

TENANT INSOLVENCY-REMEDIES AND PROCUDURES
AN OVERVIEW

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INTRODUCTION

1. In this paper I propose to give an overview of how the insolvency of a tenant can affect the rights and remedies of a landlord. I will examine the various procedures open to a tenant in financial difficulties and then assess how they impact upon the various remedies open to a landlord when faced with a defaulting tenant.

2. In preparing this paper I am very conscious of three things:
 - i. This comparatively brief paper can only scratch the surface of what is a large and complex topic (or rather series of topics).
 - ii. There are two other papers to be delivered which cover CVAs and Administration (i.e. much the most interesting topics in this field).
 - iii. The audience is probably already well familiar with most (if not all) of this.

3. The various procedures which I wish to consider are as follows:
 - i. Administration;
 - ii. CVA;
 - iii. IVA;
 - iv. Liquidation;

- v. Bankruptcy;
- vi. Administrative Receivership;
- vii. LPA/Fixed Charge Receiver.

4. The various landlord remedies which I will consider are:

- i. Distress;
- ii. Forfeiture;
- iii. Court Proceedings;
- iv. Resort to a sub-tenant;
- v. Resort against a guarantor or original tenant;
- vi. Resort to a rent deposit.

TENANT INSOLVENCY: THE VARIOUS OPTIONS

5. What follows is only a brief description of each of the procedures or options described above.

6. Administration is now governed by section 8 and Schedule B1 to the Insolvency Act 1986 (“IA86”). The procedure was substantially amended with effect from 15th September 2003 by the Enterprise Act 2002. It is a procedure whereby an administrator is appointed to a company which is then accorded a “breathing space” or moratorium from claims against it to enable one or more of various purposes to be carried out. Under the pre-2003 procedure an administrator could only be appointed by the court. However since September 2003, an administrator may be appointed:

- (a) by administration order of the Court;
- (b) by the holder of a floating charge; or
- (c) by the company or its directors;

The administrator is appointed to manage the company's affairs business and property and (as set out in paragraph 3 (1) to Schedule B1) he must perform his functions with the objective of:

- (a) rescuing the company as a going concern; or
- (b) achieving a better result for the company's creditors as a whole than would be likely were the company to be wound up (without first being in administration); or
- (c) realising property in order to make a distribution to one or more secured or preferential creditors.

7. The administrator of a company must perform his functions in the interests of the company's creditors as a whole. Paying off the secured or preferential creditors can be the administrator's objective only if it is not reasonably practicable to rescue the company or to achieve a better result than on a fire sale, and also must not unnecessarily harm the interests of the creditors of the company as a whole.

8. CVAs are governed by Part 1 of IA 86. A CVA is essentially a statutorily recognised binding agreement entered into between a company and its unsecured creditors

whereby the company agrees to pay and (provided 75% by value of those creditors vote in favour) the creditors are bound to accept, a lesser sum over a longer period than the latter might otherwise be entitled to claim. The exact terms of the arrangement are set out in the proposal and are overseen by a supervisor. Camilla Lamont is delivering a separate paper on this topic and I will leave the details to her.

9. An IVA is the equivalent procedure for an individual as opposed to a company. An IVA can (and frequently is) used as an alternative to Bankruptcy. IVAs are governed by Part VIII of IA 86. There are however a number of significant differences between the two procedures. Firstly, an IVA is commenced by making an application for an interim order to the court. Most significantly however, by sections 252 and 254, once an application is made and, further, once an interim order is granted, there is a stay on legal process which includes a landlord's right to forfeit and distress. IVAs now constitute nearly 50% of all personal insolvencies. By contrast the CVA procedure is comparatively little used.

10. Liquidation (or winding up) is of course the placing of a company's affairs into the hands of liquidator to wind up the company's business, realise its assets, distribute them to the creditors and thereafter the members and then dissolve the company. Liquidation can either be voluntary or by the court. A voluntary liquidation is commenced by the passing of a resolution of the company (usually a special or extraordinary resolution) in general meeting. It may either be a members voluntary winding up conducted under the control of the members if the directors are able to

make a declaration of solvency. Alternatively there is a creditors voluntary winding up if the directors cannot make such a declaration in which case the liquidation is controlled by the creditors. Both forms of liquidation are governed by Parts IV to VII of IA 86.

11. Certainly since the Enterprise Act 2002, the aim of the legislation has been embodied in the phrase “rescue culture”. The aim of the law should be to attempt to rescue a company in financial difficulties rather dissolve it.

12. Bankruptcy is again the roughly equivalent procedure for an insolvent individual (although dissolution is not a stated aim of the legislation in this case). The insolvent individual’s assets are vested in his trustee in bankruptcy whose job is to realise those assets and distribute the proceeds to the creditors. The bankrupt is discharged after one year and is free to start again. The procedures are set out in Parts VIII to XI of IA 86.

13. A Receiver is basically a person appointed by a secured creditor having a fixed charge over property who acts as agent for the debtor to manage the property in the interests of the creditor. The main function of a receiver appointed by a mortgagee is to assist the mortgagee in securing payment of the secured debt, and consequently is obliged to give priority to the interests of the mortgagee, even if the actions decided upon are detrimental to the mortgagor. The powers of such a receiver are set out in

the LPA 1925 but can be altered or extended by the terms of the instrument under which he is appointed.

14. Following the EA 2002, Administrative Receivership is now an increasingly rarely used procedure. An administrative receiver is defined in section 29 (2) IA 86 as: (a) a receiver or manager of the whole (or substantially the whole) of a company's property appointed by or on behalf of the holders of any debentures of the company secured by a charge which, as created, was a floating charge, or by such a charge and one or more other securities; or (b) a person who would be such a receiver or manager but for the appointment of some other person as the receiver of part of the company's property. The procedure and powers are set out in Part III of IA 86. However, in the majority of cases the grant of a floating charge by a company after 15th September 2003 will not carry with it the right to appoint an administrative receiver.

THE EFFECT OF THESE PROCEDURES ON A LANDLORD'S REMEDIES:

DISTRESS

15. Given the imminent changes to the law on distress it is perhaps worth spending a little more time on a discussion of this particular remedy.

16. The present law of distress is ancient in origin, inexpensive to operate and often effective at least as a persuasive background threat to those tenants hesitating between paying their suppliers and paying their rent. Inevitably these factors have made it a tempting target for "reform" in modern conditions. The Law Commission

provisionally recommended its abolition in the early 1990's. Fresh impetus to this tendency came with the enactment of the Human Rights Act 1998. In Fuller v Happy Shopper Markets Ltd [2001] 1 WLR 1681 Lightman J described the remedy of distress as "ancient and perhaps anachronistic" and questioned how it could be compatible with Article 8 of the Convention (relating to family life).

17. Reform has eventually arrived in the shape of the Tribunals Courts and Enforcement Act 2007 ("the 2007 act") the provisions of which are (of course!) not yet in force. I will therefore have to consider both the "old" or present law and the new or future law.

The present law of distress

18. From the Landlord's perspective, the present law has obvious advantages. Firstly, no notice needs to be given prior to distraining. If the rent is not paid within a given time from the distraint, the goods seized can be sold. In practice the use of walking possession agreements achieves the result of compelling the tenant to find the money prior to this taking place. Secondly, distress is available even where part of the premises is in residential use. In practice the bailiff will look to the commercial premises as the place to find readily realisable goods. Thirdly, distraint can extend to sums under a lease, such as insurance and service charges which are not strictly rent, provided they are reserved as rent under the lease, and quantified-See Concorde Graphics v Andromeda Investments [1983] 1 EGLR 53.

19. The position where the premises are subject to a mortgage is somewhat intricate. In theory if the mortgage postdates the lease, the mortgagee has a power to distrain, but the lessee can safely continue to pay the mortgagor as long as he is not given notice that the mortgagee intends to take possession. If however a lease is granted subsequent to the mortgage unless made under an express right in the mortgage or statutory power, the lease is void as against the mortgagee so the mortgagee cannot distrain. However the landlord can distrain since the lease is binding on the immediate parties by estoppel. In practice, mortgages of investment properties will allow the grant of leases by the mortgagor with consent of the mortgagee.

20. The main danger with distress is that of excessive distress. Landlords need to be sure that the tenant does not have some set-off against the claim- see e.g. Fuller v Happy Shopper Markets [2001] 1 WLR 1681 (Set off due to storm damage under a rent abatement clause).

21. CVA and IVAs. Where an individual debtor obtains an interim order under s.252 IA 86 it has the effect of imposing a temporary moratorium on the creditors, and s.252(2)(b) (as amended by the Insolvency Act 2000 Sch. 3 para 2(b)), expressly provides that no distress may be levied against the debtor or his property – except with the leave of the court. A landlord may, however, be able to distrain for rent whilst the application for an interim order is pending, as s.254 provides only that the court “may” prevent a landlord levying distress in that period.

22. Save for a limited exception for a small company (see Camilla Lamont's paper), there is no equivalent moratorium whilst a CVA proposal is pending.

23. Whether a landlord will be able to distrain following approval of an IVA or CVA will depend upon the extent to which the rent was the subject of the arrangement, which in turn depends on construing the arrangement. The IVA/CVA will bind the landlord whilst it remains in force and prevent it distraining to the extent that the unpaid rent is included within the arrangement. It will not prevent the landlord distraining in respect of any payment of rent falling due after the date of the CVA.

24. So far as bankruptcy is concerned, pending the hearing of a bankruptcy petition, the tenant's property remains vested in him, and as such he remains liable to pay the rent and to observe the covenants of the Lease. The landlord's ability to distrain for unpaid rent is not removed, or the exercise of the right rendered unlawful, by the presentation of the bankruptcy petition. A landlord is not so prevented by s.285, because distress is a self-help remedy and not "an action, execution or other legal process" within the meaning of that subsection (see Re Fanshaw & Yorston, ex p Birmingham & Staffordshire Gaslight Co (1870-1) L.R.11 Eq 615. However such exercise may later be undone in the circumstances set out in s.347 (2) and (3) Insolvency Act 1986, namely:

- (i) Where the landlord has distrained for rent and a bankruptcy order is subsequently made on the petition, any amount recovered by way of distress

which is in excess of 6 months' rent (the amount which would have been recoverable under s.347(1) after the commencement of the bankruptcy) or is in respect of a period or part of a period after the distress was levied, shall be held for the bankrupt as part of his estate (s.347(2)).

- (ii) Where any person has distrained upon the goods of an individual who is adjudged bankrupt before the end of the period of 3 months beginning with the distraint, so much of the goods, or the proceeds of sale, not held for the bankrupt as part of his estate under s.347(2) shall be charged for the benefit of the bankrupt's estate with the preferential debts of the bankrupt to the extent that the bankrupt's estate is for the time being insufficient for meeting those debts. (s.347(3)).

Thus distress can be levied in effect for a maximum of six months rent up to the date of a bankruptcy order and any distress levied less than three months prior to the making of an order will be charged for the benefit of preferential creditors.

25. There are further limitations on the landlord's ability to distrain for rent where a bankruptcy order has been made contained in s.285(3) Insolvency Act 1986 which provides that after the making of a bankruptcy order no person who is a creditor of the bankrupt in respect of a debt provable in the bankruptcy shall:

- (a) have any remedy against the property or person of the bankrupt in respect of that debt, or
- (b) before the discharge of the bankrupt, commence any action or other legal proceedings against the bankrupt

except with leave of the Court and on such terms as the Court may impose.

This limitation only applies in respect of unpaid rent provable as a debt in the bankruptcy – it does not prevent a landlord distraining for rent accruing after the date of the bankruptcy order (Re Binns, ex p Hale (1875) 1 Ch D 283).

26. Where a company is in liquidation, it remains liable to pay rent and observe the covenants of the Lease – subject to the power to disclaim contained in s.178.

27. There are no express restrictions on the landlord's right to distrain for rent where a company is in the process of being voluntarily wound-up under s.165 I A 86. This is subject, however, to the power in s.112 for the liquidator to apply to the court to exercise all or any of the powers which a court might exercise if the company were being wound up by the court – which may include the power to stay a uncompleted distress, under s.126(1)(b) (see Re Memco Engineering [1986] Ch 86) The test to be applied when the court is exercising its discretion is whether there are special circumstances rendering it inequitable that the landlord should be allowed to proceed with the distress (see-In re Herbert Berry Associates Ltd [1977] 1 WLR 617, Buckley LJ at 621, Goff LJ at 623).

28. Where a company is being compulsorily wound up under s.166 Insolvency Act 1986, s.128 (1) of the Act prevents a landlord exercising a right of distress after the

presentation of a winding-up petition. The landlord may, however, levy a distress with the leave of the court after the winding-up order is made (s.130(2)). It appears that the principles which will be applied are those articulated by the Court of Appeal in Re Atlantic Computer Systems Plc [1992] Ch 505 (as to which see, no doubt Katharine Holland's paper).

29. It is also worth noting a potential pitfall for landlords in s.176(2) of the Act – analogous to s.347(3) in respect of bankruptcy proceedings – which provides that where any person has distrained for rent in the period of three months ending with the date of the winding up order, those goods or effects, or proceeds of sale in respect of the same, shall be charged for the benefit of the company with the preferential debts of the company to the extent that the company's property is for the time being insufficient for meeting them.

30. The effect on the landlord's ability to distrain upon the tenant going into receivership does not differ greatly where the receiver is one appointed over the whole, or substantially the whole, of a company's property under Part III Insolvency Act 1986, or a receiver appointed over the specific Lease pursuant under the Law of Property Act 1925.

31. The appointment of a receiver does not affect the liability of the tenant to pay rent – or transfer that liability to the receiver, who is merely the agent of the tenant company.

There is no moratorium which prevents the landlord levying distress. Indeed, there is even no provision for a receiver to apply to court to stay any such attempted distress.

32. As a general rule, the appointment of an administrator does not affect the tenant's liability to pay rent, nor is the administrator personally liable for the rents, as he is merely an agent of the tenant. However, by virtue of Schedule B1 paragraph 43 IA 86, a moratorium is imposed, and no "legal process" (which expressly includes distress) may be instituted or continued against the company save with the permission of the court or consent of the administrator. That protection also extends to companies in respect of which an administration application has been made but not determined, or notice of intention to appoint administrators has been filed but the administrator not yet appointed by virtue of Sch. B1 para.44.

33. How such permission is to be sought would seem to depend on how the relevant administrator had been appointed – i.e. whether or not the Companies Court was already seized of the administration proceedings (see Rule 7 and Schedule 4 of the Insolvency Rules 1986). When considering whether to grant leave, the court should have regard to the principles articulated by the Court of Appeal in Re Atlantic Computers Plc [1992] 2 Ch 505, CA.

The new law of distress

34. Section 71 of the 2007 act declares that the common law right to distrain for arrears of rent is abolished. However, s.72 introduces CRAR, commercial rent arrears

recovery. The explanatory notes to the Act state that the section *creates a new statutory right for a landlord of commercial premises to recover rent arrears by using the procedure in Schedule 12 for taking control of the tenant's goods. This allows the landlord to enter the let premises in order to take goods belonging to the tenant, then sell those goods and recover the rent in arrear from the proceeds of sale.*

35. The detail is contained in Part 3 Chapter 2 of the Act and reference has to be made also to Chapter 1 of Part 3 and Schedules 12, 13 and 14. The main features are as follows.

36. By Section 71, the common law right to distain for arrears of rent is abolished. Distress for rent is replaced by the landlord's power to use the procedure in Schedule 12 (taking control of goods) to recover from the tenant rent payable under the lease.

37. CRAR applies only to commercial premises meaning that none of the demised premises is let for or used as a dwelling.

38. CRAR applies only to "rent" meaning the amount payable under a lease (in advance or in arrears) for possession and use of the demised premises, together with interest and VAT. "Rent" does not include any sum in respect of rates, council tax, services, repairs, maintenance, insurance or other ancillary matters (whether or not called "rent" in the lease). Where it is not otherwise identifiable, the amount payable for

possession and use of the Demised Premises is that part of the total amount payable under the Lease which is reasonably attributable to possession and use.

39. Where a business lease is continued under Part 2 of the Landlord & Tenant Act 1954, the rent payable including any interim rent counts as rent within CRAR.

40. Most importantly, CRAR can be used only to recover rent if the following conditions are satisfied:

- (a) a notice of enforcement is given;
- (b) the rent is certain, or capable of being calculated with certainty;
- (c) the amount has been reduced by any permitted deduction being any deduction, recoupment or set-off that the tenant would be entitled to claim (in law or in equity) in an action by the landlord for that rent.
- (d) the unpaid rent less (interest or VAT plus permitted deductions) is at least the minimum amount. The minimum amount is to be calculated in accordance with regulations.

41. So far as the notice of enforcement is concerned, paragraph 7 of Part 2 of Schedule 12 explains what is required. Paragraph 7 provides that an enforcement agent (the new style certificated bailiff) may not take control of goods unless the debtor has been given notice. Regulations will state the minimum period, form and content of and

service requirements for a notice. These have not yet been propounded so we do not yet know either the length of notice required or the format of the actual notice.

42. So far as the interrelationship of CRAR with the various insolvency procedures is concerned, it is not envisaged that this will be any different from their relationship with the present law of distress.

FORFEITURE

43. A landlord is not entitled to forfeit the lease merely because the tenant becomes insolvent. The lease must contain an express provision which entitles him to do so. But a proviso for re-entry by the landlord in case of the insolvency of the tenant is commonly inserted in commercial leases at a rack rent.

44. Forfeiture by peaceable re-entry is possible in the case of commercial but not residential premises, where it is precluded by section 2 of the Prevention from Eviction Act 1977. The recent case of Pirabakaran v Patel [2006] 3 EGLR 26 applies the same rule where the premises are partially used as a dwelling

45. If a company is administration, then by paragraph 43 (4) of Schedule B1 to the IA 86, a landlord may not exercise a right of forfeiture by peaceable re-entry save with consent of the administrator or with the permission of the court. Similarly by paragraph 43 (6) no “legal process” (which includes legal proceedings for forfeiture) may be instituted or continued against the company save with the permission of the

court or consent of the administrator. No doubt Katharine Holland's paper will deal in detail with the tests the court applies when faced with an application for permission.

46. So far as CVAs and IVAs are concerned no doubt Camilla Lamont will deal in detail with the position but, in summary, a landlord cannot forfeit for any arrears of rent that are caught by the terms of the arrangement but can do so for ongoing rents that are not so caught. In addition, the landlord cannot forfeit by proceedings or by peaceable re-entry without leave of the court whilst an interim order leading up to an IVA is in place. In addition no forfeiture by peaceable re-entry can take place without leave of the court when an application for such an order is pending and any proceedings can be stayed.

47. Permission of the court is required to commence proceedings for forfeiture against the property of a bankrupt by virtue of section 285(3) IA 86. However no permission is required for forfeiture by peaceable re-entry because the right of peaceable re-entry is not a "security" for the purposes of section 383(2) of the Act (see Re Lomax Leisure [2000] Ch. 502).

48. The appointment of a receiver again does not affect the landlord's ability to forfeit by either peaceful re-entry or by action.

49. Liquidation. By section 130 (2) of IA 86, a landlord needs leave of the court to proceed with "any action or proceeding" against the property of a company when a

winding up order has been made or a provisional liquidator appointed. Similar considerations to those set out in the Atlantic Computers case will be applied if permission is sought. There are no equivalent provisions in relation to voluntary liquidations. However, there is the power in s.112 for the liquidator to apply to the court to exercise all or any of the powers which a court might exercise if the company were being wound up by the court.

50. There is nothing to prevent any company or trustee from applying for relief from forfeiture should the landlord exercise its right.

PROCEEDINGS GENERALLY

51. If a landlord should wish to commence proceedings claiming, for example, arrears of rent, then essentially the same position applies as when he wishes to issue proceedings seeking to forfeit the lease for those arrears (see immediately above).

RESORT TO A SUB-TENANT

52. Under the present law, by section 6 of the Law of Distress Amendment Act 1908 a superior landlord may require a sub-tenant (or licensee) to pay his rent direct to him in order to avoid the need to distrain on account of arrears of rent due by an intermediate tenant. The requirement to pay is made by notice. The notice transfers to the superior landlord the right to recover and give a discharge for the rent payable by the sub-tenant. It follows that where the sub-tenant pays his rent to the head landlord

in this way, he discharges his liability to pay rent to his immediate landlord, to the extent of the payment.

53. Service of such a notice takes effect as a statutory assignment of a chose in action consisting of the right to receive rent and does not amount to taking possession of the intermediate tenant's property (see Wallrock v Equity and Law [1942] 2 KB 82). As such, section 6 applies even in circumstances where the head landlord would otherwise need leave to distrain (such as where the intermediate tenant is in administration or compulsory liquidation or an individual tenant is subject to a bankruptcy order).

54. It should also be noted that a section 6 notice is still effective even if the intermediate tenant has mortgaged his term to a third party and even if a receiver has been appointed under the LPA 1925 (see Rhodes v. Allied Dunbar Pension Services [1989] 1 WLR 800).

55. Section 6 (and indeed the whole of the 1908 Act) has been repealed by the 2007 Act with effect from a date yet to be announced.

RESORT TO A GUARANTOR OR ORIGINAL TENANT

56. In general (and subject to what is set out below) none of the various insolvency procedures affect the ability of a landlord to claim against a surety or a previous tenant who is still liable. There are however a number of points to note.

57. There have been a series of cases dealing with the effect of a CVA or IVA on the liability of a surety of the debtor who has entered into the arrangement. No doubt Camilla will deal with this at length, but as the Court of Appeal have recognised in the case of Johnson v Davies [1999] Ch 117, there is nothing in principle to prevent a term in a CVA or IVA from having the effect of releasing a co-debtor or surety from liability. It is a matter of construing the individual arrangement and asking two questions:

- (i) Does the arrangement act as a release of the debt so that the creditor cannot **as a matter of law** sue the surety or co-debtor;
- (ii) Does the arrangement have an express or implied term binding the creditor not to sue the surety or co-debtor (even if as a matter of law the debt is not extinguished).

58. It is as well to draw attention also briefly to the effect of disclaimer. The IA 86 enables the trustee of an insolvent individual and the liquidator of a company to disclaim onerous property including leases (see sections 178 and following for companies and sections 315 and following for individuals). The provisions are very similar. The liquidator or trustee may, by giving 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 (see sections 178 and 315). However, disclaimer of leaseholds does not take effect unless

the liquidator has served a copy of the disclaimer (so far as he is aware of their addresses) on every person claiming under the company and either:

(a) no application for a vesting order 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 was served; or

(b) where such an application has been made, the court directs that the disclaimer is to take effect (see sections 179 and 317).

59. The effect of a disclaimer is set out in sections 178 (4) and 315 (3). A disclaimer:

(i) operates 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; but

(ii) 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.

In the case of individual insolvency a disclaimer also releases the trustee from all personal liability in respect of the property as from the commencement of his trusteeship.

60. The effect of these provisions was considered in the well known case of Hindcastle v Barbara Attenborough [1997] AC 70. Where it is the original tenant who has become insolvent and no third parties (such as guarantors or sub-tenants) are involved, the effect of the disclaimer is to put an end to the lease and with it the rights and

obligations of both landlord and tenant. Where however there are persons other than the current tenant who have liabilities in respect of the lease, the effect of the disclaimer is to release the insolvent tenant but not others who have liabilities in respect of the lease. Thus, the liabilities of guarantors, the original tenant and any intermediate assignees who have given direct covenants are unaffected by the disclaimer. These persons remain liable for rent, both past and future. In such cases although the lease is determined and the reversion accelerated, nevertheless the liabilities of guarantors, original tenants and/or intermediate assignees remain as if the lease had continued. However, if no vesting order is made, and the landlord takes possession, the liabilities of those persons will come to an end as regards all future claims, since the landlord has thereby demonstrated that he regards the lease as ended for all purposes. A landlord will be deemed to have taken possession in similar circumstances to those in which he will be held to have forfeited (see Cromwell v Godfrey [1998] 2 EGLR 62).

61. Finally in this section I will deal with the very recent House of Lords decision in Scottish & Newcastle v Raguz (No. 2) [2008] 1 WLR 2494. That case dealt with section 17 of the Landlord and Tenant Covenants Act 1995 and in particular the interrelationship between sections 17 (2) and 17 (4). These read as follows:

*“(2) The former tenant shall not be liable under ... the covenant to pay any amount in respect of any fixed charge payable under the covenant unless, within **the period of six months beginning with the date when the charge becomes due**, the landlord serves on the former tenant a notice informing him— (a) that the charge is now due; and (b) that in respect of the charge the landlord intends to*

recover from the former tenant such amount as is specified in the notice and (where payable) interest calculated on such basis as is so specified ...”

*“(4) **Where the landlord has duly served a notice under subsection (2) ... the amount (exclusive of interest) which the former tenant or (as the case may be) the guarantor is liable to pay in respect of the fixed charge in question shall not exceed the amount specified in the notice unless- (a) his liability in respect of the charge is subsequently determined to be for a greater amount, (b) the notice informed him of the possibility that that liability would be so determined, and (c) within the period of three months beginning with the date of the determination, the landlord serves on him a further notice informing him that the landlord intends to recover that greater amount from him (plus interest, where payable).**”*

The notice under section 17(2) is prescribed as form 1. Paragraph 4, which is deleted if not applicable, informs the recipient that the amount specified in the notice might subsequently be determined to be for a greater sum. The notes explain that the landlord can recover a sum larger than that specified only if para 4 is left standing and a subsequent (form 2) notice under section 17(4) is served.

62. In this case the respondent, who was the original tenant under two leases of hotel premises, sought to recover from its immediate assignee sums that it had paid to the landlord on account of the default of the current tenant. The appellant's defence was that the respondent had not been legally liable to pay all of those sums because the landlord's section 17 notices had been defective and the relevant indemnity covered only sums that had been legally recoverable.

63. The leases provided for the rent payable from each review date to be the revised rent. The rent reviews due in 1995 and 1996 were not settled until 2000 and 2001. The current tenant ceased paying rent in June 1999. Section 17(2) notices in respect of

each lease were served on the respondent at regular six-month intervals from November 1999. Prior to the settlement of the 1995 review in 2000, most of these notices merely struck out para 4. Following the settlement of each review, a notice was served that simply added in the shortfall on the new revised rent. The appellant alleged that all the notices prior to the settlement of the reviews should have left para 4 standing and that the additional reviewed rent between 1995-96 and 2000-01 was therefore irrecoverable. He argued that, for the purposes of section 17(2), an increase under a rent review is to be treated retrospectively as having become due from the commencement of the rent review period, thereby triggering the six month period during which the landlord must serve a notice on the former tenant or lose the right to claim under the covenant.

64. The trial judge and the Court of Appeal accepted this argument. They also accepted that it necessarily followed that section 17(2) notices should have been served within six months of the 1995 and 1996 review dates, even though, at that time, the tenant was not in default. This was because the reviewed rent, although unquantified, had then "become due". Section 17 did not require default, rather, it required the sum to become due and to remain unpaid. This decision was greeted with widespread alarm because it meant that whenever a rent review was overdue, landlords would need to serve a "nil" section 17(2) notice (with para 4 left standing) in order to preserve a right to recover against a former tenant should the current tenant subsequently go into default.

65. The House of Lords was unanimous in its view that this "ridiculous" conclusion with "remarkably silly consequences" could be avoided by holding that a section 17(2) notice does not have to be served unless the current tenant has defaulted. The majority thought that this should be achieved by holding that the words "the date when the charge becomes due" in section 17(2) mean the date when the landlord would have been entitled to sue for the money. The additional sums payable under a rent review clause do not "become due" until the increase has been agreed or determined. The majority (3-2) held that this means that para 4 of form 1 and form 2 are of no effect. Once a delayed rent review is settled, the additional sum is a separate fixed charge that has become due. A form 1 notice (with para 4 struck out) must then be served within six months, and there is no place for a form 2 notice. So, even where the current tenant is in default while a review is pending, the former tenant receives no warning in any section 17 notice of any potential increase it will served with a separate section 17 notice after the review is settled. As Lord Hoffmann said:

"The consequence is that section 17(4) will largely have misfired; it is hard to think of cases in which a fixed charge within the meaning of the Act will have become actually payable without its amount having been determined. It means that note 4 to the Notice Regulations , saying that it was applicable to the case of an outstanding review, was a mistake. But that consequence is better than requiring landlords to serve regular notices on former tenants saying that nothing

is owing but there is a possibility that something may become owing in the future.”

66. Landlords anyway can heave a sigh of relief.

DRAWDOWN FROM RENT DEPOSIT

67. Subject perhaps (in the case of CVAs and IVAs) to the terms of the individual arrangements, properly drafted rent deposit deeds should permit drawdown no matter which of the various insolvency procedures are adopted.

68. It is perhaps worth noting that the provisions of the Financial Collateral Arrangements (No.2) Regulations 2003 disapply the provisions of section 395 of the Companies Act 1985 and the Administration moratorium provisions in paragraphs 43 (2) and 44 of Schedule B1 to the IA 86 to “financial collateral arrangements”. Most rent deposit deeds create a charge over a sum of money belonging to the tenant in favour of the landlord to secure performance of the covenants in the lease. By my reading, these rather complex provisions means that most rent deposit deeds do not require registration and can be enforced where the company is in administration, at least where both the landlord and the tenant are limited companies (or non-natural persons).

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30TH NOVEMBER 2008

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