

Real Estate Update

October 2009

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Vivien Tyrell has joined us as a partner to head our Restructuring and Insolvency practice. [More...](#)

EXPO REAL

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Any comments or queries?

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Landlords, will an administrator pay your rent in full?

In the current recession landlords are among the first to lose out when a company goes into insolvency, be it a pre-pack sale or a conventional administration process. It is important, therefore, for landlords to know what rights they retain when confronted with the administration of their tenant in order to ensure the full rent is paid - if they are still entitled to it - or, at the very least, to increase their bargaining position. In this article, we look at the circumstances where an administrator is obliged to pay the landlord's rent in full.

A recurrent problem in today's economy is that of tenants going into administration. If market rents are lower than the passing rent under a lease, landlords will hope that the administrator will use the premises as part of the administration and pay the full rent as an expense of the administration, ie on the due date and at the full amount (100 pence in the pound). In the absence of some other recourse, such as access to a rent deposit, if a landlord cannot establish that the rent is an expense of the administration he will be classified as an unsecured creditor and only be entitled to receive some distribution from any general unsecured assets which might be available in the insolvency – this will be less than 100 pence in the pound.

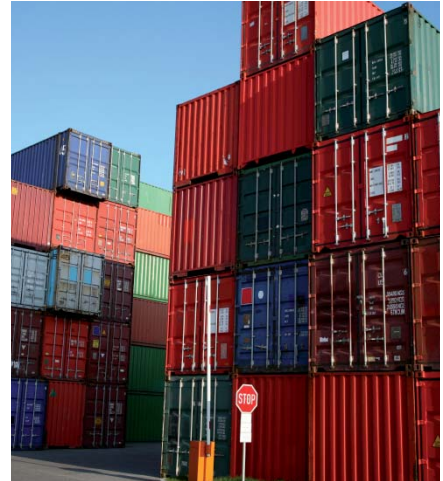
Is rent an expense?

The definition of administrators' expenses are found in the Insolvency Rules.¹ These provisions, however, require interpretation and whether the rent falls within them depends on what stance the administrator takes towards the premises which are subject to the lease. If an administrator knows from day one of his appointment that the business must be sold (including the lease), rent is highly likely to fall within the statutory definitions from the very start of the administration. However, if the administrator delays in deciding what should be done with the premises, a landlord and his advisers must look more closely at what the administrator has been doing with them prior to him formulating his decision.

A good example to take, because it is an extreme case, is whether the mere storage of goods on the premises obliges the administrator to pay the landlord his rent in full.

Expenses "*properly incurred by the administrator in performing his functions in the administration of the company*" are "allowed" (the administrator can pay them in full – ie, 100 pence in the pound). The administrator's "functions" are a combination of his powers and obligations which must reflect the objectives that he believes can be achieved. In descending order of priority these objectives are:

- rescuing the company as a going concern
- achieving a better result for the company's creditors as a whole than a liquidation would produce
- merely realising the company's property for distribution to one or more secured or preferential creditors



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It is vital to know what and when the administrator decides

The use to which the administrator is putting the premises has to be considered at each stage of his decision-making process. The moment he decides to attempt to rescue the company as a whole, it is likely that using the premises as storage is classed as part of performing his functions and, therefore, the rent charged for their use will be an allowable expense of the administration. Similarly, if he decides on the lesser objective of trying to achieve a better result for the company's creditors than on liquidation, if the stored goods are to be sold along with other parts of the business, again, the rent will be classed as an expense from the time he makes that decision. Finally, if he decides that neither of the above objectives can be achieved and all he can do is sell the company's property for the benefit of preferential or secured creditors, if the stored goods are part of the property he tries to sell, on the face of it, the premises have been used for the purposes of the administration. Again, rent is payable as an expense.

When would rent not be an expense?

Situations where storing goods on the premises do not amount to the administrator performing his functions for the purposes of the administration and, therefore, the rent not being an expense (ie not payable as to 100 pence in the pound) would be:

- the administrator discovering that the goods stored do not belong to the company but, for example, are subject to a valid retention of title clause and are therefore the supplier's property
- if the administrator only made the decision that he wished to sell the business some time after his appointment, the period prior to him making the decision may well not amount to him using the premises for the purposes of the administration. One reason why he might not make his decision at the outset could be that he was taking legal or other advice before so doing. The rent due during that initial period arguably would not amount to him using the premises for the purposes of the administration

There are, of course, many other examples of the administrator using premises, apart from storing goods. Each of the ways in which the premises are used would have to be considered in the context of all the examples set out above. Because each case will be fact-specific, it is important to find out the precise manner in which the administrator is treating the premises and the timing of his decisions concerning how to deal with the company and its assets. In this way, with the help of their legal advisers, landlords will be able to determine if the premises are being used as part of the administrator performing his functions, in which case the landlord's rent will be payable 100 pence in the pound.

In the next issue of **Real Estate Update**, we will be considering the landlord's right to forfeit the lease in the context of administration.

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The Carbon Reduction Commitment is coming... are you ready?

The clock is ticking towards the implementation of the Carbon Reduction Commitment in April 2010, which will apply across the UK. Large public and private sector organisations will be caught by the scheme, which aims to give those organisations a reputational and financial incentive to reduce their carbon footprint. Failure to comply could lead to substantial fines and even prosecution for those who knowingly mislead the regulator. We look at what the CRC means for those affected and the penalties for non-compliance.



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What is the CRC?

- A legally binding emissions trading scheme, designed to provide a financial incentive for organisations to reduce their energy usage and CO₂ emissions
- Inclusion in the scheme depends on metered electricity usage, but participants must report and purchase allowances for all energy consumption (except transport emissions)
- Participating organisations estimate their CO₂ emissions for each year and then purchase CO₂ "allowances" to cover those expected emissions
- They must then monitor their energy use during the year and actively try to reduce emissions. At the end of each year, they report actual CO₂ emissions. A league table of year-on-year CO₂ reduction will be published and organisations will get a bonus or pay a penalty, depending on their position in the league table
- Until 2013, participants buy allowances from the Government at a fixed price. From 2013, allowances will be sold by auction - market forces will determine the price
- From 2013 there will be a gradual reduction in the total number of allowances for sale, encouraging an overall reduction in energy consumption
- Participants can also buy and sell allowances on a secondary market, providing a further financial incentive to reduce energy use
- The body responsible for energy consumption in a building is the person who has the contract with the energy supplier and pays the energy bills. In a tenanted building, this might well be the tenant(s). Parent companies must calculate all their subsidiaries' emissions

Who is caught by the CRC?

- Participation depends on an organisation's metered electricity usage during 2008. Any organisation with at least one half-hourly electricity meter and which uses at least 6,000 MWh of electricity per annum will have to participate fully in the scheme
- There are reporting requirements for organisations with at least one half-hourly meter and using more than 3,000 MWh per annum
- All public sector organisations must participate

Sanctions for non-compliance

- Financial penalties for failure to meet deadlines (eg failure to register as a participant by September 2010: initial fine of £1,000, daily rate of £500)
- Naming and shaming - publication of non-compliance
- Knowingly misleading or deceiving the Environment Agency is a criminal offence punishable by up to three years in prison and/or a fine of up to £50k

Timetable for implementation

- September 2009: Environment Agency starts gathering information to assess who will be caught by the scheme
- September 2010: deadline to register as a participant
- April 2010-March 2011 - monitor emissions and report them to the Environment Agency in a "Footprint Report"
- October 2010: League table published. Get initial allowance payment back from Environment Agency, plus/minus a bonus/penalty, depending on league table position
- April 2011: first sale of allowances. Buy allowances for 2010-2011 and to cover estimated emissions for 2011-2012
- July 2010: submit Annual Report and surrender allowances for 2010-2011
- April 2012: the whole process starts again - participants purchase allowances to cover estimated emissions for 2012-2013

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Net Contribution Clauses: not necessarily "unreasonable"?

This article considers what a net contribution clause is, why they are resisted by some parties to construction contracts and the effect of a recent case on the reasonableness of such clauses.

The term "net contribution clause" will be familiar to many readers, particularly those of you who are either developers negotiating construction documents with your construction team or tenants taking a lease of new or recently built premises and who will benefit from collateral warranties.

As you will be aware, it is often the practice of building contractors or professional consultants to seek to limit their liability to clients and/or beneficiaries by seeking to include a net contribution clause in the appointment or collateral warranties, a practice which has become even more prevalent given the recent rise in the number of insolvencies.

What is a net contribution clause?

Where a client or beneficiary suffers loss as a result of a defect, there may be several parties who are responsible. If a claim is brought against any one or all of those parties, each party who is held to be at fault will be 100% liable for the loss under the principle of joint and several liability. If a single party is sued, they would



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therefore seek to join the other parties at fault into the proceedings or claim a contribution from such parties.

The purpose of a net contribution clause is to limit the liability of the party to an amount which is reasonable for them to pay in light of the extent of their responsibility for a defect. Crucially, net contribution clauses include a deeming provision that any other party at fault a) owes a similar duty to the claimant and b) has paid their fair share of the losses for which they are responsible to the claimant.

As such, the clause has severe consequences for the client or beneficiary where one of the parties who was also in breach is now insolvent. As they can no longer respond to a claim, the presence of the net contribution clause in the remaining consultant's appointment (or collateral warranty) will preclude the client (or beneficiary) from recovering 100% of its losses.

Langstane Housing Association Limited v Riverside Construction Aberdeen Ltd (2009)

This recent Scottish case considered whether a net contribution clause was a limitation clause within the meaning of the Unfair Contract Terms Act 1977 (the Act), which applies to commercial contract terms which seek to exclude or restrict liability.

The case concerned a dispute over whether an engineer was appointed on the 1988 or 1998 version of the Association of Consultancy and Engineering conditions. The client claimed it was the earlier version because it was keen to avoid the 1998 version, which included the net contribution clause, which would limit the engineer's liability for defects.

It was held that the presence of a net contribution clause did not seek to exclude or restrict liability but merely sought to ensure the consultant was held liable for its own breach and not for breaches of others. It was also stated that such clauses are not unreasonable for the purpose of the Act.

Effect of decision

This is perhaps an unsurprising result given the fact that such clauses have been in use for some years now, and the terms of construction contracts are usually negotiated in a commercial fashion.

However, it is not the most helpful of decisions because:

- most clients and beneficiaries will be of the view that the intention of a net contribution clause is by its very nature to limit (and not merely restrict) liability
- consultants and contractors may now claim that it has been held by the courts that a net contribution clause is "reasonable"; however, it does not necessarily follow that because a clause is "reasonable" for the purposes of the Act that it is acceptable for it to be included in construction contracts

No doubt construction professionals will continue to seek to negotiate the inclusion of net contribution clauses in their appointments and they may even argue that the court has upheld their use. This is not necessarily a correct assertion; the court has only stated that a net contribution is not a limitation per se. Until net contribution clauses

are fully tested in the courts, they will continue to be a hot topic of any negotiation process.

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Case note

Landlord and tenant – inadvertently accepting a surrender of a lease

Surrender by operation of law

A lease can determine early by either an express agreement to surrender (usually recorded in a formal deed) or by operation of law. In the latter circumstance, a deed is not required in order for the lease to come to an early end and in some circumstances a surrender can occur due to the conduct of the parties despite their intentions to the contrary. It is therefore vital for landlords to ensure that they do not act in such a way that could be interpreted as accepting a surrender of a lease. This article looks at a recent case, *Artworld Financial Corporation v Safaryan & Ors*, and its implications for landlords and tenants in this regard. Whilst the case concerned residential property, it also applies to commercial property.

The case

Artworld owned a large house, which it let to the Safaryan family for three years at a rent of £390k per year. The Safaryans were not happy with the property due to various technical problems and vacated the property with 15 months remaining of the term. They returned the keys to the landlord. The landlord sought to claim unpaid rent. The Safaryans' argued that the tenancy had come to an end by a surrender by operation of law and relied upon the following facts:

- the landlord accepted the keys back
- the landlord obtained a 'checkout' report and inventory
- the landlord carried out redecoration works
- furniture was returned to the property that the tenant did not want at the start of the term so had been placed into storage
- the landlord used the driveway to park cars
- members of the landlord's family moved into, slept and stayed at the property - not as caretakers
- the landlord kept the garden tidy
- the landlord re-hung the curtains, which had been removed at the tenant's request

Despite the above actions, Artworld made it clear through a series of letters issued by their solicitor that they regarded the lease as continuing and had no intention of accepting a surrender. They argued that the above actions were legitimate as they were entitled to carry them out under the terms of the tenancy and/or were protecting/preserving the property.

The Court of Appeal decision

The court did not agree with Artworld and declared that, whilst many of the actions listed above may, looked at individually, be consistent with a continuing lease, the totality of the actions lead to the conclusion that the landlord took back possession and there was an implied surrender.



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Analysis

The case does not prevent landlords from protecting or preserving their property when faced with an absent tenant. Provided the landlord is properly exercising their rights under the lease or is acting in such a way as to mitigate any loss from an absent tenant, then an implied surrender is unlikely. Equally a landlord can seek to market the property, despite a continuing tenancy, in anticipation of perhaps entering into a formal surrender with the absent tenant or the tenant becoming insolvent. In short, if a landlord goes over and above their rights in the lease and effectively re-takes possession eg by occupying it themselves, by keeping the tenant out (by changing the locks) or letting the property to a new tenant - then such actions will amount to a surrender. As the Artworld case shows, when a landlord is looking to do more than they are entitled to do under the tenancy, then it is best to seek advice to protect their position. It is also not enough to put your intentions in writing to the tenant as actions are more powerful than words.

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Round-up

Energy Performance of Buildings

The European Commission (EC) is currently redrafting the Energy Performance of Buildings Directive and the consultation process in the UK is being led by the Department for Communities and Local Government. The key changes proposed are:

- A reduction in the threshold for the display of Energy Performance Certificates in public buildings from those premises over 1,000 square metres to those over 250 square metres
- Buildings over 250 square metres visited by the public to display an EPC (where one already exists)
- Minimum energy performance requirements for all existing buildings that undergo major renovation (currently this only applies to buildings over 1,000 square metres)

The EC intends that the new directive will be implemented by 31 December 2010 for public sector buildings and 31 January 2012 for other buildings. The UK Government is seeking a longer implementation timescale but is broadly supporting the proposed changes.

Real Estate Public Sector Partner Mark Lavers notes *“The EC are clearly looking to public bodies to lead from the front in this area. It is worth keeping an eye on this consultation as the proposed changes would mean an increase in the number of buildings required to display an EPC, and another financial burden for many public bodies.”*

The consultation period ends 2 October 2009.

Workplace Parking Levy

In an effort to discourage the use of cars for commuting, the Government first consulted on the idea of a Workplace Parking Levy (WPL) back in December 1998. The idea was that a charge would be made to employers and educational establishments based on the amount of workplace car parking they provided, with the proceeds of the levy being fed back into the achievement of local transport policies.



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Round-up continued...

The first local authority to develop a detailed WPL scheme, Nottingham City Council, had that scheme confirmed by the Secretary of State for Transport on 31 July 2009. The Secretary of State's decision was based on the Workplace Parking Levy (England) Regulations which were created following a public consultation. The results of that consultation are summarised in the explanatory memorandum to the regulations and make for interesting reading, with the majority of responses commenting on the general principle and potential impact of WPL schemes rather than the regulations themselves. Perhaps this is unsurprising given the British Chambers of Commerce estimates that the costs to business could be £3.4bn a year if every local authority in England outside London were to introduce a WPL scheme.

Real Estate Corporate Occupier Partner Martin Barrett notes *"Whilst it is intended that there will be exemptions from the levy, WPL schemes should be a consideration for occupiers when choosing the right location for them. Nottingham may be the first WPL scheme set in motion but all occupiers should be aware that if a scheme is developed in their area this could add substantially to their outgoings, particularly where public transport infrastructure does not meet the demands of their staff"*.

No WPL schemes are expected to come into operation until 2011 and no levy is expected to be collected before April 2012, but that will not provide much comfort for those currently taking five-year leases. The details of the Nottingham scheme will be confirmed at a full meeting of the City Council this month.

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News

Welcome to Vivien Tyrell

Vivien Tyrell has joined us as a partner to head our restructuring and insolvency practice. She qualified as a solicitor in 1980 and became an authorised insolvency practitioner in 1989, and has practised insolvency and restructuring full-time since then. Having experienced the property recession of the early 90s, Vivien has significant understanding of the current economic climate and how it impacts the property sector. Her extensive experience in real estate includes working on all manner of property restructuring and insolvency, including administrations, LPA receiverships, liquidations and reorganisations. In addition to such work she advises boards and management on available options in the case of companies under financial stress or having to deal with counter-parties in such circumstances. She is particularly renowned for restructurings under schemes of arrangement. She is recognised in the major directories as a leader in her field.



EXPO REAL

Between 5-7 October RPC is attending EXPO REAL. Please contact Martin Barrett or Olle Kickler to arrange a meeting. We look forward to seeing you in Munich.



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