

Handling insolvent tenants

Q&A Emma Humphrey and James Pickering address the landlord's position

CAN I RE-LEASE THE UNIT TO A NEW TENANT?

QUESTION

One of my tenants has a 15-year lease but has been struggling to pay the rent for the past year. I received the keys to the premises from him this morning, with a note saying that he can no longer continue to trade and has been declared bankrupt. As a potential new tenant has already expressed interest, I am quite keen to cut my losses and re-let the unit. Can I proceed to negotiate a new lease?

ANSWER

It could be risky in these circumstances. You should undertake some checks to explore whether the tenant may have created any third party interests in the premises, eg a charge or underlease. Then you can consider whether you would prefer to approach the trustee-in-bankruptcy about a formal surrender or a disclaimer, or to seek to forfeit the lease.

CAN I FORFEIT DESPITE ADMINISTRATION PAY?

QUESTION

I am a landlord of commercial premises. My tenant is in administration and I am receiving rent as an expense of the administration. I am aware of the moratorium which applies to companies in administration but would like to forfeit the lease as I believe I can find a new tenant who will pay a higher rent. Would an application for forfeiture have any chance of success?

ANSWER

Perhaps. You would need to show that: (1) the forfeiture would not impede the purposes of administration; or (2) if the forfeiture would impede the purpose of the administration, that the balance between your interests and those of the tenant's creditors lies in your favour.

EXPLANATION

Obtaining better paperwork to confirm the end of the tenancy should help ensure that you can address any concerns raised by those advising the potential new tenant.

One option is to agree a more formal deed of surrender with the tenant's trustee-in-bankruptcy, although this will probably involve costs and could take time. Alternatively, you could serve notice on the trustee-in-bankruptcy to require him/her to decide whether to disclaim the lease (see section 315 of the Insolvency Act 1986). Once notice is served, the trustee has 28 days to decide and any disclaimer will end your tenant's rights in the property.

However, as with a surrender, the rights of any third parties such as subtenants and mortgagees will continue (*Hindcastle Ltd v Barbara Attenborough Associates Ltd and others* [1996] 1 EGLR 94) and can be complicated to deal with. You should check the tenant's title for such interests before you proceed.

EXPLANATION

In *Re SSRL Realisations Ltd (in administration); Lazari Investments Ltd v Saville and others* [2015] EWHC 2590 (Ch); [2015] PLSCS 268, the landlord applied to forfeit a lease of premises it had granted to its tenant, part of a well-known restaurant chain. The tenant went into administration and the administrators applied to assign the lease – which had 16 years remaining – to a subsidiary of the tenant. The landlord refused on the basis that, among other things, the proposed assignee was not of sufficient financial standing.

During the course of the proceedings the administrators put forward evidence that another company, X, had offered to acquire the lease for a premium of £250,000, thereby demonstrating that the lease had significant value. In response, the landlord said X had since confirmed that the lease was unsuitable as, at the time it made the offer, X had been unaware that the landlord had terminated an outdoor seating licence.

In determining the matter, the court applied the principles in *Re Atlantic Computer Systems plc* [1992] Ch 505,

One route for determining the tenancy which will also end any third party interests is forfeiture. Any forfeiture based on bankruptcy would need to be preceded by service of a notice under section 146 of the Law of Property Act 1925. However, no such notice should be needed if your tenant owes rent arrears. Whether or not notice is required, the Court of Appeal confirmed in *Places for People Homes Ltd v Sharples; A2 Dominion Homes Ltd v Godfrey* [2011] EWCA Civ 813; [2011] PLSCS 194 that the moratorium on actions against an undischarged bankrupt (see section 285(3)(b) of the Insolvency Act 1986) does not extend to forfeiture action. Therefore, assuming the premises are vacant, you may be able to forfeit through peaceable re-entry.

Although this is usually quick and cost-effective, be aware that the Land Registry is unlikely to close the title for some months because of the tenant's right to apply for relief and this could be a concern to your incoming tenant.

considering (1) whether forfeiture would impede the purposes of administration, and (2) if so, where the balance lay between the landlord's interest and those of the tenant's creditors. While the lease had some potential premium value, the administrators were unable to unlock that value due to the landlord's exercise of its rights, including termination of the outdoor seating licence.

Further, the likely level of any premium was modest in the context of an administration where there was an estimated shortfall of £11m such that it could not be said that its lack of recoverability would impede the purpose of administration.

As for balancing the landlord's legitimate interests with those of the creditors, it was noted that, while the landlord had been receiving rent, it had nevertheless lost the opportunity to lease the property to a new tenant on terms which would have been financially advantageous. This being the case, the landlord was granted permission to forfeit.

While each case will turn on its own particular facts, SSRL offers commercial landlords some comfort.