Landlords Welcome Landmark Decision In *Re Game Station*

The Court of Appeal in the case of *Re Game Station*[1] has held that rent payable by a tenant that enters administration is a priority expense of the administration while the leasehold premises are being used for the benefit of the administration. The rent will be treated as accruing from day to day.

The question at the heart of the *Re Game Station* Court of Appeal decision was: when is rent no more than a provable debt in the administration and when does it rank as an expense of the administration in priority to the administrator's own remuneration and costs? Until *Re Game Station*, the answer differed depending upon whether rent is payable in advance or in arrears and whether the landlord's claims fall due before, during or after the period when the administrator uses the premises for the purpose of the administration. This anomaly created some unfair legal outcomes and has been radically addressed by Lewison LJ in *Re Game Station*.

The decision overturns the cases of *Goldacre*[2] and *Luminar*[3], which were decided on the basis that it is not possible to apportion rent payable in advance. Instead, *Re Game Station* establishes that the Apportionment Act 1870 (which permits apportionment only where rent is payable in arrears) is in fact irrelevant to the application of the principle in *Lundy Granite*[4] (also known as the "salvage principle"). Lewison LJ found that previous case law had lost sight of the fact that the salvage principle is founded in equity and this had left the law in an unsatisfactory state.

High Court followed *Luminar* and *Goldacre* but Granted Permission to Appeal

Re Game Station involved the administration of the Game group of companies. The rent was payable quarterly in advance under various leases in which one of the companies in the group was the tenant. On 25 March 2012 the rent became due. It was not paid and the next day the group entered administration. Trading continued in some of the stores that were sold to Game Retail Ltd (the respondent tenant). The Administrator refused to pay the outstanding rent (approximately £3 million) which had fallen due before his appointment but continued to trade (rent free) from the property until the next quarter date.

The Administrator based his actions on the cases of *Goldacre* and *Luminar*. These decided that if a quarter's rent (payable in advance) falls due during a period in which administrators are using the property for the purposes of the administration, then (since rent payable in advance cannot be apportioned) the full quarter's rent is payable, even if the administrators cease to occupy the premises mid-quarter. However, where a quarter's rent payable in advance falls due before entry into administration, none of it is payable as an administration expense even if the administrators continue to use the property for the purposes of the administration. The rent is instead provable as a debt in the administration.

The judge also followed those two decisions but granted permission to appeal.

Application of the Salvage Principle

The consortium of landlords appealed on the basis that whether rent payable in advance is apportionable at common law or under the Apportionment Act 1870 is irrelevant. The relevance lies in the salvage principle.

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[1] *Pillar Denton Ltd and others v Jervis and others* [2014] EWCA Civ 180 (24 February 2014)
[2] *Goldacre (offices) Ltd v Nortel Networks UK Ltd* [2009] EWHC 3389 (CH)
[3] *Leisure (Norwich) II Ltd v Luminar Lava Ignite Ltd* [2012] EWHC 951 (Ch)
[4] *Re Lundy Granite Co ex p Heavan* (1870-71) LR 6 Ch App 462

Under the salvage principle, rent will be recoverable as an expense of the administration or liquidation where the liquidator or administrator makes use of or retains possession of leasehold premises.

The respondent tenants argued that the application of the salvage principle is dependent on the date at which liability for rent accrues due. They argued that only rent which is payable in arrears can be apportioned to the period of use. If the instalment falls due before the commencement of the administration and is payable in advance, the whole instalment is due on that date. The instalment cannot be apportioned to the period of use by the administrator of the premises. The claim for that instalment is therefore only a provable debt in the administration.

It was common ground that the salvage principle and the right to prove for a debt are not mutually exclusive. Under rules 12.3 and 13.12 of the Insolvency Rules, sums due under agreements made prior to a company's administration are unsecured claims which are provable in the administration (including sums continuing to fall due after administration). The fact that the liabilities under the lease were therefore provable debts did not mean that the salvage principle could not apply.

Court held that Apportionment is Irrelevant

Lewison LJ found that the fact that rent payable in advance is not apportionable under the Apportionment Act 1870 does not inevitably lead to the conclusion that the salvage principle does not apply. The salvage principle was never expressed in terms of when rent falls due or when rent accrues but is framed by reference to the period during which the company uses the landlord's property to its own advantage.

Lewison LJ also held that the salvage principle is one of equity and found that the rationale behind the salvage principle is a *"judge-made deeming provision under which the office holder is deemed to have incurred the liability in the course of the winding up or administration"*. Accordingly, equity treats the rent liability relating to the period when the company uses the landlords' property for its own benefit as if it were an expense of the liquidator or administrator. It is fair and it makes common sense that the landlord is paid the rate of rent under the lease for the period when the company uses the premises for the purpose of the relevant insolvency proceeding and the rent will be treated as accruing from day to day. The decision equally applies to administration and liquidation.

Comment

Lewison LJ specifically acknowledged in *Re Game Station* that reliance on previous case law has led to companies entering administration on the day immediately following a quarterly rent payment day expressly to avoid payment to the landlord in full. The problem has been exacerbated by a prompt sale of the business to a new company that can trade for the first quarter rent free. This was effectively the scenario in *Re Game Station* and it was clear that the law was unsatisfactory.

As Lewison LJ pointed out in the case, much of the past law relating to the treatment of rent during an administration was established at a time when rent was typically paid in arrears. Nowadays, rent is usually paid in instalments in advance for fixed periods. As a result, the development of the common law had led in many cases to injustices and it is not surprising that many landlords and administrators have been dissatisfied with their legal position. Fortunately, the successful appeal in *Re Game Station*, which relies on an equitable principle, means that the approach taken towards the treatment of rent payable by a corporate tenant subject to an insolvency process where the office holder continues to use the premises will be clearer and fairer for all parties.

If you would like to learn more about the issues in this alert, please contact your usual Ropes & Gray attorney, or any of the attorneys listed below.

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