



Insolvency update

Yet another blow to the rescue culture: High Court rules that rent will usually rank as an administration expense

Ever since the introduction of the new administration regime, there has been fierce debate as to whether or not the flexible approach to the treatment of rent as an administration expense laid down by the Court of Appeal in the Atlantic Computers case in relation to the old administration regime, is appropriate in relation to the new administration regime. The Atlantic Computers approach provides that there is no hard and fast rule that rent should automatically be paid as an expense in an administration and that in determining whether it should be paid or not, it is appropriate to carry out a balancing exercise between the interests of the landlord on the one hand and the interests of the administration, on the other. A similar approach was adopted under the old administration regime and continues to be adopted under the new administration regime, in relation to applications for leave to take enforcement action against a company in administration, notwithstanding the statutory moratorium.

The debate has arisen because the Enterprise Act 2002 introduced a new Rule 2.67 into the Insolvency Rules defining what liabilities might properly be treated as administration expenses and the order of priority in which those expenses are to be paid. Rule 2.67 is almost identically worded to Rule 4.218, which deals with liquidation expenses and many argued that this was an indication that Parliament intended the Courts to adopt a similar approach to the treatment of administration expenses as the House of Lords had adopted to the treatment of liquidation expenses under Rule 4.218 in the Toshoku Finance case, which pre-dated the Enterprise Act 2002 changes. In that case, the House of Lords rejected the proposition that to constitute a liquidation expense within Rule 4.218, an expense had to not only fall within one of the categories within Rule 4.218 but also had to satisfy a test of having been incurred for the benefit of the insolvent estate (commonly referred to as the “Lundy Granite principle”). It held that Rule 4.218 was a definitive statement of what constituted a liquidation expense (subject to the Court’s limited discretion under section 156 Insolvency Act 1986 to re-arrange the priorities of expenses falling within Rule 4.218) and if an expense was incurred after the date of the liquidation, which fell within one of the categories within Rule 4.218, it constituted an expense and had to be paid without further ado. It held, however, that the Lundy Granite principle was relevant in the context of determining whether or not liabilities arising in relation to pre-liquidation contracts, such as leases, should be *deemed* to fall within Rule 4.218 as having been incurred for the benefit of the insolvent estate.

Exeter City Council v Bairstow & Others (2007) EWHC 400 (Ch) (often referred to as the “Trident Fashions” case) was the first application to come before the Courts dealing directly with the interpretation of Rule 2.67. The case concerned the treatment of business rates in an administration. The High Court ruled that by adopting Rule 2.67, which was in essentially the

same terms as Rule 4.218, at a time when Parliament would have been fully aware of the House of Lords' decision in Toshoku Finance, the traditional flexible approach to administration expenses as set out in Atlantic Computers was no longer appropriate and that the Toshoku Finance approach had to be adopted instead. The Judge held that rates accruing due during the administration constituted a "necessary disbursement" within paragraph (f) of Rule 2.67 therefore, applying the reasoning in the Toshoku Finance case, had to be paid as an expense of the administration. Further, this applied irrespective of whether the premises continued to be occupied during the administration or not.

Given the decision in the above case, it was only a matter of time before we were likely to see a challenge to the Atlantic Computers approach to the treatment of rent during an administration.

That challenge was finally made in the case of Goldacre (Offices) Limited v Nortel Networks UK Ltd (in administration), which was decided shortly before Christmas. As feared by Insolvency Practitioners, the High Court has, in that case, dealt a further blow to the rescue culture by determining that the Toshoku Finance approach rather than the Atlantic Computers approach should apply. It held that where the Lundy Granite principle applies (in other words, where administrators continue to retain or use any part of leased premises for the benefit of the administration), they are obliged to pay the rent due under the lease as an expense of the administration. Significantly for Insolvency Practitioners, such rent will be payable ahead of the Insolvency Practitioner's own remuneration. What is more, the administrator must pay the rent as an administration expense whether or not the landlord seeks payment or seeks to take enforcement action against the company. If the administrator does not automatically pay the rent as an administration expense, the Court has jurisdiction to make an order requiring him to do so pursuant to Rule 2.67.

The decision in this case strengthens the commercial position of landlords faced with a tenant in administration and means that when considering taking on an administration and considering the proposed strategy, Insolvency Practitioners will need to consider suitable arrangements to meet the potential ongoing liability for rent as an administration expense, which will be payable ahead of their own remuneration (an administrator's remuneration is payable under paragraph (h) of Rule 2.67). The one piece of good news for Insolvency Practitioners is that the administrator is not obliged to pay the rent immediately upon it falling due, if the administrator does not have sufficient funds to do so. There is no right on the part of the landlord to immediate payment.

As to the circumstances in which the Lundy Granite principle will apply, pending further case law, we only have the cases dealing with the application of the Lundy Granite principle to liquidations as guidance. These cases demonstrate that the principle will apply where the administrator retains property for the purpose of advantageously disposing of it as well as where he continues to use the premises for the benefit of the estate. This is almost certainly likely to cover situations where an administrator continues to trade the business from the premises, decides to market the business and assets, including the lease or allows a purchaser of the business and assets of the insolvent company into occupation of the premises under a licence to occupy. However, where the administrator closes down the business, has the company's plant and machinery valued and is in the process of deciding upon what he should do going forward, it appears that the rent will only be payable as an administration expense from the time the administrator decides (if he does so) to put the lease on the market.

It is clear from the liquidation cases that where a liquidator serves notice of disclaimer of the lease on the landlord, even where the company remains in occupation for some time after service of the notice, the rent accruing following service of the notice will not be payable as a

liquidation expense. However, the disclaimer option is not available to an administrator and it remains to be seen whether offering to surrender the lease will have the same effect or whether, in order for the Lundy Granite principle to cease to apply, the administrator will have to completely vacate the premises, including removing any plant and machinery.

There is no doubt that this decision comes as a further blow to the rescue culture. The decision could lead to more companies being placed into liquidation (not least to enable the lease to be disclaimed in appropriate cases) and secured lenders might be discouraged from funding a rescue through administration if they are concerned that the payment of rent, as a priority claim, will deplete the floating charge realisations. Further, it might be more difficult to find an Insolvency Practitioner who is willing to take an appointment in circumstances where it is not clear whether the company will have sufficient assets to pay all of the administration expenses, including the administrator's own remuneration (although as the Court noted in the Trident Fashions case, the Court does have power to alter the order of priorities set out in Rule 2.67 if the assets do turn out to be insufficient to meet all the expenses). Following the Trident Fashions case, the Government acted to reverse the potentially damaging effects of the decision in that case by introducing an exemption from rates for companies in administration and it remains to be seen what, if any, action is taken to mitigate the effects of the decision in this case.

Should you require further information on the case please view the pdf entitled 'Goldacre (Offices) Limited v Nortel Networks UK Ltd (in administration)' within the Insolvency section of our publications page.

Contact us

If you have any queries on the case or require advice as to how the case is likely to affect any administration that you are dealing with or are proposing to deal with, please do not hesitate to contact:

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