NEIL Myerson SOLICITORS

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The Neil Myerson Solicitors Property newsletter

In this edition of Commercial Property Write we look at some of the topical issues relating to commercial property, including the abolition of ratings relief for vacant properties; the introduction of new regulations which will require the production of Energy Performance Certificates; insolvency issues for landlords and a review of overage provisions.

Latest news from Neil Myerson Solicitors

There have been a number of developments with the Commercial Property team since our last edition of Commercial Property Write. The existing team has been further strengthened with the addition of two new solicitors. Joanne Perritt joins from an International Law Firm and will specialise in a wide range of property matters including insolvency matters. Farina Moghal joins from a large commercial firm based in London and will specialise in landlord and tenant work and acquisitions and disposals.

Feedback

We are always pleased to receive your feedback on Commercial Property Write. Please either complete the feedback form and return it by post or fax to 0161 941 4411 or email us at feedback@neil-myerson.co.uk.

Website

For further information or to download any of the featured articles please visit our website at www.neil-myerson.co.uk.

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Is there something you would like to say?

We warmly encourage your comments and/or suggestions regarding our newsletter "Commercial Property Write", or indeed anything else relating to the services we provide. Please feel free to contact any of the Neil Myerson team with your comments, or alternatively you could use the "Write Feedback Form" enclosed. Either way, we look forward to hearing from you.

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Empty Property **Relief**

As many readers will be aware, the Rating (Empty Properties) Act 2007 (the "Act") came into force on 1st April 2008. The Act abolished Business Rates Relief that was formerly available to owners of vacant commercial property.

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The Government has stated that their aim was to:

"provide a strong incentive to bring empty property back into use. This will help to increase the supply of premises to let, and so reduce business rents and improve the competitiveness of the UK, as well as bringing forward brownfield sites for re-development and so reduce the need for new development on environmentally valuable greenfield land".

Owners of commercial property will need to plan for the financial impact of the changes brought about by the Act and determine whether there is any way of minimising it.

Previously, landlords did not have to pay any business rates within the first three months of a property being unoccupied, and after that they only had to pay 50% of the full occupied rate. Empty industrial property was exempt from payment of business rates altogether.

Under the Act the full rate is now payable on empty office and retail properties after three months, and after six months for industrial property unless it:

- is held by a charity and appears likely to be next used for charitable purposes;
- is held by a community amateur sports club and appears likely to be next used for the purposes of the club;
- qualifies for an exemption from rates under the Non-Domestic Rating (Unoccupied Property) Regulations 1989 (as amended) ("1989 Regulations").

Exemption is appropriate in the following circumstances as prescribed by the 1989 Regulations:

- where the owner is prohibited by law from either occupying, or allowing the property to be occupied;
- where the property is kept vacant by reason of action taken by or on behalf of the Crown or any local or public authority with a view to prohibiting the occupation of the property or to acquiring it;
- where the property is the subject of a building preservation notice as defined by section 58 of the Town and Country Planning Act 1971 or is included in a list compiled under Section 54 of the Act (i.e. a Listed Building); or
- where the property is included in the Schedule of Monuments compiled under Section 1 of the Ancient Monuments and Archaeological Areas Act 1979.

No property with a Rateable value below £2,200 is subject to an empty rate charge.

Certain owners are also exempt from empty rates:

- where the owner is entitled to possession only in his capacity as the personal representative of a deceased person;
- where the owner is subject to certain insolvency events e.g. bankruptcy or liquidation;
- where a property comprises what is defined as a qualifying industrial hereditament' and is constructed or adapted for use in the course of a trade or business and is constructed or adopted for the use for one or more of the following purposes:
    - the manufacture, repair or adaptation of goods or materials or the subjection of goods or materials to any process;
    - storage (including the storage or handling of goods in the course of their distribution);
    - the working or processing of minerals;
    - the generation of electricity.

The introduction of the Act has meant that industrial property will no longer be fully exempt from rates. The property will be given an initial period of 6 months where no charge is made, but thereafter rates will be charged at 100% of the occupied rate.

If a property is not capable of beneficial occupation – for instance, if it is in poor condition and cannot be economically repaired – the valuation officer may judge that it should be taken out of the rating list altogether. However, please be aware that if the property is damaged for the purposes of avoiding rates, under new anti-avoidance legislation the valuation officer will be required to disregard the change in the property's state when assessing the rateable value. So for instance, if the roof is removed from an empty property for the purpose of avoiding rates, it may be valued as if the roof had not been removed.

If a property is only partly occupied, the billing authority has discretion to request that the valuation officer apportions the property's rateable value between its occupied and unoccupied parts.

The Act provides that the empty part will receive a complete exemption from rates for the first three months it is empty (or, if it is an industrial property, for the first six months). After the initial rate-free period expires, in most cases the apportionment will cease to have effect and the occupied business rate will apply to the whole property. This will ensure that occupiers can benefit from any occupied part. However, if the property would qualify for the new zero rate or for an exemption from rates when empty, the apportionment will continue to have effect and the owner will not be liable for rates on the empty part.

Properties are commonly withheld from the market whilst development proposals are being considered, planning permission is being sought or where it is not profitable to bring a property to the market. There is concern that the Act may jeopardize such schemes and have no positive effect on the market. Developers and landlords may become more cautious in developing or investing in areas where a quick turn around may be risky.

The changes introduced by the Act may result in higher costs for property owners, with no guarantee of satisfying the Government's initiative to encourage property owners to return commercial property to the market by reducing the financial incentives available when it is vacant.

Environmental Issues in Property - Energy Efficiency in Buildings

This is the first of a series of articles that will run over several issue of Commercial Property Write looking at environmental developments that affect commercial property.

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We are all aware of the challenges posed by climate change, but reducing our carbon footprint extends further than recycling your household waste and driving a more environmentally friendly car. Buildings are currently responsible for around 50% of the UK's total carbon dioxide emissions. Their energy efficiency is, therefore, key.

The Energy Performance of Buildings Directive (2002/91/EC), now incorporated into the Energy Performance of Buildings (Certificates and Inspections) (England and Wales) Regulations 2007 (the “2007 Regulations”), aims to improve the energy performance of all buildings (including commercial and residential) by requiring that:

- all new buildings, and large buildings subject to major renovations, meet certain minimum energy performance requirements. This is being achieved by amendments to Building Regulations.
- All boilers and air conditioning systems in buildings be regularly inspected. Advice is to be provided on the replacement of boilers and other modifications to heating systems, whilst air conditioning systems must now be inspected at least every five years; and
- Energy performance certificates (EPCs) be made available to prospective buyers and tenants whenever a building is constructed, sold or rented. Display energy certificates (DECs) will also need to be displayed in large buildings occupied by public authorities and by institutions providing public services.

In this article we look at the requirement for Energy Performance Certificates in relation to Commercial Properties.

What is an EPC?

An EPC is a certificate, issued by an accredited energy assessor, setting out details of the energy efficiency of a particular building or part of a building. Similar to the energy efficiency labels on domestic appliances, an EPC will give an "asset rating" expressed on a scale from A (being the most energy efficient) to G, together with other information, including the total useful floor area of the building and details of the energy assessor who issues the certificate.

An EPC is valid for 10 years unless a new assessment is carried out, leading to the issue of a new EPC, which will automatically supersede a previous EPC, even if it is less than 10 years old.

When an EPC is obtained, a recommendation report will also be provided. This contains suggestions for the improvement of the energy performance of the building, which are broken down into cost-effective alterations to improve energy performance and measures that require a greater amount of expenditure. The carrying out of the recommendations made is not mandatory, but the value that may be added to the property by carrying them out should be considered.

How will EPC’s affect Commercial Properties?

The provision of an EPC, together with a recommendation report, is to become a legal requirement for all commercial "buildings" when constructed (and in some cases modified), sold or let.

A “building” is defined by the 2007 Regulations as:

> “a roofed construction having walls, for which energy is used to condition the indoor climate”

This means that buildings with only hot water and/or electric lighting will not require an EPC. Other exempt buildings include;

- Temporary buildings with a planned time of use of two years or less;
- Industrial sites and workshops with low energy demand;
- Non-residential agricultural buildings with low energy demand; and
- Stand-alone buildings with a total useful floor area of less than 50 square metres, which are not dwellings.

Other commercial properties however, such as retail units, office space and any industrial spaces that are heated or air conditioned will require an EPC, on construction (or when specific modifications are carried out), sale or letting, resulting in significant implications for developers, owners, occupiers and managers of buildings.

The Trigger for EPC’s

The requirement for an EPC for new build commercial properties, or for properties that have been modified (so as to have more or less parts than it originally had and where such modification includes the provision or extension of the property’s heating or air cooling system), will be triggered when the construction or modification works are completed. In such cases, it is the person carrying out the construction or modification works that must provide the EPC to the property owner. Unless this has been done, it will not be possible to obtain a Completion Certificate for the works, as required under Building Regulations.

The requirement for an EPC for existing, unmodified commercial properties will be triggered when the property comes to be sold or let (including assignments of leases and grants of sub leases). The requirement will even apply where a building that is being sold is subsequently to be demolished, unless certain conditions can be satisfied such as the intention to demolish, suitability for redevelopment and sale of the property with vacant possession.

According to guidance issued by the Department for Communities and Local Government in January 2008, it does appear that an EPC will not be required when there is a lease renewal, lease extension, surrender of a lease or acquisition by compulsory purchase order.

Where the sale/letting trigger applies, it is the seller/landlord who must produce a valid EPC to the proposed purchaser/tenant. Where assignments or sublettings are concerned, it will be the existing tenant of the Property who will need to produce an EPC. Whether they, in turn are able to obtain this from their landlord may be a matter of negotiation. The EPC must be provided on the earlier of the following dates:

- The date that the seller or landlord provides written information about the building to a person who has requested information;
- The date that a prospective buyer or tenant views the building; or
- The date that a contract is entered into to sell or rent out the building.

Details of all EPC’s, together with recommendation reports, will be stored for at least 20 years in a central register, maintained by Landmark Information Group on behalf of the Government. This is largely to allow owners and occupiers to obtain additional copies of their EPC if required and to enable prospective purchasers or tenants to check that the EPC that they have been provided with is valid.

When will EPC’s be required from?

From 6 April 2008 - EPCs required for the construction, sale or letting of non-dwellings with a total useful floor area over 10,000 square metres. The guidance provided by the Department for Communities and Local Government Guidance states that where contracts for the sale or letting of a property were exchanged before 6 April 2008, the duty to provide an EPC will not apply.

From 1 July 2008 - EPCs required for the construction, sale or letting of non-dwellings with a total useful floor area over 2,500 square metres.

From 1 October 2008 - EPCs required for the construction, sale and letting of all remaining buildings that are not dwellings

Transitional arrangements for properties being marketed before the relevant commencement dates are in place however, all commercial buildings will be subject to requirements on their owners to produce EPCs from 1 October 2008.

Overage Payments

In the current economic climate, with increased uncertainty regarding both residential and commercial property development, developers are increasingly seeking ways to acquire land for possible future development without paying a development premium up front. Likewise, sellers are increasingly looking for ways to maximise capital values for property whilst securing a share in any potential future development value of land.

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In addition, public sector landowners (or charities) are very often required to transfer land at the best price obtainable and will seek a mechanism to protect any possible "betterment value" should land sold subsequently be developed.

The term "overage" simply refers to an additional payment made by a purchaser of land, if and when the value of the land increases because of subsequent development. These "trigger events" often take the form of the following:

- Grant of planning permission;
- Further sale of the land (with the benefit of planning permission);
- Completion of development (or the sale of a completed development).

Whichever event triggers the payment of an overage sum, a seller must always be wary to protect the overage payment properly as it may be years after the original agreement was entered into that the payment becomes due. Issues such as the insolvency of a buyer or the subsequent transfer of the land to a third party (with no contractual connection to the original vendor) need to be considered carefully from the outset of the transaction.

- **Types of overage arrangement**

There are two basic types of overage:

The first (known as "positive overage") obliges the buyer to make an additional payment if a particular event (such as a grant of planning permission) occurs following completion of the original sale.

The second type of overage (known as "negative overage") occurs where a seller prevents the land from being used for a particular purpose until an overage payment is made.

- **Protection of overage payments**

Overage arrangements need to be correctly protected. However, the mechanism chosen to do this needs to be considered carefully. Certain methods may impact upon a buyer's financing arrangements and/or the use to which the affected land may be put.

- **Methods of Security**

There are a number of different alternatives available and the main options are as follows:

(i) Legal Charge and Restriction

On the transfer of the land, the seller takes a Legal Charge over the property to protect the overage payment. This charge is registered at the Land Registry and an appropriate restriction (preventing further dealings of the land without the consent of the charge holder) is registered against the affected land. Once the "trigger event" occurs (such as the grant of planning permission or completion of development), the overage payment becomes payable. If the overage payment is not made as agreed, the charge holder would be able to use its rights under the legal charge to force the sale of the land (and recover the overage payment from the sale proceeds).

Although often effective, the creation of a Legal Charge is not without its problems. In a recent case, a Legal Charge was used to secure an overage payment. However, the Court found that, on the precise construction of the overage agreement, the "trigger event" had not yet occurred and, as a consequence, the beneficiary of the option could not exercise its power of sale. Caution therefore needs to be taken to ensure the "trigger event" is correctly defined.

Another difficulty encountered when using a Legal Charge is the requirement to obtain the consent of any existing lender. Development is very often financed by a lender who will wish to secure its own interest by way of a Legal Charge. It will not wish to have this charge inhibited in any way and an appropriate restriction is often placed on the register of the affected land (preventing creation of other charges without its consent). Without this consent, it will be impossible to register any further legal charge at the Land Registry. Even if consent is forthcoming, the lender may require the parties to enter into an agreement regulating the relationship between respective Legal Charges (known as a Deed of Priority). Relegating the priority of the seller's legal charge behind that of the buyer's lender might ultimately lead to the seller being unable to realise payment of the overage sum.

(ii) Guarantee/bond

Alternatively, a guarantee or bond could be used to protect the overage payment. The validity of any guarantee or bond is, however, greatly affected by the solvency of the person (or more likely the company) providing the guarantee. No company can be regarded as financially impregnable and, should a "trigger event" not take place for many years after the original transfer of the land, there is a real risk that the party providing the guarantee or bond may have become insolvent by that time. In addition bonds from third parties such as Banks or other financial institutions are more reliable but are very expensive for a buyer to procure.

(iii) Restrictive Covenant

The parties may agree to the imposition of a restriction on the title to the property not to develop the land (or use it for specified activities) until an overage payment is made. This promise (known as a covenant) would be protected by a restriction at the Land Registry and will bind all successors in title to the land.

Although commonly used and relatively simple to administer, there are a number of potential pitfalls. The beneficiary of the overage agreement (or its successors) must retain land that genuinely benefits from restrictive covenant. It is not sufficient just to retain a small strip of land. In addition, the Courts will not generally enforce such restrictive covenants where the principal aim of their creation was to obtain payment. A restrictive covenant of this type may be challenged in the Lands Tribunal (if the restriction is deemed to be obsolete or impedes the reasonable use of land).

(iv) Personal Covenant and chain of Deeds of Covenant

Perhaps the most commonly used form of protection is for the original contract between the seller and buyer to contain either a positive overage obligation or negative overage obligation and then the parties agree that a restriction shall be placed upon the title to the land which effectively prevents the sale of the land without the buyer having entered into a Deed of Covenant with the original seller confirming that the buyer will also be bound by the provisions of the overage obligations in the original contract. This method creates a direct contractual relationship between the buyer and the beneficiary of the overage agreement and tends not to interfere with the buyer's financing arrangements but does give the seller a degree of control over the property.

- **Conclusion**

There is very little judicial interpretation regarding overage arrangements and a great deal of uncertainty still surrounds this area of law. Whilst a positive obligation on a buyer to make a payment secured by way of a restriction and chain of Deed of Covenants is the preferred option the parties do need to take great care in ensuring that the agreement is accurately documented and that their interests are properly protected.

Disputes in relation to the interpretation of overage agreements are becoming much more common and so specialist advice is imperative to avoid any problems at a later date.

Collateral Warranties

Although most people will have heard of collateral warranties there is often still a degree of uncertainty as to what they actually are and when they might be used. This article briefly outlines the intended purposes, pitfalls and explores some alternatives to collateral warranties.

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Collateral warranties are used primarily to create a contractual relationship between parties who would not otherwise have such a link. They are frequently relied upon during construction projects where there may be no direct contractual relationship between the purchaser (or tenant) of the finished project and those involved in the design and build process (such as architects or contractors). Whilst it is possible to bring a civil claim for negligence against defective workmanship or materials without a direct contractual relationship, recovery for purely economic losses (i.e. the cost of correcting defective works) cannot be recovered via this route.

In recent years, changes to the law have given an identifiable third party redress against a party to whom a direct contractual relationship does not exist. However, this avenue of redress is seldom used and is often carved out of any contract. Reliance on collateral warranties, therefore, remains the main route taken by purchasers and their respective funders and as such they will seek warranties from everyone involved in the construction process.

There are limitations of collateral warranties as a means of redress and there are potentially extremely serious pitfalls for over-reliance on these as a "watertight" means of protection.

The most fundamental component of a collateral warranty is that the entity providing it remains solvent (or that it maintains adequate professional indemnity insurance) so that it can be forced to honour the obligations created by the collateral warranty if required to do so.

A contractor with little or no funds (nor adequate insurance) may simply fold its operation once construction has been completed (or even during the construction process) to avoid expensive payments under a collateral warranty (thus rendering the warranty virtually useless). Extreme care must therefore be taken to ensure that the entity providing the warranty has in place adequate indemnity insurance.

A contractor's indemnity insurance will be on a claims arising basis which means that the insurer will only be liable if it is providing insurance at the time any defect comes to light. Collateral Warranties usually provide cover for a period of 12 years, primarily because defects in property may not manifest themselves for several years after the original construction. It is therefore imperative that the contractor continues to maintain its indemnity insurance for the full 12 year period. It may be appropriate to obtain a guarantee for the contractor's obligations under a warranty to give added protection to the purchaser or funder.

Another trap which may catch out the unwary is the right of the warrantor to offset sums owed to it by another party against actions for damages from the beneficiary of the warranty. This is particularly relevant where the recipient of a collateral warranty seeks to sue a sub-contractor in circumstances where the main contractor is insolvent. A recent case highlighted this situation: a supermarket had employed a developer to construct a new supermarket and accompanying car park. The car park suffered from numerous defects (for which the supermarket paid to have remedied) and, when the developer became insolvent, the supermarket sought to sue the sub-contractor (under the contractual warranty).

Unfortunately, the sub-contractor successfully argued that, because it was owed money by the now insolvent developer, these sums could be offset against the sum for which the supermarket was suing. The sub-contractor was successful and was able to offset those monies owed to it by the insolvent developer under the main contract against its liability to the supermarket under the collateral warranty.

Individuals or partnerships should be very wary of providing collateral warranties without the express approval of their professional indemnity insurers (as partnerships providing a warranty signed by one partner will usually create a liability binding against all the other partners).

Although a number of "standard form" warranties are now available, great care must be taken to ensure that the form of warranty entered into is approved both by the relevant professional body regulating the warrantor and by their insurers. Even minor deviations from the approved form of warranty may render any indemnity insurance invalid. Therefore, those seeking to rely on a warranty should ensure that it contains a clause confirming the approval of the warrantor's professional indemnity insurers.

As an alternative to the provision of collateral warranties, some insurers now provide latent defect insurance policies to protect prospective purchasers against expense caused by latent defects in the construction of the premises.

Such insurance usually lasts for a period of ten years after completion of the development and allows a purchaser to recover compensation without the need to rely on a warranty. Consequently this removes the risk of the contractor becoming insolvent and failing to have maintained adequate indemnity insurance. Such insurance, however, is not cheap and may not be available once the development has been completed (as it is often a requirement that the insurance company have the ability to inspect the development during its progression). Therefore many developers are unwilling to provide such cover.

The issues of collateral warranties are complex and need careful consideration and advice at an early stage.

Insolvency

With the uncertainties surrounding the current economic climate there are increasing numbers of companies that are becoming insolvent. This article looks at some of the issues which might arise for landlords when faced with an insolvent tenant.

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Tenant Administration – what a landlord needs to know

Administration provides a framework for the rescue of an insolvent company. The government introduced extensive changes to the process in the Enterprise Act 2002 as a method of promoting a rescue culture.

An administrator can now be appointed by an out of court method as well as by application to the court. The increasing importance of a commercial landlord having an awareness of the process of administration and the implications of a tenant being placed into administration becomes clear when the statistics are considered: in 2002, before the implementation of the Enterprise Act 2002, there were 643 administration orders made, in 2006, 3,560 companies were placed into administration and in 2007, the figure was 2,329. In the first few months of this year there have already been a number of high profile administrations.

When steps are taken to place a company into administration, restrictions come into effect whereby creditors are unable to take action that could impede the achievement of the purpose of the administration. This "statutory moratorium" severely limits the steps that a landlord may take. A landlord will need to obtain the permission of the court or the consent of the administrator before it can:

- Distrain for rent;
- Forfeit a lease by peaceable re-entry;
- Begin or continue any court proceedings; or
- Take any steps to enforce any security (e.g. if the landlord has the benefit of a charged rent deposit).

An administrator does not have the power to disclaim the liability of a tenant under a lease.

There are a number of ways in which a landlord may discover that its tenant has been placed into administration. The landlord can telephone the Central Registry of Winding-up Petitions if the administration is in the High Court, or the local County Court of the company if the administration is in the County Court. This will reveal whether an application or an order has been made (in the case of a court appointment) or the prescribed documents have been filed (in the case of an out of court appointment). Once an administrator has been appointed, he or she must send notice of the appointment to Companies House within 7 days. The administrator must also obtain details of the company's creditors (which would include a landlord creditor) as soon as reasonably practicable following appointment and notify them of the appointment. In addition, all business correspondence must give notice of the administration.

Once a company has been placed into administration, a landlord is unlikely to be able to recover any arrears of rent accruing in relation to the period up to the date of administration. It is likely that, unless the landlord is able to pursue a guarantor or a former tenant of the company, it will only have an unsecured claim in the administration for these sums, which will rank alongside all the other unsecured creditors.

If the administrator is intending to trade the business whilst he or she markets the same in an attempt to achieve a sale of the business as a going concern, or the survival of the company, the landlord should attempt to persuade the administrator to agree to pay the rent accruing from the date of appointment as an expense of the administration.

If the tenant, acting by the administrator, fails to pay the rent, the landlord will continue to incur losses. In such circumstances, it may be preferable to seek to terminate the lease either by surrender or forfeiture.

Surrender requires the agreement of both landlord and tenant and, if the administrator is not prepared to cooperate, it may not be possible to proceed by this route.

If the lease contains a right of forfeiture, the landlord may be able to apply to court for leave to forfeit, if the administrator does not consent to the same. The ground of forfeiture will depend on the breach committed. If the tenant is in administration, breaches could be non-payment of rent, the fact of the administration or, possibly, the administrator having let a third party into occupation of the property without the consent of the landlord. The latter ground will be especially common in so-called "pre-pack" situations, where the administrator sells the business immediately upon appointment and often grants a licence or some other short term right to occupy the property to the purchaser, without the landlord's consent.

The legislation does not provide any guidance on the factors that the courts should consider when faced with an application for leave to forfeit a lease, but case law indicates that the court will consider the effect that the forfeiture would have on the achievement of the purpose of the administration and will try to balance this with the proprietary rights of the landlord and the rights of other creditors. For example, where the company was no longer trading from the property and its assets had been sold to a third party, who wished to trade from the property, the court held that forfeiture would not prejudice the administration. In addition, if the administrator does not intend to procure the company to trade from a property, the forfeiture of the lease would not prejudice any other creditors, who would potentially have benefited if the company were to trade.

It seems likely that, unless the administrator can clearly demonstrate that the premises are required for the purposes of the administration and agrees to pay the rent in the future, an application by a landlord for leave to forfeit will be granted. Any leave given by the court is likely to result in the landlord having a lever to obtain payment of rent in the event that the administrator still wants to retain the premises and, if an administrator were to apply for relief from forfeiture, it is almost certain that relief would only be granted if an undertaking for the payment of rent was forthcoming.

An insolvent tenant can generally apply for relief from forfeiture in the same way as a solvent tenant, however the commercial considerations in applying for relief and the likelihood of the tenant being able to satisfy any conditions that would be attached to the grant of relief will clearly differ.

The impact of company voluntary arrangements

Company voluntary arrangements (CVAs) are governed by the Insolvency Act 1986. They enable a distressed company to propose a compromise of some or all of their liabilities, with a view to the business continuing. The proposals, if approved by 75% of voting creditors by value, become binding on all creditors, even if they voted against the compromise.

The recent case of Prudential Assurance Co Ltd and others v PRG Powerhouse Limited and others provides welcome reassurance to landlords and other creditors that, although CVAs are flexible and bind all creditors, they should not be used to deprive creditors of valuable guarantee rights which they may have against solvent third parties.

The case concerned an electrical retailer, PRG Powerhouse Limited (Powerhouse), which faced financial difficulties and decided to cease trading from 35 of its 88 stores. The 35 closed stores were all leasehold and many of the landlords had taken guarantees from Powerhouse's parent company, which was still solvent.

Powerhouse proposed a CVA to deal with the claims arising from the closure of the stores. The CVA proposals only compromised the claims arising from the closure of the 35 premises and all other creditors would be paid in full from Powerhouse's ongoing trading from the remaining stores. The landlords of the closed stores would be subject to the most severe compromise of their claims, as the terms of the CVA prevented them from bringing claims for accruing rent against either Powerhouse under the relevant lease, or the parent company under its guarantee. These landlords would only be able to share in a £1.5 million fund, which would provide a maximum of 28p in the pound on 12 months' rent, irrespective of the actual losses suffered.

The CVA proposals were approved by a sufficient percentage of the creditors, which is unsurprising on the basis that the terms did not prejudice them in any way. The landlords of the closed premises acknowledged the financial difficulties of Powerhouse, but strongly objected to the attempt to remove their rights to pursue the parent company for any losses caused to them due to Powerhouse's default.

The issues for determination by the court were whether the CVA did prevent the landlords of the closed premises from claiming against the parent company under the guarantees and, if so, whether this was a fair and proper result.

The court held that the CVA did not automatically release the guarantees. A CVA is a contract between the company and each creditor bound by the CVA. The terms of a CVA cannot release (or otherwise directly affect) rights and obligations which exist between a creditor and a third party. The court did, however, accept that (in theory) a CVA could have the effect of removing a creditor's ability to bring claims against third parties such as guarantors, because there could be a term which requires the creditor to agree not to sue a third party (i.e. in this case the parent company). This term would not affect the creditor's relationship with the guarantor, but it could (in theory) be enforced by Powerhouse.

The court held that this result would be "unfairly prejudicial" to the landlords of the closed premises who were holding guarantees. These landlords would suffer disproportionate prejudice compared with Powerhouse's other creditors. The landlords were also suffering more than they would have, had Powerhouse been placed into insolvent liquidation. In a liquidation, the landlords would have been able to recover their losses from the parent company and the court acknowledged that the reason a landlord takes a guarantee is to protect it in case of the tenant's default or insolvency.

The judgement provides some important guidance on the permissible treatment of creditors within a CVA:

- Where creditors of a distressed company have negotiated guarantees from a solvent third party, the distressed company's CVA cannot simply strip those rights away at the time when they are most needed;
- It will not be fair to remove rights against solvent third parties, unless full compensation is offered. If the third party was insolvent, it should promote its own independent insolvency process, which would in turn treat all of its creditors fairly;
- It may sometimes be necessary for different parties to be treated differently to ensure a fair outcome: whilst all the creditors were unsecured as against Powerhouse, the position of the landlords with the guarantees was materially different to the position of the rest of the landlords and the other unsecured creditors.

However, landlords faced with a CVA need to consider their position very carefully to ensure that they obtain the maximum level of protection.

Conclusion

Whether faced with a possible tenant administration or a CVA it is clear that landlords must act quickly and decisively when faced with a potentially insolvent tenant and seek professional advice on the options that are open to it.