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Feature | Insolvency

The Court of Appeal's decision in a recent case makes clearer the path a landlord can take in bringing proceedings against companies in administration on lease breaching. Adam Plainer explains

BEHIND WITH THE RENT

The recent decision by the Court of Appeal in the matter of *Innovate Logistics (in administration) v Sunberry Properties* offers useful guidance on the likely approach of the courts when considering applications by landlords for permission to bring proceedings against companies in administration to terminate occupational licences granted in breach of a lease. This is a topical issue as the grant of such licences to third-party purchasers is often an important and necessary component of pre-pack administrations.

The facts

Innovate operated a business storing and distributing frozen and chilled foods. Sunberry was Innovate's immediate landlord in respect of a leasehold facility at Holmewood in Derbyshire, pursuant to a lease which contained a covenant against assignment and parting with possession or occupation of the whole or part of the property.

Innovate became insolvent on a cash flow and balance sheet basis and could not meet the quarterly basic rent instalment. Administrators were duly appointed on 30 June, 2008.

At the same time, the administrators entered into an agreement with Yearsley Holmewood for the sale as a going concern of the storage and distribution business to ensure the continuity of Innovate's business. The lease of the property was not included in the sale. Rather, Yearsley was granted a six-month occupational licence of the property. Pursuant to the terms of that licence, Yearsley agreed to pay to Innovate monthly payments equal to one month's passing rent under the lease. In turn the administrators agreed to pass on to Sunberry the sums paid by Yearsley in respect of its occupation.

Sunberry objected to Yearsley's occupation and requested that the administrators either brought the arrangements with Yearsley to an end or consented to Sunberry issuing proceedings against Innovate and Yearsley for a mandatory order terminating the licence. The administrators refused to comply and Sunberry therefore applied to the Birmingham District Registry under paragraph 43(6) of Schedule B1 to the Insolvency Act [1986] for permission to bring proceedings against Innovate for the mandatory order terminating the licence.

Decision at First Instance – 15 July, 2008

The judge recognised that the grant of permission was at the discretion of the court and that general guidance on the balancing exercise to be conducted between the legitimate interests of the landlord and company creditors had been given by the Court of Appeal in *Re Atlantic Computer Systems*. The judge decided that it was not necessary to conduct this balancing exercise given that the purpose of the administration had been achieved on the sale to Yearsley and that the administrators had caused Innovate to breach the alienation provisions in the lease. On this basis, the judge granted Sunberry permission to bring proceedings against Innovate for a mandatory order terminating the licence arrangements with Yearsley.

Court of Appeal – 1 August, 2008

Innovate appealed that decision arguing that the purpose of the administration had not been achieved given that the book debts relating to the storage and distribution of the customer products had not been realised. It was submitted that the judge had wrongly concluded that he was not required to carry out the balancing exercise described in *Re Atlantic Computers* and that a breach of the alienation provisions in the lease did not itself operate to displace the discretion of the court. Rather, it was simply a factor to be taken into account in

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conducting the necessary balancing exercise.

The Court of Appeal was invited to exercise that discretion afresh and to take account of the fact that: (i) an immediate termination of Yearsley's occupational licence would put in jeopardy the ability of the administrators to collect in the book debts; (ii) as a matter of commercial necessity and urgency the administrators had had no option but to grant an occupational licence; and (iii) the licence was for a temporary period only during which time Sunberry would receive monthly payments equal to the passing rent (during which it would have received nothing from Innovate had the licence not been granted).

On behalf of Sunberry, it was submitted either that the situation fell outside the balancing exercise described in the guidance in Re Atlantic Computers or that, in exercising that discretion, the court should attach significant weight to the fact that a refusal to grant permission to commence proceedings would lead to a confiscation of Sunberry's proprietary rights to enforce material terms of the lease and to a loss of its bargaining position with Yearsley. On this latter point, it was submitted that Sunberry wished to protect and exploit its ability to negotiate with and persuade Yearsley, by means of the proceedings or the threat of them, to regularise its unlawful occupation of the property. It was argued that it was wrong for the administrators to withhold permission for the proposed proceedings in order to afford Yearsley a bargaining counter against Sunberry and to protect it from the consequences of its unlawful act.

The Court of Appeal held that the judge had been wrong to conclude that the purpose of the administration had been achieved. Innovate had outstanding and substantial book debts and one of the objectives of the administrators was to collect them for the benefit of the creditors. In order to achieve that objective it was essential for Yearsley to occupy the property and so take over and perform Innovate's contracts.

It was also held that the court was to have regard to the consequences of the administration and of the order sought for the persons affected by them. In other words, the court was to follow the guidance described in *Re Atlantic Computers* and the judge was wrong not to have done so.

In conducting the necessary balancing exercise, the Court of Appeal found that:

1. If Sunberry were permitted to bring proceedings for a mandatory injunction, that would have the effect of preventing Innovate and Yearsley from continuing to perform the outstanding contracts, making it likely that the collection of Innovate's debts would be substantially prejudiced with consequential loss to the creditors.
2. It was obvious from the fact that Sunberry was not seeking to exercise its right of forfeiture that the rent payable under the lease was higher than the current market rent. It followed that Sunberry had benefited from the making of the administration order, together with the agreement of the administrators to pay to Sunberry the licence fees paid by Yearsley at the same rate as the rent payable under the lease, as against what it would have received if Innovate had gone into liquidation.
3. The loss of the bargaining position of which Sunberry complained consisted of the threat of the mandatory injunction requiring Innovate to terminate Yearsley's licence and it was clear that Sunberry's objective was to obtain an agreement under which Yearsley would take an assignment or a new lease on terms that would be more beneficial to Sunberry than could be obtained on the open market. Accordingly, the Court of Appeal doubted whether the loss of such a bargaining position was a relevant consideration. It was therefore held that, where Sunberry contended that it was indisputably entitled to an injunction if it was permitted to bring proceedings, the court's principal focus must be on the consequences of the grant of that injunction rather than on what Sunberry might obtain by the threat of those proceedings.

The Court of Appeal therefore held that the result was in favour of refusing permission when weighing the potential or likely loss to Innovate's creditors if permission was given and an injunction granted as against the loss to Sunberry resulting from refusing permission. Accordingly, the appeal by Innovate was allowed and Sunberry's application for permission to commence the proposed proceedings to terminate the licence was dismissed.

Approach of the courts

The striking feature of this case was that Sunberry did not apply for permission to forfeit the lease but to bring proceedings for a mandatory injunction requiring a termination of the licence arrangements granted by the administrators of Innovate. In doing so, the Court of Appeal recognised that Sunberry were looking to use the threat of those proceedings to negotiate with Yearsley lease terms which were more advantageous to Sunberry than could be achieved on the open market and that it was the loss of the bargaining position in this regard that was objected to by Sunberry. The Court of Appeal was not impressed with the force of this argument and made it clear that, in relation to requests for permission, the loss of such a bargaining position will not in itself be sufficient to either avoid the application of the guidelines set out in *Re Atlantic Computers* or to satisfy the court that, on any such application, the prejudice suffered by the landlord is a relevant consideration to be taken into account.

The courts will always consider carefully any contractual breaches caused by administrators. However, in circumstances where the grant of a prohibited licence is temporary, is necessary for the purposes of the administration and is on terms such that the licence fee is to be handed over by the administrators to the landlord, the decision in *Re Innovate* indicates that the courts are likely to view applications by landlords for immediate restoration of their proprietary rights with some degree of caution. In the context of pre-pack administrations, this is welcome news.

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