

## Understanding Tenant Insolvency

As the credit crunch enters its next phase, landlords are increasingly affected by tenant insolvency.

Where a solvent tenant has failed to pay rent the landlord has many remedies e.g. distrain for rent against goods at the premises, issue court proceedings for recovery of rent or forfeit the lease. However, if the tenant's failure to pay rent is due to insolvency, or the serious risk of the tenant becoming insolvent, then a landlord may be restricted by insolvency laws.

Landlords need to be aware of relevant insolvency law and the effect of this on their ability to pursue an insolvent tenant for arrears. The Insolvency Act 1986, as amended by the Insolvency Act 2000, and the Enterprise Act 2002 set out a number of insolvency regimes.

### **/1. Administration**

Administration is predominately seen as a rescue framework for companies, although there can be other purposes for an administration. Once the administrator has been appointed (usually by the directors of the company), a moratorium comes into effect. The moratorium on enforcement action by creditors means that a landlord has to obtain the consent of the court or the administrator prior to distraining for rent, forfeiting the lease, issuing/continuing court proceedings or taking any steps to enforce security (for example with drawing monies from a rent deposit). The steps that a landlord may take are, therefore, severely limited.

Much attention has been given recently to 'pre-pack' administrations – the Insolvency Service predicts around 100 per month in 2009. A pre-pack administration is where a new buyer for the company (shorn of its debts and liabilities) is lined up before the administrators are appointed and the role of the administrator is little more than to transfer the business to the new buyer. Landlords (and creditors in general) have been concerned about pre-pack administrations because the new buyer is often related to the old insolvent company. The lack of transparency on such administrations has obliged the government to consider reviewing this type of arrangement.

### **/2. Company Voluntary Arrangements (CVAs)**

This is an agreement between a company, its shareholders and its creditors which involves delayed or reduced debt payments or capital restructuring if approved by the majority (in some cases of 75%) of those voting. Many small companies will file for a CVA moratorium on creditor proceedings. The moratorium normally lasts for 28 days but can be extended. If the tenant has obtained a CVA moratorium, then the landlord must have the permission of the court before taking any enforcement action. ACVA can cover future payments due by the tenant (including rent).

A landlord will be bound by the terms of a CVA even if they did not vote in favour of the CVA. It is important that a landlord attends any creditors' meeting to have a say in the terms of the CVA.

### **/3. Receivership**

This is a creditor's remedy. An administrative receiver is a receiver of the company's assets and is appointed by or on behalf of any debenture holder of the company. The Enterprise Act 2002 abolished administrative receivers save for charges dated before 15 September 2003. A receiver can continue to be appointed in relation to a property under a charge under the Law of Property Act 1925 ("LPA receiver"). The appointment of an administrative receiver or LPA receiver does not effect the landlord's right to distrain for rent, sue for rent or forfeit the lease. Any of these enforcement actions may be taken without the consent of the court or the receiver and provide the landlord with greater flexibility than when a tenant is in administration.

### **/4. Liquidation/Winding Up**

In the event that a corporate rescue is not possible, an insolvent company may be placed into liquidation and its assets sold. Liquidation often follows receivership or administration. The liquidator distributes the proceeds of sale in a defined order of priority. During a tenant's voluntary winding up, the landlord may generally distrain for rent, sue for rent or forfeit the lease without leave of the court. However, a creditor or liquidator may apply to the court for an order to restrain any action, including court actions for non payment of rent. If there is a compulsory winding up, the leave of the court is usually required for any enforcement action. The liquidator may also disclaim or terminate liabilities, including the tenant's interest, rights and liabilities under the lease.

A landlord needs to consider the type of insolvency affecting the tenant before deciding what action to take in relation to any rent arrears or other liability of the tenant under the lease (including future losses). The potential remedies, factors and outcomes differ for each type of insolvency and each particular tenant company. There are many actions to consider when a landlord decides how to proceed when a tenant becomes insolvent. Given the recent reduction in empty rates relief (even with the recent changes), a landlord may not want to take back possession of the property as it will trigger the landlord's liability for payment of rates. To ensure they are in the best position, a landlord should monitor the financial performance of their tenants closely. The earlier a landlord spots their tenant is in financial difficulties the longer they will have to decide how to best protect their position and the better the outcome is likely to be for the landlord.

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