

**ADMINISTRATION**  
**- A PRACTITIONER'S VIEW**  
**- LIFE AFTER *INNOVATE***

*by*

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1. Before turning to the detailed facts of Innovate Logistics Ltd (In Administration) v Sunberry Properties Ltd [2009] BCC 164 it is worth reminding ourselves of the relevant statutory background. It is necessary to set the landlord and tenant relationship within the framework of administration.
  
2. The starting point in the relationship between a tenant's administrator and its landlord is unlikely to be a happy one. The administrator will probably be appointed against a background of pre-existing debt and default, both in terms of the tenant's compliance with its obligations under its lease and in terms of breaches of other contracts it has entered. The court may make an administration order in relation to a company *only* if satisfied that the company is or is likely to become unable to pay its debts<sup>1</sup>.
  
3. In order to appoint an administrator, the court must also be satisfied that the administration order is reasonably likely to achieve the "purpose" of the administration<sup>2</sup>. That "purpose" must be either to:
  - a. rescue the company as a going concern, or
  - b. achieve a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or
  - c. realise property in order to make a distribution to one or more secured or preferential creditors<sup>3</sup>.

Depending upon the "purpose" in any particular case, the landlord may or may not be appeased by the appointment. Whatever the landlord's views might be as to the benefit of any future relationship with the tenant if it is "rescued" as a going concern, it is highly unlikely that the landlord would benefit from the appointment

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<sup>1</sup> Schedule B1 to the Insolvency Act 1986 (as amended), Paragraph 11(a)

<sup>2</sup> Paragraph 11(b)

<sup>3</sup> Paragraph 3(1)

if the “purpose” of the administration is to realise property for a secured or preferential creditor, for example.

4. During the administration the administrator also has sweeping statutory powers that he may exercise. In achieving the “purpose” of the administration, the administrator may do anything necessary or expedient for the management of the affairs, business and property of the company<sup>4</sup>. In terms of the landlord and tenant relationship, these powers include<sup>5</sup>:
  - a. Power to take possession of, collect and get in the property of the company.
  - b. Power to sell or otherwise dispose of the property of the company by public auction or private contract.
  - c. Power to appoint any agent to do any business which he is unable to do himself or which can more conveniently be done by an agent.
  - d. Power to do all such things (including the carrying out of works) as may be necessary for the realisation of the property of the company.
  - e. Power to make any payment which is necessary or incidental to the performance of his functions.
  - f. Power to carry on the business of the company.
  - g. Power to do all other things incidental to the exercise of the foregoing powers.
  
5. Then, most materially from a landlord’s point of view, there is the impact of the statutory moratorium to consider<sup>6</sup>. Paragraph 43 of Schedule B1 to the Insolvency Act (as amended) provides, amongst other matters, that once the administrator has been appointed:

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<sup>4</sup> Paragraph 59(1)

<sup>5</sup> Paragraph 60 and Schedule 1

<sup>6</sup> It is important to remember however that the moratorium does not affect substantive rights. It acts to postpone their enforcement: Barclays Mercantile Business Finance Ltd v Sibec Developments Ltd [1992] 1 WLR 1253, per Millett J.

“(2) No step may be taken to enforce security over the company’s property except –

- (a) with the consent of the administrator, or
- (b) with the permission of the court.

(4) A landlord<sup>7</sup> may not exercise a right of forfeiture by peaceable re-entry in relation to premises let to the company except –

- (a) with the consent of the administrator, or
- (b) with the permission of the court.

(6) No legal process (including legal proceedings, execution, distress and diligence) may be instituted or continued against the company or property of the company except –

- (a) with the consent of the administrator, or
- (b) with the permission of the court.

(7) Where the court gives permission for a transaction under this paragraph it may impose a condition on or a requirement in connection with the transaction.”

6. This moratorium or statutory freeze is at the heart of the administration procedure. It is derived from the former s 11 of the 1986 Act<sup>8</sup>.

7. As a result, if the tenant was in breach of any covenant in its lease before the administration, or breaches any covenant of the lease during the administration,

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<sup>7</sup> It is provided at paragraph 43(8) that for the purposes of paragraph 43 “landlord” includes a person to whom rent is payable.

<sup>8</sup> Paragraph 43(4), which prevents a landlord from exercising a right of forfeiture by peaceable re-entry, was added later in 2003.

the landlord will be unable to enforce its substantive rights against the tenant without first applying for the permission of the administrator or the court under paragraph 43 of Schedule B1 to the Insolvency Act 1986.

8. In the event that the administrator refuses consent, and the landlord applies to court, the relevant guidelines to be applied by the court in considering whether or not it will grant permission are set out in In Re Atlantic Computer Systems Plc [1992] at pp 542C-544C. The Court of Appeal's guidance was given in relation to the application of s 11, but are equally applicable to paragraph 43 of Schedule B1<sup>9</sup>. The guidelines are that:
1. the applicant for lifting the stay carries the burden of proof;
  2. the stay is intended to assist the company under the management of the administrator to achieve the purpose for which the administration order was made;
  3. if granting leave to a landlord of land or the hirer of goods to exercise his proprietary rights and repossess his land or goods is unlikely to impede the achievement of that purpose, leave should normally be given;
  4. in other cases, when a landlord seeks possession, the court has to carry out a balancing exercise, balancing the legitimate interest of the landlord and the legitimate interest of the other creditors of the company;
  5. in carrying out the balancing exercise, great importance, or weight, is normally given to the proprietary interest of the landlord;
  6. the underlying principle being that an administration for the benefit of unsecured creditors should not be conducted at the expense of those who have proprietary rights which they are seeking to exercise save to the extent that this may be unavoidable, and even then this will usually be acceptable only to a strictly limited extent; and
  7. it will normally be a sufficient ground for the grant of leave if significant loss will be caused to the landlord by a refusal to grant leave.

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<sup>9</sup> See Innovate v Sunberry below.

9. A landlord is most likely to have to assess the likely impact of these guidelines when it wishes to forfeit the lease on account of a breach of covenant either before or during the administration or when it wishes to seek injunctive relief against its tenant.

### **Innovate Logistics Limited (In Administration) v Sunberry Properties Ltd**

10. The importance of Innovate Logistics Limited (In Administration) v Sunberry Properties Ltd lies in the Court of Appeal's approach to the application of the guidelines set out in In Re Atlantic Computer Systems Plc. I consider that the fundamental messages to be taken from the decision are that:
  - a. what may seem scandalous from a landlord's personal point of view may well be reasonable when viewed in terms of the wider "purposes" of the administration as a whole;
  - b. it is vitally important to identify and assess the relationship between the "purpose" of the administration and the impact of the proceedings that the landlord wishes to commence before making an application to the court;
  - c. the test to be applied by the court in considering an application for permission is entirely fact specific. Each case must be assessed on its own individual facts and merits.
  
11. I appeared in Innovate in the Court of Appeal as junior counsel (with Simon Mortimore QC and Blair Leahy), for the successful appellant tenant company Innovate (in administration). We were instructed by its administrators. The facts of the case provide a perfect example of how administrators may well act during an administration, of how landlords may feel as a result, and of the Court of Appeal's commercial approach to the "bigger picture" that property litigators face in making or opposing applications under the Insolvency Act 1986.

### ***The Facts***

12. Innovate was a logistics provider, offering supply chain solutions to customers: delivery and storage of customers' goods. Its business, conducted from several sites, including leasehold properties, primarily concerned the storage and distribution of food for customers. The frozen food side of the business was very substantial.
13. The subject premises were a cold store measuring 8.28 acres or thereabouts. It had the capacity to store frozen food awaiting distribution worth £20-£25 million on about 25,000 pallets.
14. Innovate held the premises under a lease dated 18 December 1998 (the "Lease") for a term expiring on 24 December 2028 at a basic passing rent of £1,225,530 per annum, payable quarterly in advance on the usual quarter days, subject to upward only rent reviews every five years, plus insurance rent and the payment of all rates and outgoings. The Lease was on full repairing and insuring terms.
15. The proviso for re-entry provided that the Lease may be forfeited (amongst other matters) if the rents reserved or any part of the rents reserved shall be unpaid for 21 days after becoming payable; any of the tenant's covenants shall not be performed or observed; or the directors of the tenant resolve to present a petition for an administration order in respect of the tenant.
16. The Lease included a comprehensive alienation covenant:

"Not to assign or charge any part of the Demised Premises (as distinct from the whole) nor part with or share possession or occupation of the whole or any part of the Demised Premises save as permitted by clause 3.19.5 [a group company sharing provision]"

This was an absolute covenant. Not qualified by any provision enabling any such arrangement to be put in place subject to landlord's consent, or on the basis that landlord's consent to such an arrangement was not to be unreasonably withheld.

17. As at 31 March 2008 there was an estimated deficiency against unsecured creditors of between about £14 million and £21.5 million depending on whether Innovate's book debts could be recovered in their full value. If they could be, the secured creditor would be paid in full and there would be a surplus for unsecured creditors. There was no prospect that Innovate could be rescued as a going concern [purpose a. at paragraph above]. There was however a real prospect that an administration would achieve "a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration)" [purpose b. at paragraph 3 above].
18. There were two main reasons for this. The first reason was that if Innovate went into liquidation it would be unable to fulfil its outstanding contracts for customers who owed it substantial debts. Customers would have to make urgent alternative arrangements to protect, store and deliver their goods. The costs of this would be passed on to the company and the amount of debts that could be recovered would be seriously reduced to the prejudice of the secured and unsecured creditors. On the other hand if Innovate's business could be sold as a going concern, so that as far as customers were concerned business continued as normal, there was a good prospect that all or substantially all the company's debts would be recovered. As at 30 June 2008 Innovate's book debts owed by more than about 400 customers amounted to £12m.
19. The second reason was that a going concern sale should lead to better prices for Innovate's assets. It would also lead to reduced creditor claims, since many ongoing contracts, including employment, HP and equipment lease contracts, would be taken on by the purchaser. Reduced creditor claims would of course produce a better result for the remaining creditors.

20. Against this background, on 1 July 2008, the same day as the administration order was made, the administrators sold Innovate's business to a third party company, YHL. As a term of the contract, YHL undertook to perform and discharge, among others, the customer contracts placed with the business as agents for Innovate. The administrators would collect the secured debts as agents for the secured creditor and YHL would provide all reasonable assistance to the administrators in the collection of debts.
21. The Lease of the premises was excluded from the sale. However, as part of the transaction, Innovate granted YHL a licence to occupy the premises for six months, subject to earlier forfeiture by the landlord, notice from Innovate to terminate on an earlier date in the event of failure by YHL to pay the agreed licence fees and/or to observe the tenant's covenants in the Lease (other than in respect of occupation), or notice from YHL to terminate on an earlier date ("the Licence").
22. During the licence period, YHL was to pay the administrators a sum equal to the annual rent and insurance rent for each month, service charges and VAT. Notice was served and accepted to exclude the arrangement from the protection of the Landlord and Tenant Act 1954, Part II.

### ***The Case at First Instance***

23. On Thursday 10 July 2008, Sunberry issued an ordinary application under Schedule B1, paragraph 43(6) for permission to commence proceedings against Innovate and YHL for a mandatory order that they immediately terminate YHL's Licence to occupy the Property on the ground that the Licence was in breach of clause 3.18.1 of the Lease. On the same day Sunberry made a without notice application for an order that time for service of the Application be abridged to 1 clear day.

24. Sunberry's application was heard by HHJ Simon Brown QC (sitting as an additional judge of the Chancery Division) on Tuesday 15 July 2008. Sunberry argued that the actions of the administrators would normally entitle a landlord to an immediate order for termination of the licence arrangement. Since Hemingway Securities v Dunraven (1996) 71 P&CR 30, a landlord's preferred remedy is often of course to seek an injunction terminating the unlawful arrangement and enforcing the tenant's contractual obligations. In terms of reported cases, such an order was made most recently in Crestfort Limited v Tesco Stores [2005] 37 EG 148. The tenant is sued on the covenant and the unlawful assignee/subtenant/licensee in tort on the basis of inducing a breach of contractual relations. On the facts, the breach could be categorised in landlord and tenant terms as a cynical and deliberate breach of contract. It was clear that both Innovate and YHL were aware of the terms of the Lease.
25. The Judge held that the grant of the Licence by Innovate was a "flagrant" breach of the alienation clause, and was arranged without the landlord's knowledge. He said it was "quite reprehensible conduct" to "foist the landlord with a new occupier, and:
- "this purpose was only achieved by a form of subterfuge on the landlord because the landlord was not told that his interests in the property had been impugned by a "done deal"."*
- He held that the administrators were not entitled to give to YHL, as the purchaser of the business, an advantageous licence in respect of the landlord's premises. That was a benefit to YHL to which they were not entitled.
26. However, Sunberry also contended that the purpose of Innovate's administration had been achieved when the business was sold by the administrators to YHL. As such, the fact that there was subsequently a clear breach of the covenant against alienation took the landlord's application under paragraph 43 of Schedule B1 out of the familiar pattern of balancing the legitimate interests of the applicant against the legitimate interests of the other creditors of Innovate in accordance

with the guidance of the Court of Appeal in In Re Atlantic. The Judge accepted this.

27. As a result, HHJ Simon Brown QC granted permission to Sunberry under paragraph 43(6) of Schedule B1 to the Insolvency Act 1986 to commence proceedings for a mandatory injunction requiring Innovate to terminate the Licence granted to YHL.
28. On 11 July 2008, YHL gave notice to terminate the Licence on 10 October 2008.

### ***Court of Appeal***

29. Innovate applied for a stay of the order and for permission to appeal. Its appeal was expedited by the Court of Appeal and heard on the 1 August 2008.
30. At the conclusion of the hearing on 1 August 2008, the Court of Appeal allowed Innovate's appeal against the grant of permission orally, with the written judgment to follow. Consequential matters, such as interest and payments, were the subject of subsequent written submissions before judgment was eventually handed down on 18 November 2008. In the event, YHL actually left the premises on 10 September 2008, and the Licence terminated on that date.
31. Given the absolute nature of the alienation covenant, the case on appeal regarding the grant of the Licence proceeded upon the basis that there was no defence to the allegation of breach of the alienation covenant in the Lease. The key facts that Innovate relied upon however were that:
  - a. YHL's occupation was to be temporary only; and
  - b. YHL was a reputable company; and
  - c. YHL was simply continuing Innovate's existing business use of the premises and performing Innovate's pre-existing contracts; and

- d. YHL was bound to perform Innovate's covenants, and would also pay a monthly licence fee equivalent to the rent (on a pro rata basis) which the administrators were to pass immediately to Sunberry each month during the period of YHL's occupation. Sunberry would, therefore, receive payment in circumstances where it would otherwise receive no payment at all on the facts of the case.
32. Most materially, it was also apparent that Sunberry had no interest in terminating the Lease and recovering vacant possession of such specially adapted premises in the prevailing market, particularly if the premises were over-rented as alleged by YHL. In reality, in seeking to commence proceedings for an injunction requiring termination of the Licence, it was clear that Sunberry had deliberately chosen not to seek permission to forfeit the Lease for breach of the covenant to pay the quarterly rent in advance pre-administration on 24 June 2008, or to serve a s. 146 Law of Property Act 1925 notice as a precursor to seeking permission to forfeit on the grounds of breach of the alienation covenant.
33. Instead Sunberry's preferred, and confessed agenda, on appeal was to try and use the circumstances resulting from the administration to force an assignment of the term of the Lease by the Company to YHL. It was motivated by a desire to secure its present rental stream (subject to upwards only rent reviews), and the performance of the tenant's covenants (including the covenant to repair), until the end of the contractual term in 2028. Sunberry expressly argued that the refusal of permission to seek an injunction to terminate the Licence would deprive it of its negotiating position to force YHL to take an assignment of the residue of the term of the Lease from Innovate. A result that would be something of a windfall for Sunberry given Innovate's administration.
34. In considering these arguments, the decision turned upon whether or not the "purpose" of the administration had been achieved when the pre-pack sale took place as HHJ Simon Brown had found. Innovate stressed that the "purpose" of this administration was not rescue as a going concern, but a better realisation for

creditors. As such, the Administrators were obliged to perform their functions to achieve this objective and were bound to do so “in the interests of the company’s creditors as a whole”. Viewed in this way, in this case:

- a. the breach was commercially necessary and unavoidable if value was to be obtained for the Company’s contracts and its book debts collected by YHL,
- b. the breach was technical and temporary,
- c. Sunberry was to be fully compensated for the use of the Property, and
- d. the creditors could not be said to be receiving a windfall from the breach.

In order to manage the business to achieve the administration’s purpose it was commercially necessary and unavoidable that YHL should have a short period of occupation at the premises in order to distribute and relocate customers stock held there. It was simply not practicable for the administrators to remove £20 million of frozen goods stored on 25,000 pallets at the premises on the date of the agreement, and YHL was not interested in taking an assignment of the Lease.

35. Accordingly, a stay of Sunberry’s remedies was required just as much as if Innovate was still carrying on this same business itself under the management of the administrators. The intended injunction proceedings would impede the administration and conflict with the statutory purpose. If Sunberry succeeded, the injunction would terminate YHL’s ability to carry out or take over Innovate’s contracts and assist in getting in its book debts. This would lead to massive disruption as customers would be forced to take urgent steps to protect, preserve and relocate their goods at the premises. The adverse effect on the ability to get in debts still owed by those customers was obvious.
36. Against this background, Innovate argued that there can be no hard and fast rules in applying the Re Atlantic guidelines. Administrators often repudiate or breach contracts in the proper performance of their functions. A breach of contract is simply a factor to be considered in the balancing exercise, having

regard to the respective commercial interests of the landlord and the other creditors.

37. Apart from anything else, it appeared rather unlikely that Sunberry's interest in reversion on a term due to run until 2028 would be significantly diminished by the grant of a 6 month Licence, if at all. In circumstances where the tenant is in administration, it seems unlikely that the landlord's reversion would be diminished by a licensee paying the rent and performing the tenant's covenants. YHL was also part of a group that would apparently have good covenant strength and reputation, and was a company to which Sunberry was theoretically willing to assign the term of the Lease itself.
38. The Court of Appeal accepted Innovate's submissions and allowed its appeal. It held that the purpose of the administration would not be achieved until the debts were recovered. Sunberry's application for permission to commence the proposed injunctive proceedings was dismissed.

### **Subsequent Cases**

39. Such cases as have come to light since Innovate emphasise the messages of that case. In particular the need to establish the relationship between the breach and the purpose of the administration, and to consider the specific facts of the case in question.
40. In Aubrey Investments Limited v Massive Limited (in administration) (2008, unreported), a landlord applied to the Companies Court for permission to institute legal proceedings for forfeiture and mesne profits and damages. The administrators had breached the alienation covenant by parting with possession or occupation of the whole otherwise than by a permitted assignment or underletting and without consent.
41. Grant Thornton was appointed administrator in January. The subject property was part of a pub and bar group with 20 outlets, including the property. The

- decision was taken to continue trading whilst efforts were made to sell the group as a going concern. A contract for the sale of the group's business and certain assets, including the property, to IPT was exchanged on 22 April, and completion took place on 19 May. At contractual completion a management agreement was entered into with IOL and the company in administration granted the manager licence to occupy pending assignment to the purchaser.
42. The initial consideration paid was £2m. Upon each property being assigned the sale contract provided that the relevant attributable purchase price would be set off against that sum. Once the aggregate of the purchase prices exceeded the initial sum, the balance would be payable by IPT. After the application for consent to assign was made to it the landlord did not accept rent because it did not wish to waive any breach of the alienation covenant.
  43. The Registrar held that leave to commence proceedings would impede the purpose of the administration. The creditors would lose the benefit of the property by reason of the forfeiture unless relief was granted and there were possible further benefits to creditors by the arrangement continuing. The Registrar noted that the size of the administrator, and the fact that only 20 outlets were involved, should not have been insurmountable hurdle to prior consultation with the landlord. However whilst there was justified criticism of the administrators' conduct that did not mean leave should be granted. It was not sufficient to outweigh the balance. The rent was to be paid as a term of the refusal of permission.
  44. By contrast in Somerfield Stores Ltd v Spring (Sutton Coldfield) Ltd [2010] L&TR 8, the Court granted a tenant permission under Schedule B1 paragraph 43(6) to continue its application for a new tenancy under the Landlord and Tenant Act 1954 Part II against a landlord in administration.
  45. The landlord had opposed the tenant's application for a new tenancy pre-administration on the basis that it intended to redevelop. However, once the landlord went into administration it no longer had a current intention to redevelop

because it was not then in a position to do so by virtue of the administration. When the tenant applied to the administrators for permission to continue with their application the administrators refused on the basis that they wanted 6 to 12 months to put in place a viable scheme to enable the property to be redeveloped for the benefit of the sole secured creditor, a bank. The scheme would necessitate obtaining planning permission, securing pre-lets and reaching a suitable arrangement with a developer. The bank held a charge for indebtedness well in excess of the value of the property and the administrators did not expect any distribution to be made to preferential or unsecured creditors.

46. The tenant applied to the Court. HHJ Purle QC held that it was clear that the landlord did not currently intend to redevelop. The tenant had the equivalent of a proprietary right and the rights of third parties, whether creditors or not, should not be prejudiced unless truly necessary to achieve the purpose of the administration. The Court had to strike a balance in accordance with In Re Atlantic between the rights of the administrators to achieve an orderly administration and the right of the tenant to have its application heard. Given that the LTA 1954 application had to be heard sooner or later it was wrong for the tenant to be in a state of uncertainty indefinitely. This was particularly so as administrators are to perform their functions as quickly and efficiently as reasonably practicable and administrations are only valid in the first instance for 12 months.

### **The Administrators' Obligations to Pay Rent**

47. I should also mention a matter that was not the subject of oral argument in Innovate. That is an administrator's liability to pay rent to a landlord as an expense of the administration where the premises are used for the purposes of the administration. The keen reader of the facts of Innovate will have noticed that:
- a. Innovate went into administration and granted the Licence to YHL a week *after* the June quarter's rent had fallen due and the tenant company had failed to pay it;

- b. Sunberry's claim was not for future rent based upon the administrators' use of the premises during the administration but rather for permission under paragraph 43 of Schedule B1 to the Insolvency Act 1986 to commence proceedings for an injunction to secure YHL's vacation of the premises before the next quarter day;
  - c. Sunberry rejected the administrators' attempts to pay any sums to it. No doubt it wished to avoid any suggestion of waiver or estoppel;
  - d. if Sunberry had succeeded on appeal, the administrators would have had no funds to make any payments to Sunberry.
48. Once Innovate's appeal was allowed, Sunberry submitted written submissions claiming interest and payment, in particular, of the rent that was due to fall due on the September quarter day (in the event, of course, the Licence did not endure until that date). Sunberry did not seek to contend that it was entitled to the payment of the quarterly rent on the usual quarter days as an expense of the administration; it accepted that it did not have a right to be paid these sums as an administration expense. The Court of Appeal proceeded upon the basis of Sunberry's concession. It held that in the particular circumstances of the case the monthly payments that the administrators had tendered should be paid for the duration of YHL's occupation.
49. It is to be noted that the facts and the subject matter in Innovate were therefore very different to those of the recent case of Goldacre (Offices) Ltd v Nortel Networks UK Ltd (in administration) [2009] EWHC 3389 (Ch). In contrast to Innovate, the application in Goldacre (which Neville will talk about), was an application for a ruling that the administrators, having decided to use part of the leasehold premises to carry out the administration, were liable to pay the full rent as it fell due as an expense of the administration pursuant to the Insolvency Rules 1986. In Goldacre, HHJ Purle QC acknowledged that the issue of rent as an administration expense had not been debated in Innovate, and recognised that this was unsurprising given the facts of that case and each parties' commercial agenda.

50. In Goldacre it was held, applying the House of Lords decision in In Re Toshoku Finance UK plc (in liquidation) [2002] 1 WLR 671 regarding the very similarly worded Insolvency Rule relevant to a company in liquidation, that where administrators adopt a contract for conducting the administration in a beneficial manner, all liabilities arising under that contract after the date of adoption are entitled to priority. As such, it was held that administrators who elect to hold leasehold premises may do so only on the terms and conditions contained in the lease, and that the administrators will become liable to pay the next quarter's rent when it falls due post administration as one of the costs of the administration.
51. HHJ Purle QC was of the view that the court had no discretion as to whether to declare rent an administration expense under either Rule 2.67(1)(a) or (f) of the Insolvency Rules. He did however consider that the court might have a discretion as to whether to grant a remedy for non payment. That, of course, brings one back to the making of an application to the court for permission under paragraph 43 of Schedule B1 and the application of the In Re Atlantic guidelines.

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