the landlord comes last in the pecking order of those who may obtain a vesting order and if those who come before him (including any subtenants) decline to take a vesting order, they are thereafter excluded from any interest in the property.
101. At first sight, this might seem a surprising result. However, it is not when one considers the rationale for those provisions. The effect of a disclaimer is not just to bring the lease to an end as between the landlord and tenant but also to bring the sublease to an end as between the tenant and the subtenant. Without this, the tenant would continue to have liabilities (as landlord under the sublease) in respect of the property. Whilst the subtenant retains the right to remain in the property, his right to do so does not arise under the sublease but by virtue of the statutory deeming provisions which entitle him to remain in the property for so long as he pays the rent and complies with the other obligations under the disclaimed lease. He may formalize the position if he wants by applying for a vesting order in his favour but he cannot be compelled to do any of these things if he does not wish to do so. Of course, he then risks being ousted by the landlord but that may be a consequence he is prepared to face, particularly if the market rent is significantly lower than the rent under the disclaimed lease and the sublease.
102. In short, therefore, there is no route by which *following a disclaimer* the landlord can step into the shoes of the insolvent tenant so as to obtain the benefit of the sublease. To achieve this result, he will need to act before any disclaimer has taken place and to enter into discussions with the liquidator/TIB with a view to taking a surrender of the headlease lease so as to put himself in a position where he can obtain the benefit from the sublease. It may even be worth offering some money in return for such a surrender. This may ultimately produce a better result for the landlord and more quickly and cheaply than other alternatives.

#### *Maximising value of claim in liquidation/bankruptcy*

103. If the insolvent tenant has significant assets and there is therefore the prospect of a substantial distribution in the winding up/bankruptcy, the landlord may be concerned to maximize the value of his claim in the winding up/bankruptcy. There is nothing he can do to increase the value of his proof for rent or other monies accrued prior to the winding up/bankruptcy. However, as explained above, where the liquidator/TIB has disclaimed the lease, the landlord may claim in the winding up/bankruptcy for any losses suffered as a result of the disclaimer.
104. This is one respect in which disclaimer actually improves the landlord's position by comparison with his position in the absence of disclaimer. Disclaimer gives him the opportunity to claim, in effect, for future rent, something which he would not otherwise be able to claim in the winding up/bankruptcy. Depending upon the

likely value of such claim (as to which see the summary of the relevant principles given above), he may positively wish to encourage the liquidator/TIB to disclaim. Furthermore, once the liquidator/TIB has disclaimed, he may wish to keep an eye on the ramifications of his actions (eg in terms of attempts to re-let) on the likely valuation of such claim.

105. Finally, the landlord may also be able to use the prospect of such a claim (and its impact on the likely level of distributions to creditors) as a lever in any negotiations with the liquidator/TIB aimed at heading off disclaimer and securing a surrender of the lease with a view to enabling the landlord to obtain the benefit of a valuable sublease.

#### *Final comments*

106. The above demonstrates the importance to landlords of giving early consideration to their options whenever tenants show signs of getting into financial difficulty and formulating a strategy for dealing with the situation which includes the possibility that a liquidator/TIB may be appointed and may disclaim the lease. As time passes, the options available to landlords will become more limited. If the landlord waits until the liquidator/TIB has disclaimed, he may find that potentially attractive options are closed to him.
107. Once the tenant has gone into liquidation/winding up, the landlord may want to know whether the liquidator/TIB is going to disclaim so that he knows where he stands. Otherwise he could be left in a situation of uncertainty for a long period. However, there is a solution to this in that s 178(5) gives persons interested in property in question (which would include the landlord) the right to put liquidator/TIB to election as to whether he will disclaim and, if he does not do so within 28 days, the liquidator/TIB will lose the ability to do so.

#### **CONCLUSION**

108. The discussion above will, it is hoped, demonstrate the importance for those who stand to be affected by a disclaimer (actual or anticipated) to give consideration to their options at the earliest opportunity. Whilst the options may sometimes be straightforward, in many cases they will be far from straightforward. Unfortunately, there are few, if any, "rules of thumb". Each case will turn on its own circumstances. Moreover, as time passes, the available options will often become more limited.

James Ayliffe  
Wilberforce Chambers  
27 October 2006

## **INSOLVENCY ACT 1986**

### **178 Power to disclaim onerous property**

- (1) This and the next two sections apply to a company that is being wound up in England and Wales.
- (2) Subject as follows, the liquidator may, by the giving of the prescribed notice, disclaim any onerous property and may do so notwithstanding that he has taken possession of it, endeavoured to sell it, or otherwise exercised rights of ownership in relation to it.
- (3) The following is onerous property for the purposes of this section--
- (a) any unprofitable contract, and
  - (b) any other property of the company which is unsaleable or not readily saleable or is such that it may give rise to a liability to pay money or perform any other onerous act.
- (4) A disclaimer under this section--
- (a) operates so as to determine, as from the date of the disclaimer, the rights, interests and liabilities of the company in or in respect of the property disclaimed; but
  - (b) 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.
- (5) A notice of disclaimer shall not be given under this section in respect of any property if--
- (a) a person interested in the property has applied in writing to the liquidator or one of his predecessors as liquidator requiring the liquidator or that predecessor to decide whether he will disclaim or not, and
  - (b) the period of 28 days beginning with the day on which that application was made, or such longer period as the court may allow, has expired without a notice of disclaimer having been given under this section in respect of that property.
- (6) Any person sustaining loss or damage in consequence of the operation of a disclaimer under this section is deemed a creditor of the company to the extent of the loss or damage and accordingly may prove for the loss or damage in the winding up.

### **179 Disclaimer of leaseholds**

- (1) 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 the period of 14 days beginning with the day on which the last notice served under this subsection was served; or
- (b) where such an application has been made, the court directs that the disclaimer shall take effect.

(2) Where the court gives a direction under subsection (1)(b) it may also, instead of or in addition to any order it makes under section 181, make such orders with respect to fixtures, tenant's improvements and other matters arising out of the lease as it thinks fit.

### **180 Land subject to rentcharge**

- (1) The following applies where, in consequence of the disclaimer under section 178 of any land subject to a rentcharge, that land vests by operation of law in the Crown or any other person (referred to in the next subsection as "the proprietor").
- (2) The proprietor and the successors in title of the proprietor are not subject to any personal liability in respect of any sums becoming due under the rentcharge except sums becoming due after the proprietor, or some person claiming under or through the proprietor, has taken possession or control of the land or has entered into occupation of it.

### **181 Powers of court (general)**

- (1) This section and the next apply where the liquidator has disclaimed property under section 178.
- (2) An application under this section may be made to the court by--
  - (a) any person who claims an interest in the disclaimed property, or
  - (b) any person who is under any liability in respect of the disclaimed property, not being a liability discharged by the disclaimer.
- (3) Subject as follows, the court may on the application make an order, on such terms as it thinks fit, for the vesting of the disclaimed property in, or for its delivery to--
  - (a) a person entitled to it or a trustee for such a person, or
  - (b) a person subject to such a liability as is mentioned in subsection (2)(b) or a trustee for such a person.
- (4) The court shall not make an order under subsection (3)(b) 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.
- (5) The effect of any order under this section shall be taken into account in assessing for the purpose of section 178(6) the extent of any loss or damage sustained by any person in consequence of the disclaimer.

(6) An order under this section vesting property in any person need not be completed by conveyance, assignment or transfer.

### **182 Powers of court (leaseholds)**

(1) The court shall not make an order under section 181 vesting property of a leasehold nature in any person claiming under the company as underlessee or mortgagee except on terms making that person--

(a) subject to the same liabilities and obligations as the company was subject to under the lease at the commencement of the winding up, 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 at the commencement of the winding up.

(2) For the purposes of an order under section 181 relating to only part of any property comprised in a lease, the requirements of subsection (1) apply as if the lease comprised only the property to which the order relates.

(3) Where subsection (1) applies and no person claiming under the company as underlessee or mortgagee is willing to accept an order under section 181 on the terms required by virtue of that subsection, the court may, by order under that section, vest the company's estate or interest in the property in any person who is liable (whether personally or in a representative capacity, and whether alone or jointly with the company) to perform the lessee's covenants in the lease.

The court may vest that estate and interest in such a person freed and discharged from all estates, incumbrances and interests created by the company.

(4) Where subsection (1) applies and a person claiming under the company as underlessee or mortgagee declines to accept an order under section 181, that person is excluded from all interest in the property.

...

### **315 Disclaimer (general power)**

(1) Subject as follows, the trustee may, by the giving of the prescribed notice, disclaim any onerous property and may do so notwithstanding that he has taken possession of it, endeavoured to sell it or otherwise exercised rights of ownership in relation to it.

(2) The following is onerous property for the purposes of this section, that is to say-

(a) any unprofitable contract, and

(b) any other property comprised in the bankrupt's estate which is unsaleable or not readily saleable, or is such that it may give rise to a liability to pay money or perform any other onerous act.

(3) A disclaimer under this section--

(a) operates so as to determine, as from the date of the disclaimer, the rights, interests and liabilities of the bankrupt and his estate in or in respect of the property disclaimed, and

(b) discharges the trustee from all personal liability in respect of that property as from the commencement of his trusteeship,

but does not, except so far as is necessary for the purpose of releasing the bankrupt, the bankrupt's estate and the trustee from any liability, affect the rights or liabilities of any other person.

(4) A notice of disclaimer shall not be given under this section in respect of any property that has been claimed for the estate under section 307 (after-acquired property) or 308 (personal property of bankrupt exceeding reasonable replacement value) [or 308A], except with the leave of the court.

(5) Any person sustaining loss or damage in consequence of the operation of a disclaimer under this section is deemed to be a creditor of the bankrupt to the extent of the loss or damage and accordingly may prove for the loss or damage as a bankruptcy debt.

### **316 Notice requiring trustee's decision**

(1) Notice of disclaimer shall not be given under section 315 in respect of any property if--

(a) a person interested in the property has applied in writing to the trustee or one of his predecessors as trustee requiring the trustee or that predecessor to decide whether he will disclaim or not, and

(b) the period of 28 days beginning with the day on which that application was made has expired without a notice of disclaimer having been given under section 315 in respect of that property.

(2) The trustee is deemed to have adopted any contract which by virtue of this section he is not entitled to disclaim.

### **317 Disclaimer of leaseholds**

(1) The disclaimer of any property of a leasehold nature 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 claiming under the bankrupt as underlessee or mortgagee and either--

(a) no application under section 320 below 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 subsection was served, or

(b) where such an application has been made, the court directs that the disclaimer is to take effect.

(2) Where the court gives a direction under subsection (1)(b) it may also, instead of or in addition to any order it makes under section 320, make such orders with respect to fixtures, tenant's improvements and other matters arising out of the lease as it thinks fit.

### **318 Disclaimer of dwelling house**

Without prejudice to section 317, the disclaimer 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--

(a) no application under section 320 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

(b) where such an application has been made, the court directs that the disclaimer is to take effect.

### **319 Disclaimer of land subject to rentcharge**

(1) The following applies where, in consequence of the disclaimer under section 315 of any land subject to a rentcharge, that land vests by operation of law in the Crown or any other person (referred to in the next subsection as "the proprietor").

(2) The proprietor, and the successors in title of the proprietor, are not subject to any personal liability in respect of any sums becoming due under the rentcharge, except sums becoming due after the proprietor, or some person claiming under or through the proprietor, has taken possession or control of the land or has entered into occupation of it.

### **320 Court order vesting disclaimed property**

(1) This section and the next apply where the trustee has disclaimed property under section 315.

(2) An application may be made to the court under this section by--

(a) any person who claims an interest in the disclaimed property,

(b) any person who is under any liability in respect of the disclaimed property, not being a liability discharged by the disclaimer, or

(c) 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.

(3) Subject as follows in this section and the next, the court may, on an application under this section, make an order on such terms as it thinks fit for the vesting of the disclaimed property in, or for its delivery to--

(a) a person entitled to it or a trustee for such a person,

(b) a person subject to such a liability as is mentioned in subsection (2)(b) or a trustee for such a person, or

(c) 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.

(4) The court shall not make an order by virtue of subsection (3)(b) 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.

(5) The effect of any order under this section shall be taken into account in assessing for the purposes of section 315(5) the extent of any loss or damage sustained by any person in consequence of the disclaimer.

(6) An order under this section vesting property in any person need not be completed by any conveyance, assignment or transfer.

### **321 Order under s 320 in respect of leaseholds**

(1) The court shall not make an order under section 320 vesting property of a leasehold nature in any person, except on terms making that person--

(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.

(2) For the purposes of an order under section 320 relating to only part of any property comprised in a lease, the requirements of subsection (1) apply as if the lease comprised only the property to which the order relates.

(3) Where subsection (1) applies and no person is willing to accept an order under section 320 on the terms required by that subsection, the court may (by order under section 320) vest the estate or interest of the bankrupt in the property in any person who is liable (whether personally or in a representative capacity and whether alone or jointly with the bankrupt) to perform the lessee's covenants in the lease.

The court may by virtue of this subsection vest that estate and interest in such a person freed and discharged from all estates, incumbrances and interests created by the bankrupt.

(4) Where subsection (1) applies and a person declines to accept any order under section 320, that person shall be excluded from all interest in the property.

## **INSOLVENCY RULES 1986**

### **4.187 Liquidator's notice of disclaimer**

- (1) Where the liquidator disclaims property under section 178, the notice of disclaimer shall contain such particulars of the property disclaimed as enable it to be easily identified.
- (2) The notice shall be signed by the liquidator and filed in court, with a copy. The court shall secure that both the notice and the copy are sealed and endorsed with the date of filing.
- (3) The copy notice, so sealed and endorsed, shall be returned by the court to the liquidator as follows--
  - (a) if the notice has been delivered at the offices of the court by the liquidator in person, it shall be handed to him,
  - (b) if it has been delivered by some person acting on the liquidator's behalf, it shall be handed to that person, for immediate transmission to the liquidator, and
  - (c) otherwise, it shall be sent to the liquidator by first class post.

The court shall cause to be endorsed on the original notice, or otherwise recorded on the file, the manner in which the copy notice was returned to the liquidator.

- (4) For the purposes of section 178, the date of the prescribed notice is that which is endorsed on it, and on the copy, in accordance with this Rule.

### **4.188 Communication of disclaimer to persons interested**

- (1) Within 7 days after the day on which the copy of the notice of disclaimer is returned to him under Rule 4.187, the liquidator shall send or give copies of the notice (showing the date endorsed as required by that Rule) to the persons mentioned in paragraphs (2) to (4) below.
- (2) Where the property disclaimed is of a leasehold nature, he shall send or give a copy to every person who (to his knowledge) claims under the company as underlessee or mortgagee.
- (3) He shall in any case send or give a copy of the notice to every person who (to his knowledge)--
  - (a) claims an interest in the disclaimed property, or
  - (b) is under any liability in respect of the property, not being a liability discharged by the disclaimer.
- (4) If the disclaimer is of an unprofitable contract, he shall send or give copies of the notice to all such persons as, to his knowledge, are parties to the contract or have interests under it.
- (5) If subsequently it comes to the liquidator's knowledge, in the case of any person, that he has such an interest in the disclaimed property as would have entitled

him to receive a copy of the notice of disclaimer in pursuance of paragraphs (2) to (4), the liquidator shall then forthwith send or give to that person a copy of the notice.

But compliance with this paragraph is not required if--

- (a) the liquidator is satisfied that the person has already been made aware of the disclaimer and its date, or
- (b) the court, on the liquidator's application, orders that compliance is not required in that particular case.

#### **4.189 Additional notices**

The liquidator disclaiming property may, without prejudice to his obligations under sections 178 to 180 and Rules 4.187 and 4.188, at any time give notice of the disclaimer to any persons who in his opinion ought, in the public interest or otherwise, to be informed of it.

#### **4.190 Duty to keep court informed**

The liquidator shall notify the court from time to time as to the persons to whom he has sent or given copies of the notice of disclaimer under the two preceding Rules, giving their names and addresses, and the nature of their respective interests.

#### **4.191 Application by interested party under s 178(5)**

Where, in the case of any property, application is made to the liquidator by an interested party under section 178(5) (request for decision whether the property is to be disclaimed or not), the application--

- (a) shall be delivered to the liquidator personally or by registered post, and
- (b) shall be made in the form known as "notice to elect", or a substantially similar form.

#### **4.192 Interest in property to be declared on request**

(1) If, in the case of property which the liquidator has the right to disclaim, it appears to him that there is some person who claims, or may claim, to have an interest in the property, he may give notice to that person calling on him to declare within 14 days whether he claims any such interest and, if so, the nature and extent of it.

(2) Failing compliance with the notice, the liquidator is entitled to assume that the person concerned has no such interest in the property as will prevent or impede its disclaimer.

#### **4.193 Disclaimer presumed valid and effective**

Any disclaimer of property by the liquidator is presumed valid and effective, unless it is proved that he has been in breach of his duty with respect to the giving of notice of disclaimer, or otherwise under sections 178 to 180, or under this Chapter of the Rules.

#### **4.194 Application for exercise of court's powers under s 181**

(1) This Rule applies with respect to an application by any person under section 181 for an order of the court to vest or deliver disclaimed property.

(2) The application must be made within 3 months of the applicant becoming aware of the disclaimer, or of his receiving a copy of the liquidator's notice of disclaimer sent under Rule 4.188, whichever is the earlier.

(3) The applicant shall with his application file in court an affidavit--

(a) stating whether he applies under paragraph (a) of section 181(2) (claim of interest in the property) or under paragraph (b) (liability not discharged);

(b) specifying the date on which he received a copy of the liquidator's notice of disclaimer, or otherwise became aware of the disclaimer; and

(c) specifying the grounds of his application and the order which he desires the court to make under section 181.

(4) The court shall fix a venue for the hearing of the application; and the applicant shall, not later than 7 days before the date fixed, give to the liquidator notice of the venue, accompanied by copies of the application and the affidavit under paragraph (3).

(5) On the hearing of the application, the court may give directions as to other persons (if any) who should be sent or given notice of the application and the grounds on which it is made.

(6) Sealed copies of any order made on the application shall be sent by the court to the applicant and the liquidator.

(7) In a case where the property disclaimed is of a leasehold nature, and section 179 applies to suspend the effect of the disclaimer, there shall be included in the court's order a direction giving effect to the disclaimer.

This paragraph does not apply if, at the time when the order is issued, other applications under section 181 are pending in respect of the same property.

*See rules 6.178 to 6.186 for broadly similar provisions applicable in bankruptcy*

## Landlord and Tenant (Covenants) Act 1995

### 19 Right of former tenant or his guarantor to overriding lease

(1) Where in respect of any tenancy ("the relevant tenancy") any person ("the claimant") makes full payment of an amount which he has been duly required to pay in accordance with section 17, together with any interest payable, he shall be entitled (subject to and in accordance with this section) to have the landlord under that tenancy grant him an overriding lease of the premises demised by the tenancy.

(2) For the purposes of this section "overriding lease" means a tenancy of the reversion expectant on the relevant tenancy which--

(a) is granted for a term equal to the remainder of the term of the relevant tenancy plus three days or the longest period (less than three days) that will not wholly displace the landlord's reversionary interest expectant on the relevant tenancy, as the case may require; and

(b) (subject to subsections (3) and (4) and to any modifications agreed to by the claimant and the landlord) otherwise contains the same covenants as the relevant tenancy, as they have effect immediately before the grant of the lease.

(3) An overriding lease shall not be required to reproduce any covenant of the relevant tenancy to the extent that the covenant is (in whatever terms) expressed to be a personal covenant between the landlord and the tenant under that tenancy.

(4) If any right, liability or other matter arising under a covenant of the relevant tenancy falls to be determined or otherwise operates (whether expressly or otherwise) by reference to the commencement of that tenancy--

(a) the corresponding covenant of the overriding lease shall be so framed that that right, liability or matter falls to be determined or otherwise operates by reference to the commencement of that tenancy; but

(b) the overriding lease shall not be required to reproduce any covenant of that tenancy to the extent that it has become spent by the time that that lease is granted.

(5) A claim to exercise the right to an overriding lease under this section is made by the claimant making a request for such a lease to the landlord; and any such request--

(a) must be made to the landlord in writing and specify the payment by virtue of which the claimant claims to be entitled to the lease ("the qualifying payment"); and

(b) must be so made at the time of making the qualifying payment or within the period of 12 months beginning with the date of that payment.

(6) Where the claimant duly makes such a request--

(a) the landlord shall (subject to subsection (7)) grant and deliver to the claimant an overriding lease of the demised premises within a reasonable time of the request being received by the landlord; and

(b) the claimant--

- (i) shall thereupon deliver to the landlord a counterpart of the lease duly executed by the claimant, and
- (ii) shall be liable for the landlord's reasonable costs of and incidental to the grant of the lease.

(7) The landlord shall not be under any obligation to grant an overriding lease of the demised premises under this section at a time when the relevant tenancy has been determined; and a claimant shall not be entitled to the grant of such a lease if at the time when he makes his request--

- (a) the landlord has already granted such a lease and that lease remains in force; or
- (b) another person has already duly made a request for such a lease to the landlord and that request has been neither withdrawn nor abandoned by that person.

(8) Where two or more requests are duly made on the same day, then for the purposes of subsection (7)--

- (a) a request made by a person who was liable for the qualifying payment as a former tenant shall be treated as made before a request made by a person who was so liable as a guarantor; and
- (b) a request made by a person whose liability in respect of the covenant in question commenced earlier than any such liability of another person shall be treated as made before a request made by that other person.

(9) Where a claimant who has duly made a request for an overriding lease under this section subsequently withdraws or abandons the request before he is granted such a lease by the landlord, the claimant shall be liable for the landlord's reasonable costs incurred in pursuance of the request down to the time of its withdrawal or abandonment; and for the purposes of this section--

- (a) a claimant's request is withdrawn by the claimant notifying the landlord in writing that he is withdrawing his request; and
- (b) a claimant is to be regarded as having abandoned his request if--
  - (i) the landlord has requested the claimant in writing to take, within such reasonable period as is specified in the landlord's request, all or any of the remaining steps required to be taken by the claimant before the lease can be granted, and
  - (ii) the claimant fails to comply with the landlord's request,

and is accordingly to be regarded as having abandoned it at the time when that period expires.

(10) Any request or notification under this section may be sent by post.

(11) The preceding provisions of this section shall apply where the landlord is the tenant under an overriding lease granted under this section as they apply where no such lease has been granted; and accordingly there may be two or more such leases interposed between the first such lease and the relevant tenancy.

## 20 Overriding leases: supplementary provisions

- (1) For the purposes of section 1 an overriding lease shall be a new tenancy only if the relevant tenancy is a new tenancy.
- (2) Every overriding lease shall state--
  - (a) that it is a lease granted under section 19, and
  - (b) whether it is or is not a new tenancy for the purposes of section 1;

and any such statement shall comply with such requirements as may be prescribed by [land registration rules under the Land Registration Act 2002].

- (3) A claim that the landlord has failed to comply with subsection (6)(a) of section 19 may be made the subject of civil proceedings in like manner as any other claim in tort for breach of statutory duty; and if the claimant under that section fails to comply with subsection (6)(b)(i) of that section he shall not be entitled to exercise any of the rights otherwise exercisable by him under the overriding lease.
- (4) An overriding lease--
  - (a) shall be deemed to be authorised as against the persons interested in any mortgage of the landlord's interest (however created or arising); and
  - (b) shall be binding on any such persons;

and if any such person is by virtue of such a mortgage entitled to possession of the documents of title relating to the landlord's interest--

- (i) the landlord shall within one month of the execution of the lease deliver to that person the counterpart executed in pursuance of section 19(6)(b)(i); and
  - (ii) if he fails to do so, the instrument creating or evidencing the mortgage shall apply as if the obligation to deliver a counterpart were included in the terms of the mortgage as set out in that instrument.
- (5) It is hereby declared--
  - (a) that the fact that an overriding lease takes effect subject to the relevant tenancy shall not constitute a breach of any covenant of the lease against subletting or parting with possession of the premises demised by the lease or any part of them; and
  - (b) that each of sections 16, 17 and 18 applies where the tenancy referred to in subsection (1) of that section is an overriding lease as it applies in other cases falling within that subsection.

- (6) No tenancy shall be registrable under the Land Charges Act 1972 or be taken to be an estate contract within the meaning of that Act by reason of any right or obligation that may arise under section 19, and any right arising from a request made under that section shall not be [capable of falling within paragraph 2 of Schedule 1 or 3 to the Land Registration Act 2002]; but any such request shall be registrable under

the Land Charges Act 1972, or may be the subject of a notice [under the Land Registration Act 2002], as if it were an estate contract.

(7) In this section--

- (a) "mortgage" includes "charge"; and
- (b) any expression which is also used in section 19 has the same meaning as in that section.



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