Disclaiming Onerous Leases

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Do you have unwanted leasehold premises?

Clients often approach us thinking that there is nothing they can do about unwanted leases, other than find a new tenant and re-let the premises. This situation can often arise after an acquisition or a change in strategy. Worse still, we are often presented with a situation where the client has a property strategy whereby everything, including onerous leases, is transferred to a property company within the group and thereafter it becomes part of the annual void cost, if not re-let.

There is another way – a liquidator of a company in voluntary liquidation has the power to disclaim an onerous lease. Importantly, the power to disclaim a lease is available in a solvent liquidation, and this can be a useful restructuring tool to help clients terminate unwanted leases.

What does a disclaimer do?

Put simply, it forces the landlord to accept "a surrender" because the disclaimer serves to terminate the company's obligations under the lease. The liability remains, but this becomes a damages claim in the liquidation and has to be mitigated with anticipated future rentals from a new tenant. The claim therefore comprises the difference between the passing rent and the current market rent, with a void period to allow time for a new tenant to be found, plus dilapidations. The claim is then discounted on a net present value basis to reflect the fact that it is being paid early. The leading case on this is Re: Park Air Services plc ("Park Air")[1], which was a solvent liquidation.

Stephen Browne
Senior Managing Director

O: +44 20 8052 2415
M: +44 7710 378740
E: Stephen.Browne@teneo.com

1. House of Lords - Christopher Moran Holdings Ltd. v. Bairstow and Another (parliament.uk)

This approach enables a balance to be struck between compensating a landlord for the early surrender of a lease, but also enables a company to be removed from an onerous lease. For a company to remain in solvent liquidation, it would naturally require sufficient assets with which to settle the landlord's claim in full.

So, what is the catch?

Some leases have guarantees which oblige the guarantor to take on a new lease for the remaining term in the event of a default. If there is an obligation of this nature, it will need to be reviewed carefully to see if payment of the claim in full discharges the guarantor's obligation. For leases written after 1 January 1996, with authorised guarantee agreement ("AGA") provisions, there is normally a standard disclaimer clause that obliges the outgoing tenant to give a guarantee and to take on a new lease for the remaining term, if the lease gets disclaimed. So again, care needs to be taken that settlement of the claim fully discharges any liability under the AGA for the guarantor.

What happens if there are sub-tenants?

If there are sub-tenants, the under-lessee usually has the right to remain in the property in accordance with the underlease terms. They have legal status of "irremovability." In practical terms, any sub-tenants in occupation would help to confirm the rental income for the Park Air claim calculations. Naturally, the economic benefits generated by sub-tenants must be passed to the landlord post-disclaimer as they will transfer with the lease.

How does it work?

The company must have been placed into a Members' Voluntary (solvent) Liquidation – a process governed by UK statute and regulations – before the right of disclaimer exists. The company must therefore be capable of being placed into liquidation, which may require preparatory "tidying-up" steps.

In group situations, a disclaimer is not an option if unwanted leases are held in a key trading company. Whilst it may be possible to assign the unwanted leases to another company that is suitable for liquidation, the landlord's consent is likely to be required. Further, the landlord may claim foul play/breach of process if that company is then placed into liquidation shortly thereafter.

As stated above, the key is not to transfer unwanted leases to a company within the group that is strategic or has important assets within it, as this will restrict the ability to disclaim the leases.

Other considerations

It is very difficult to take a company out of liquidation – it is therefore essential that a full understanding of all the history and contracts is obtained and reviewed as part of the pre-liquidation planning. In addition, the tax implications should also be reviewed to ensure no adverse impact will occur irrespective of the lease and property position.

As noted above, for a disclaimer process to have merit, a company must be capable of being placed into liquidation. However, this does not preclude a liquidation target company from informing the landlord of its intention to commence solvent liquidation and trying to agree and pay the claim (on a Park Air basis) before the liquidation begins. This approach is advantageous in avoiding having to pay statutory interest on the claim (currently 8% p.a. from the date of liquidation commencement to the date payment is made). It also flushes out any guarantees that may have been forgotten about. The benefit for the landlord is that the property will be returned to their control at an earlier date.

Another favourable point is that business rates are not payable by a liquidator, on the condition that the premises are vacant and not being used for the benefit of the winding-up. This can be very helpful where it has not been possible to agree the landlord's claim pre-liquidation, as it may prove a greater saving than the interest cost of 8% referred to above.

In recent years, landlords have increased their capabilities for assessing trading performance and covenant strength and are likely to be better informed and more outspoken in challenging restructuring proposals. A robust covenant can make the situation feel uncomfortable initially but, based on our experience, it is key to enter into open and early dialogue with the landlord, particularly after an acquisition, so that the disclaimer can effectively be dealt with in the name of the acquired business.

Relationships with landlords who have leased multiple properties to a group need to be thought about and carefully managed. Landlords, if not familiar with the process, can at first see the use of liquidation as a tool to disclaim a lease as an abuse of process. However, it is an accepted practice and, once they have explored the position and received appropriate legal advice, they tend to be keen to engage with liquidators – particularly based on receiving payment from the company in liquidation using the Park Air claim calculation.

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