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In Practice

Authors Jason Sheard and Kirsty Hunter

Goldacre revisited – all change following *Luminar*?

KEY POINTS

- Where rent under a lease is payable in advance and falls due prior to the appointment of administrators of a tenant, it is not payable as an expense of the administration.
- Where rent is payable quarterly in advance and becomes due whilst the administrators are using premises (for the purposes of the administration) the rent (for the whole quarter period) is payable as an expense of the administration.
- Where a lease provides for a tenant to pay rent in arrears and the rent falls due (whilst the administrators are using premises for the purposes of the administration) it is established that rent (relating to the period after the appointment of the administrators of the tenant) is payable as an expense. There is, however, some uncertainty as to whether a landlord may claim the proportion of rent (relating to the period prior to the appointment of the administrators) as an expense.

The treatment of rent as an administration expense has once again been the subject of a High Court ruling in the recent *Luminar* case (*Leisure Norwich (II) Ltd & others v Luminar Lava Ignite Ltd (in administration) & others* [2012] EWHC 951 (Ch)).

THE FACTS

Administrators were appointed in October 2011 over a number of companies owned by the Luminar Group which operated a number of nightclubs and (up until its companies entered administration) was one of the largest nightclub operators in the UK. At the time of the administrators' appointment, the rent (for the 29 September 2011 quarter) was in arrears.

The administrators continued to trade from the premises whilst it marketed the business and assets for sale but were not in a position to pay the outstanding rent. On 1 December 2011 the landlord ("Leisure") sought permission to forfeit the leases. The statutory moratorium imposed by para 43(4) of Sch B1 to the Insolvency Act 1986 prevented Leisure from exercising its right to forfeit the leases (by peaceable re-entry or bringing other proceedings to do so) against the tenants (who were in administration) without first obtaining the consent of the administrators or the permission of the court. The administrators initially refused to grant their consent.

ISSUES

Leisure argued that:

- the rent due on 29 September 2011 (even though the administrators were appointed in December 2011) should be payable as an expense of the administration; and
- where a landlord seeks to forfeit a lease after the appointment of administrators (and permission is refused) the rent that is unpaid should become payable as an expense (irrespective of when the sums were due) if such sums relate to a period when the administrators are occupying the premises.

The administrators contended that the earlier judgment of *Goldacre* (*Goldacre (Offices) Ltd v Nortel Networks UK Ltd (in administration)* [2009] EWHC 3389 (Ch)) did not apply to rent payable in advance which had fallen due prior to the appointment of administrators. The administrators concluded that rent is only payable as an expense of the administration if:

- it falls due after the administration has commenced; and
- the administrators are using the premises for the purposes of the administration.

DECISION

The court agreed with the administrators. The "*Lundy Granite Principle*" established that if an insolvent company retains or uses a third party's asset for the benefit of the company's creditors, then the company should pay for that use in full from the proceeds of the realisation of its assets. In *Luminar*, however, Leisure sought to rely specifically on the case of *Silkstone* (*Re Silkstone & Dodsworth Coal & Iron Co* [1881] 17 Ch D 158) which held that rent payable in arrears which fell due for payment during a liquidation was an expense (despite the fact that such sums related to a period of time before the relevant company entered liquidation). However, in *Luminar*, the court held that this principle did not extend to debts which were already due at the commencement of an administration (as in the *Luminar* case) and therefore *Silkstone* did not apply.

The court deemed it appropriate to apply *Goldacre* and was not prepared to extend the administrators' liability for the 29 September 2011 quarter rent, which, whilst payable in advance, fell due before the appointment of the administrators. Consequentially, it held that:

In Practice

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- the rent was only a provable unsecured claim for the landlord which did not rank for priority payment; and
- only rent that falls due during an administration period is payable as an expense of the administration.

A distinction can be drawn between the facts of *Goldacre* and *Luminar* in that whilst both related to a period during which administrators were using premises:

- *Goldacre* related to rent that fell due for payment during the administration period; and
- *Luminar* related to rent falling due before the appointment of the administrators.

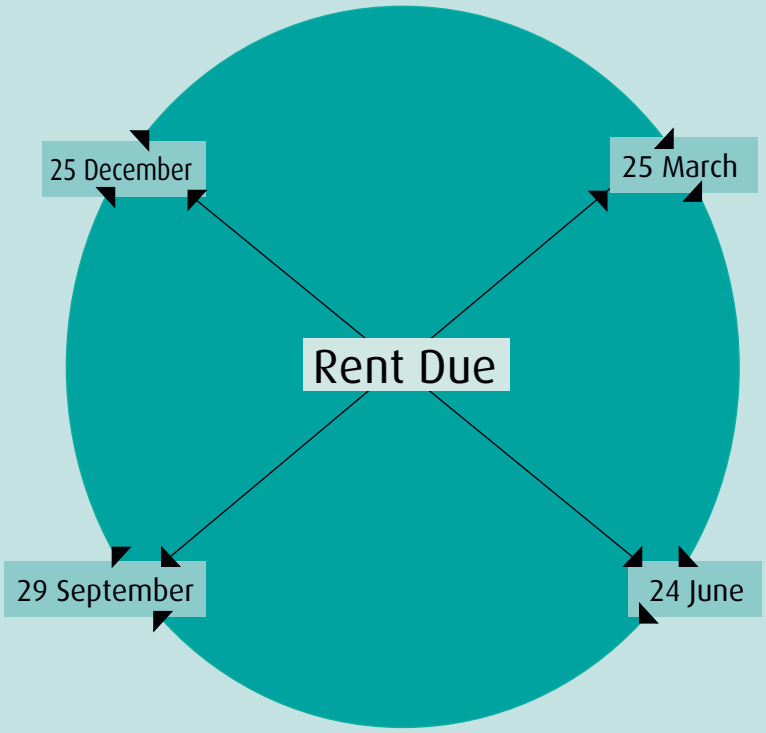
It is clear that only the first scenario results in rent being payable as an expense.

WHAT DOES "USING A PROPERTY FOR THE PURPOSE OF THE ADMINISTRATION" ACTUALLY MEAN?

Whilst this point was not specifically addressed in *Goldacre* or *Luminar*, it is an important issue which may ultimately determine whether rent is considered as an expense. Administrators should be wary of inadvertently "using" premises during the administration period (even if they have vacated them) – in particular, the following may constitute "use" of premises:

- allowing a purchaser of the tenant's business or another third party to occupy on a licence basis (or other short term arrangement);
- storing or keeping assets, equipment, records or chattels at premises;
- actively marketing premises for sale, although simply permitting the lease to continue (without occupation) should not amount to "use"; or
- partial occupation of premises.

Figure 1



While the administrators must derive some sort of benefit (for the creditors) by their use of the premises, the safest course of action (when vacating premises) would be for them to ensure that all records, furniture and equipment are completely removed. This should defeat any assertion by a landlord that the administrators are using the premises for the purposes of the administration.

WHAT IS THE POSITION INCURRING RENT PAYABLE IN ARREARS?

Whilst most leases provide for the payment of rent in advance, in some circumstances (and particularly for older leases), rent may be payable in arrears. There is some uncertainty as to how such rent (which falls due during the administration period but relates, in part, to a period prior to the administration period) should be treated. While the judge in *Silkstone* (as mentioned above) held that the whole rent (which was payable in arrears) was an expense, the court in *Luminar* (albeit *obiter*) suggested that the same conclusion (if applying the facts of *Silkstone*) may not necessarily be reached by a court today. This leaves a degree of uncertainty as to whether pre-administration rent (which is payable in arrears) would rank as an expense.

WHAT DOES IT MEAN IN PRACTICE?

The *Luminar* decision (which followed the principles laid down in *Goldacre*) indicates that the timing of appointment of administrators is crucial in determining expense liability.

Figure 1 shows the typical cycle of rent quarter days under a lease (where rent is payable quarterly in advance during the term).

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Figure 2

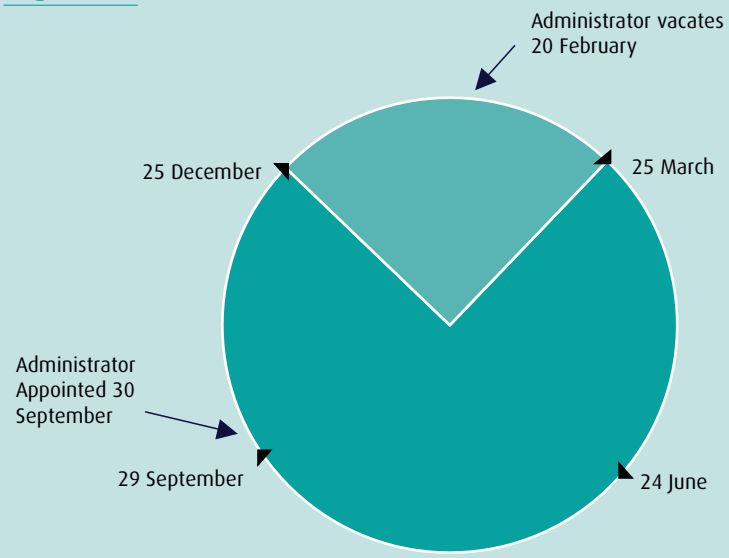
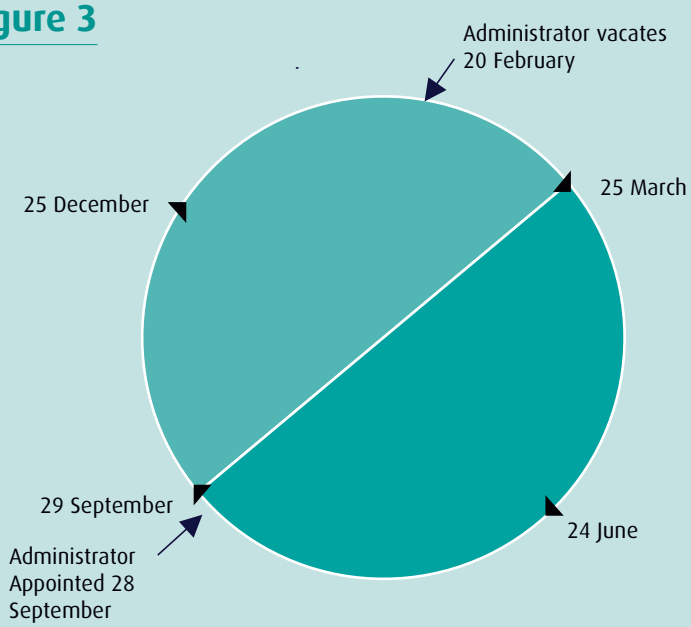


Figure 3



Figures 2 and 3 above demonstrate how the timing of the appointment of an administrator can impact on liability for rent.

In the example shown in Figure 2, the administrators are appointed on 30 September, the day after the 29 September quarter day. The period of time for which rent would be (applying *Goldacre*) reimbursable as an expense is shown hatched blue. Only the 25 December quarter rent (which becomes due during the administration period) and not the 29 September quarter rent is caught as an expense. Equally, if administrators choose to vacate premises on 20 February, the whole of the 25 December quarter rent (despite the fact that the administrators were no longer using the premises) would still be treated as an expense. The key factor to note here is actual use (of the premises) by administrators when the rental payment falls due, not occupation and use for the whole period itself.

In the example shown in Figure 3, administrators are appointed on the 28 September, the day before the 29 September quarter day. Here the whole 29 September quarter rent would be an expense in addition to the period detailed in Figure 2.

CONCLUSIONS

While not ground breaking in itself, *Luminar* is, if nothing else, a timely reminder of the decision in *Goldacre*. It is clear that the timing of the appointment of administrators can impact immensely on both landlords and administrators. The recent administration of The Game Group plc (where the administrators were appointed on 26 March 2012 (the day after the 25 March 2012 quarter day) is a clear example of how *Goldacre* can be utilised to limit administrators' exposure to rent. If timed correctly (as with *Game*) administrators can secure the benefit of a substantial rent-free period (of up to three months in which to dispose of the business or otherwise vacate leasehold premises).

While this provides useful breathing space for administrators (especially where funds are unavailable to meet rental payments) landlords are often left out of pocket.

A much fairer system would be for administrators to be obliged to pay rent as an expense only in respect of the period for which they are using the premises for the purposes of the administration. Perhaps, in order to create a level playing field, *Goldacre* should be re-visited after all? ■