MARRIOTT HARRISON

RESTRUCTURING May 2016

KEEP CALM AND (NO) SURRENDER

A core component of any business is the property from which it trades. Whilst this might be owned on a freehold basis, most businesses lease their property. The economic status of property is brought into sharpest relief when a company gets into financial difficulties. This will be the point when the true "value" of the property comes to be determined – sometimes a lease will have a positive or premium value, but very often it will be a significant liability in the hands of an insolvent tenant or its insolvency practitioner.

Where a property is an onerous liability, a liquidator will be able to disclaim it. IPs acting in other capacities do not have a similar disclaimer right, so will be forced to consider other avenues. These will include trying to surrender the lease to the landlord.

The question of what constitutes a surrender has recently come before the courts in the case of ***Padwick Properties Limited v Punj Lloyd Limited [2016].*** In the case, the tenant company went into administration and its ultimate parent, as guarantor on the lease, unsuccessfully claimed that the landlord's actions on the facts meant that the lease it had guaranteed had already been surrendered. Had the lease been found to have been surrendered, the guarantor would not have had to pay future arrears and take a new lease of the property as prescribed by the terms of the guarantee.

The court reaffirmed some old decisions on surrender and provided useful insights into what would - and would not - constitute a surrender by operation of law (that is, terminating a lease early in the absence of a written surrender document). Whilst the judge emphasised that it will be necessary to look at a landlord's conduct as a whole in deciding whether or not it had accepted a surrender by operation of law, several specific steps taken in the case were examined in the judgment. These steps are

commonly taken, so it is illustrative to examine what legal effect they might have.

Before doing so, let's be clear on what is meant by the "surrender" of a lease. The court in the case put it succinctly: "Surrender by operation of law is a consensual transaction, constituted by conduct that is unequivocal on both sides and that renders it inequitable thereafter for either party to dispute that the tenancy has ended". The legal principle underlying surrender by operation of law is estoppel.

1. **Vacation**: The tenant's administrators contended that the lease ended simply because the tenant had vacated the premises. The Court rejected this argument as evidence of a surrender.

2. **Grant of a licence by the tenant**: As part of a sale of the business of an insolvent company, it is common for the company's administrators to grant a licence of the tenant company's lease to the purchaser. In this case, it was agreed that the purchaser would pay a licence fee (equivalent to the rent passing under the lease) to the administrators on the basis that the administrators would pass the same on to the landlord as rent. The landlord appeared to have been aware of this arrangement and, although it did not object to the purchaser's occupation under licence (which was in breach of the alienation provisions of the lease), the Court was satisfied that the landlord's actions in accepting the payments did not constitute an acceptance of a surrender of the lease.

3. **Return of the keys**: Once the purchaser had vacated the premises, the tenant's administrators returned the keys to the landlord's solicitors saying that if the keys were not accepted they would be thrown away. Whilst the landlord's solicitors did accept the keys, they did so strictly on the basis (as evidenced in writing) that they were doing so for "security only and not as a surrender". The Court acknowledged that someone had to hold the keys and held that the landlord's solicitors' actions were sensible in the circumstances with their statement as to the basis on which the keys were to be held being sufficient to defeat the contention that this constituted a surrender. If, however, the solicitors had countersigned and returned a covering letter saying that receipt of the keys was an acceptance of a surrender, the outcome would have been very different.

4. **Securing the property**: The landlord became aware shortly after the purchaser had vacated that some of the doors to the property had been left unlocked, so it took steps to secure the property. The landlord's insurers initially required round-the-clock security for the property which the landlord had to arrange. Eventually, the insurers conceded that the landlord's obligations would be met if it boarded up the lower floor windows of the property with steel screens and installed monitored intruder and smoke alarms. The Court accepted that none of these actions amounted to an acceptance of a surrender, especially because the tenant had said it was not going to take any steps to "protect" the property. The Court confirmed that a landlord is entitled to take steps to protect and preserve its property. There was no evidence that the property's locks were changed to exclude the tenant, nor to allow the landlord to enter the property for its own beneficial use (each of which would have been mutually exclusive to the lease remaining in place). In such circumstances, the Court was satisfied that the landlord had not gone beyond simply protecting its own interest in securing the property.

5. **(Simply) Marketing**: The landlord marketed the property "with vacant possession" for a short while until its solicitors said such actions could prejudice its claims against the guarantor. Perhaps somewhat surprisingly, the Court confirmed that

simply marketing did not amount to an acceptance of a surrender as the landlord was only doing what, in the circumstances, was the best it could do.

6. **Granting occupation to a third party**: Whilst the property was vacant, the police had asked if they could use the property's yard to kennel their dogs. At one level this appealed to the landlord as the property was being vandalised, but the landlord declined on the basis that if it had authorised a third party to occupy the property this would have been construed as evidence of its acceptance of a surrender. Similarly, the Court held that if the marketing exercise had resulted in a new tenant taking occupation, the landlord would have been deemed necessarily to have accepted a surrender in order for it to have been able to grant the new tenancy.

Whilst every case will turn on its own particular facts, the judgement in the Padwick case provides a number of useful lessons and reminders for both landlords and insolvency practitioners appointed to insolvent tenants. Most notably, if a landlord consistently emphasises (in writing) that it is not accepting a surrender and hence that the lease is still in existence, it is going to be very difficult to successfully assert anything to the contrary. Of course, if it is agreed that a lease is to be determined, then this should be clearly recorded in a deed of surrender and release.

May 2016

Authors

Brett Israel
Partner
Restructuring and Insolvency
Brett.israel@marriottharrison.co.uk

Mark Lavers
Partner
Real Estate
mark.lavers@marriottharrison.co.uk

Marriott Harrison LLP
11 Staple Inn
London WC1V 7QH
www.marriottharrison@co.uk