Butterworths Company Law Cases/BCLC 1997 2/Re ITM Corp Ltd (in liq),; Sterling Estates v Pickard UK Ltd (formerly Paxus Professional Systems Ltd) and others - [1997] 2 BCLC 389

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Re ITM Corp Ltd (in liq),; Sterling Estates v Pickard UK Ltd (formerly Paxus Professional Systems Ltd) and others

CHANCERY DIVISION (COMPANIES COURT)

MICHAEL CRYSTAL QC SITTING AS A DEPUTY JUDGE OF THE HIGH COURT

16, 17, 18 DECEMBER 1996

Insolvency – Disclaimer by liquidator of lessee company – Freeholder seeking order vesting disclaimed interest in itself – Subtenants having proprietary interest under lease – Whether court having jurisdiction to make order – Insolvency Act 1986, ss 181, 182.

The respondent, Sterling Estates, was the freehold owner of a property, Meridien House. Meridien House had been let by Sterling's predecessor in title to ITM Corp Ltd (ITM) by a lease dated 22 May 1985 for a term of 25 years. The first appellant, Pickard (UK) Ltd (Pickard), was the subtenant of parts of Meridien House. In January 1992 Pickard allowed the second appelant, Solution 6 (UK) Ltd (Solution) into occupation. Solution paid rent to ITM initially and later to Sterling Estates pursuant to a notice under the Law of Distress Amendment Act 1908. ITM was ordered to be compulsorily wound up and a liquidator was appointed. On 8 March 1996 the liquidator gave notice, disclaiming all interests in the property, to Sterling Estates, Pickard and Solution. Sterling Estates did not apply for an order that the disclaimed property be vested in Pickard or Solution as both companies had made it plain that if put to an election, they would elect to be excluded from all interest in the property, since to do so would make no economic sense as the rent under the head lease was £18 per square foot at a time when the current rental would be £7 per square foot. Therefore, on 7 May 1996, Sterling Estates applied in the winding up of ITM for an order vesting ITM's disclaimed interest in itself. On 30 October 1996 Mr Registrar Buckley made an order vesting the unexpired term of the lease in Sterling Estates subject to, and with the benefit of, the existing sub-leases. Pickard and Solution appealed against the order.

Held – The court had no jurisdiction under s 181 of the Insolvency Act 1986 to make the order sought. In order to bring itself within that section, Sterling had to show that it was a person claiming an interest in the disclaimed property and that it was a person entitled to the property. The authorities showed that a landlord was a person claiming an interest in the disclaimed property and thus Sterling satisfied the first requirement, but it did not satisfy the second as it was not entitled to the property. The disclaimer of the interest by the head lessee did not result in the subtenant losing his interest in the property. He remained entitled to possession of the property and thus the landlord was not entitled to it. A landlord could only become entitled to possession of the property once all the interests of all other relevant parties

who had, or could obtain, an interest in the property had been cleared away by invoking the mechanism contained in s 182.

Cases referred to in judgment

AE Realisations (1985) Ltd, Re *[1987] BCLC 486, [1987] 3 All ER 83, [1988] 1 WLR 200.*

Cock, Re, ex p Shilson (1887) 20 QBD 343, DC.

Finley, Re, ex p Clothworkers' Co (1888) 21 QBD 475, CA.

Hill v East and West India Dock Co (1884) 9 App Cas 448, HL.

Hindcastle Ltd v Barbara Attenborough Associates Ltd [1996] 2 BCLC 234, [1996] 1 All ER 737, [1997] AC 70, [1996] 2 WLR 262, HL.

Appeal

The appellants, Pickard UK Ltd and Solution 6 (UK) Ltd, appealed against the order of Mr Registrar Buckley made on 30 October 1996, whereby he ordered that 'The unexpired term of a lease dated 22nd May, 1985 made between Liverpool Victoria Trustees Limited and ITM Corporation Ltd of Meridien House, 100 Hanger Lane, London, W.5 be vested in Sterling Estates [the respondent] subject to, and with the benefit of, the existing sub-leases of various parts of the property'. The facts are set out in the judgment.

Jonathan Gaunt QC (instructed by *Dibb Lupton Alsop*) for Pickard UK Ltd and Solution 6 (UK) Ltd.

Linden Ife (instructed by *Berwin Leighton*) for Sterling Estates.

National Westminster Bank plc, the third respondent to the original application, did not appear and was not represented.

MICHAEL CRYSTAL QC.

The background

Sterling Estates is the freehold owner of Meridien House, 100 Hanger Lane, London W5. Meridien House was let by Sterling's predecessor in title, Liverpool Victoria Trustees Ltd, to ITM Corp Ltd (ITM) by a lease dated 22 May 1985 for a term of 25 years from 22 May 1985.

Paxus Professional Systems Ltd, now called Pickard UK Ltd (Paxus) is the subtenant of parts of Meridien House, having been granted underleases in respect of the ground floor, the first floor and the third floor.

In January 1992 Paxus allowed Solution 6 (UK) Ltd (Solution 6) into occupation of the ground, first and third floors. Solution 6 paid the rent to ITM and, pursuant to a notice under the Law of Distress Amendment Act 1908, to the freeholder. ITM refused to consent to the assignment of the underleases to Solution 6, and no assignment has ever taken place. It is not necessary for present purposes to determine whether Solution 6 is a periodic sub-undertenant of Paxus, a periodic subtenant of ITM, or a mere licensee.

ITM was ordered to be compulsorily wound up on 20 September 1995, and a liquidator was appointed. On 8 March 1996 the liquidator gave notice of disclaimer, so far as material, in the following terms:

> 'I, Frederick Charles Satow, ACA, the liquidator of the above-named company, disclaim all of my interest in property situate at Meridien House, Hanger Lane, London, W.5, comprised in a lease dated 22 May

> 1985 between Liverpool Victoria Trustees Limited (1) and ITM Corporation Limited (2) for a term of 25 years from 22 May 1985 . . .'

Notice of this disclaimer was given, so far as is material, to Sterling Estates, Paxus and Solution 6.

On 7 May 1996 Sterling Estates applied in the winding up of ITM for an order vesting ITM's disclaimed interest in itself. On 30 October 1996 Mr Registrar Buckley made an order that:

> 'The unexpired term of a lease dated 22nd May, 1985 made between Liverpool Victoria Trustees Limited and ITM Corporation Limited of Meridien House, 100 Hanger Lane, London, W.5 be vested in Sterling Estates (the applicant) subject to, and with the benefit of, the existing sub-leases of the various parts of the property.'

Paxus and Solution 6 appeal against that order. The question raised by this appeal is whether the court has jurisdiction to make the order made by Mr Registrar Buckley.

Disclaimer: aspects of the statutory framework

Section 178 of the Insolvency Act 1986 (the 1986 Act) gives a liquidator the power to 'disclaim . . . onerous property' (see s 178(2)). A disclaimer under s 178 'operates so as to determine, as from the date of the disclaimer, the rights, interests and liabilities of the company in or in respect of the property disclaimed' (s 178(4)(a)). The disclaimer 'does not, except so far as is necessary for the purpose of releasing the company from any liability, affect the rights or liabilities of any other person' (s 178(4)(b)).

A disclaimer under s 178 of any property of a leasehold nature—

> 'does not take effect unless a copy of the disclaimer has been served (so far as the liquidator is

> aware of their addresses) on every person claiming under the company as underlessee or mortgagee and either . . . no application under section 181 . . . is made with respect to [the] property [within] 14 days [of the date on which the last notice has been served]; or . . . where an application [is] made, the court directs that the disclaimer [should] take effect.' (See s 179.)

Section 181 contains the general powers of the court 'where the liquidator has disclaimed property under section 178'. Section 181(2)(a) provides:

> 'An application under this section may be made to the court by—(a) any person who claims an interest in the disclaimed property . . .'

Section 181(3)(a) provides:

> 'Subject as follows, the court may on the application make an order, on such terms as it thinks fit, for the vesting of the disclaimed property in, or for its delivery to—(a) a person entitled to it . . .'

Section 181 applies to all property of a company which is capable of disclaimer, ie onerous property. Section 178(3) defines onerous property as—

> '(a) any unprofitable contract, and (b) any other property of the company which is unsaleable or not readily saleable or is such that it may give rise to a liability to pay money or perform any other onerous act.'

Section 182 imposes restrictions on the power of the court to vest property of a leasehold nature 'in any person claiming under the company as underlessee or mortgagee'. The court can make such a vesting order only on terms which subject the underlessee or mortgagee—

> 'to the same liabilities and obligations as the company was subject to under the lease at the commencement of the winding up, or . . . subject to the same liabilities and obligations as [the underlessee or mortgagee] would be subject to if the lease had been assigned to him at the commencement of the winding up.' (See s 182(1).)

In a case where s 182(1) applies—

> 'and no person claiming under the company as underlessee or mortgagee is willing to accept an order [on the terms required by the statute], the court may . . . vest the company's estate or interest in the property in any person who is liable (whether personally or in a representative capacity, and whether alone or jointly with the company) to perform the lessee's covenants in the lease.' (See s 182(3).)

Where s 182(1) applies 'and a person claiming under the company as underlessee or mortgagee declines to accept an order under section 181, that person is excluded from all interest in the property' (s 182(4)).

Sections 178(4), 181 and 182 of the 1986 Act substantially re-enact s 55(2) and (6) of the Bankruptcy Act 1883 (the 1883 Act). The relevant provisions of the 1883 Act were re-enacted in s 54 of the Bankruptcy Act 1914. The provisions of that Act were the model for s 267 of the Companies Act 1929. The 1929 Act introduced provisions for the disclaimer of onerous property into the winding up of a company for the first time. A description of the relevant legislation between 1883 and 1996 is to be found in the judgment of Vinelott J in *Re AE Realisations (1985) Ltd* [1987] BCLC 486 at 489, [1988] 1 WLR 200 at 204. Section 55(2)

and (6) of the 1883 Act are set out in that judgment (see [1987] BCLC 486 at 492–493, [1988] 1 WLR 200 at 207–208).

Disclaimer: where other persons have an interest in the property

In *Hindcastle Ltd v Barbara Attenborough Associates Ltd* [1996] 2 BCLC 234, [1997] AC 70, the House of Lords considered the consequences of disclaimer on insolvency. Lord Nicholls of Birkenhead, who gave the leading speech, identified three principal categories of landlord and tenant situations where disclaimer on insolvency has an impact. The three categories are: (1) a case where only a landlord and tenant are involved; (2) a case where others have liabilities in respect of the lease; and (3) a case where other persons have

an interest in the property. The actual case before the House of Lords fell into category (2). The case before me falls into category (3). In relation to a case in this category, Lord Nicholls observed ([1996] 2 BCLC 234 at 246, [1997] AC 70 at 89):

> 'In both instances considered so far no person had acquired a proprietary interest under the lease before disclaimer. The third typical case is where a third party has acquired such an interest. The prime example is a subtenant. I can deal with this very shortly. In order to free the tenant from liability, it is necessary to extinguish the landlord's rights against the tenant and also the subtenant's rights against the tenant. The tenant's interest in the property is determined, but not so as to affect the interest of the subtenant. Determination of the subtenant's interest in the property is not necessary to free the tenant from liability. Hence the subtenant's interest continues. No deeming is necessary to produce this result. Here the deeming relates to the terms on which the subtenant's proprietary interest continues. His interest continues unaffected by the determination of the tenant's interest. Accordingly the subtenant holds his estate on the same terms, and subject to the same rights and obligations, as *would* be applicable *if* the tenant's interest had continued. If he pays the rent and performs the tenant covenants in the disclaimed lease, the landlord cannot eject him. If he does not, the landlord can distrain upon his goods for the rent reserved by the disclaimed lease or bring forfeiture proceedings. In practice, matters are likely to be brought to a head by one of the parties making an application for a vesting order.' (Lord Nicholls' emphasis.)

Accordingly, the subtenant's proprietary interest in the property continues unaffected by the determination of the tenant's interest on its disclaimer by the liquidator of the tenant. The subtenant remains entitled to possession of the property under the underlease, subject to payment of the rent.

Disclaimer: how the legislation is intended to work

Section 55(2) and (6) of the 1883 Act were the subject of authoritative consideration by the courts in the late 1880s. In *Re Cock, ex p Shilson* (1887) 20 QBD 343 a lessee mortgaged property by sub-demise. He went bankrupt and his trustee in bankruptcy disclaimed the lease. The lessor applied for an order that the mortgagee should be excluded from all interest in and security upon the property, unless within seven days he elected to accept an order vesting in him the disclaimed property, subject to the same liabilities and obligations as the bankrupt was subject to under the lease. The Divisional Court in Bankruptcy (Cave and A L Smith JJ) held that such an order could be made upon the application of the lessor.

Cave J, delivering the judgment of the court, said (at 348–349):

> 'Let us see how the case will work out in practice. A. grants a lease for ninety-nine years at 100*l*. a year to B., who assigns to C., who in consideration of an advance of £2,000*l*. demises to D. for the residue of the term, except three days, at a peppercorn. C. becomes bankrupt, and his trustee wishing to disclaim brings A., B., and D. before the Court. A. cannot apply for a vesting order because he is not entitled to the

> property, nor can B. so long as D. is willing to take a vesting order. B. therefore applies that D. may be put to his election, and if he declines to take a vesting order that he may be excluded, and a vesting order made in favour of him, B. The same thing occurs where C. is the lessee and B. is only a surety for him. Where there is no person liable, either jointly with the bankrupt or alone, to perform the lessee's covenants we are of opinion that . . . the landlord may apply that the sub-lessee may be put to his election. If he elects to take a vesting order he gets one. If he declines the landlord may ask for an order excluding the sub-lessee from all interest in and security upon the property, and vesting the property in him, the landlord, discharged from the sub-lease, because, by virtue of the disclaimer and of the exclusion of the sub-lessee he has become the party entitled. This course appears to us to be warranted by the language of the Act, and to carry out its provisions. Until the sub-lessee has declined to take a vesting order the Court has no power to make a vesting order either in favour of the original lessee or of the surety for the bankrupt, if there is one, and, consequently, if the power could only be exercised upon an application by a sub-lessee it would remain a dead letter, for the sub-lessee never would have any interest in making such an application, and the person liable jointly with the bankrupt, or alone, could not get a vesting order until the sub-lessee had declined. Where all the parties are before the Court upon an application for leave to disclaim, the vesting order may at once be offered to the sub-lessee, and on his refusal may be granted to the surety or original lessee, or if there is no person liable alone or jointly with the bankrupt, an order for a vesting order and for delivery of possession, or for a vesting order only, as the circumstances may require, may be made in favour of the lessor. Where no leave to disclaim is required, and consequently the parties interested in the property disclaimed or liable to perform the covenants of the lease are not brought before the Court by the trustee, we are of opinion that the person liable to perform the covenants, or, in the absence of such person, the lessor, may bring the sub-lessee before the Court, and ask for an order for his exclusion and for a vesting order, or for delivery of the property, if the sub-lessee refuses himself to take a vesting order.'

The essence of the Divisional Court's view was that the court had no power under s 55 of the 1883 Act to make a vesting order in favour of a landlord until the interests of all other relevant parties who had or could obtain an interest in the property had been cleared away through use of the statutory machinery.

Re Cock, ex p Shilson was approved and followed by the Court of Appeal in *Re Finley, ex p Clothworkers' Co* (1888) 21 QBD 475, where a similar application was under consideration. In this case the mortgagee had in fact taken possession of the mortgaged premises and let them to a tenant after the adjudication in bankruptcy. The judgment of the court (Lord Esher MR, and Lindley and Bowen LJJ), was delivered by Lindley LJ. Lindley LJ observed (at 485–487):

> 'Next we must consider the more complicated case of the original lessee becoming bankrupt, and we must consider it, first, as between him and his lessor. As between them the consequences will be the same if there were no sub-lease. As between the lessee and the sub-lessee the consequences will apparently be these. The lessee's rights and interests and liabilities are determined under sub-s. 2, and the extinction of his rights involves the extinction of the liability of the sub-lessee under his covenants. We must next consider the case as between the original lessor and the sub-lessee. Now their rights and liabilities are preserved by sub-s. 2, and, subject to the effect of a vesting order, whatever that may be, the case will stand in this way—the sub-lessee, although freed from his covenants to his own immediate lessor, must perform the covenants of the original lease or he will be liable to be distrained upon and to be ejected by the original lessor. That is obviously his position, and that was the position in which a lessee found himself, on the disclaimer of the lease by the trustee in the bankruptcy of his assignee, in *Hill v East and West India Dock Co* ((1884) 9 App Cas 448), under the Bankruptcy Act, 1869. That is by no means an enviable position, and it is a strange position in which to leave him. But the present Bankruptcy Act goes further. It does not stop with sub-s. 2,

> but sub-s. 6 has also to be considered. The sub-lessee can evidently apply under sub-s. 6 for an order vesting the lease in him; there is no controversy about that. But the question is, whether the lessor can apply for an order vesting the lease in the sub-lessee? It appears to us, for the reasons which I have already stated, having regard, that is, to the meaning of the word "property" and of the words "person claiming any interest in the disclaimed property," that the lessor can apply for such an order. But, whether the application is made by the sub-lessee or by the original lessor, in either case the vesting order can only be made in favour of the sub-lessee, subject to the covenants and conditions of the original lease, and, if the sub-lessee will not take the property on those terms, which, of course, he need not do, then these consequences appear to follow: First, the sub-lessee will be excluded from all interest in the disclaimed property. Whether the latter part of the proviso in clause 6 will apply will depend upon whether there is any such person as is there referred to. There may or may not be. If no vesting order is made, the lease will be determined under sub-s. 2, the sub-lease will be determined under sub-s. 6, and the lessor will take the property freed from both lease and sub-lease. This appears to us to be the logical consequence of the Act, and it is impossible not to see that it is a very startling result. It will very seriously affect the old practice of taking securities on leasehold property by way of sub-demise, the whole object of which was to prevent the mortgagee from becoming liable to the rent and to the covenants and obligations of the original lease. If the decision of the Divisional Court in *Ex parte Shilson* (20 QBD 343) is right, as we think it is, this anomaly will be introduced into the practice of conveyancing in the event of the bankruptcy of a mortgagee of leasehold property by sub-demise.'

Given the provenance of the 1986 Act, the guidance provided by the Victorian cases is equally applicable to the current disclaimer legislation: see

per Vinelott J, *Re AE Realisations (1985) Ltd* [1987] BCLC 486 at 489, [1988] 1 WLR 200 at 204. In *Hindcastle* [1996] 2 BCLC 234 at 248, [1997] AC 70 at 91 Lord Nicholls described *Re Finley* as one of the leading cases. He also stated that Lindley LJ's analysis of the effect of the 1883 Act was similar to his own in relation to categories 1 and 3 of the principal types of landlord and tenant situations on which disclaimer on insolvency has an impact (see [1996] 2 BCLC 234 at 248–249, [1997] AC 70 at 91).

The current application

Sterling Estates has not applied for an order that the disclaimed property be vested in Paxus or Solution 6, subject to the same liabilities and obligations as ITM was subject to under the head lease, or that they be excluded from all interest in the property. It has not done so because Paxus and Solution 6 have made it plain that if they are put to their election they will elect to be excluded from all interest in the property. The rent under the headlease is £18 per square foot. A current rental would be of the order of £7 to £8 per square foot, and, accordingly, electing to become subject to the headlease would make no economic sense. Instead Sterling Estates contends that the court can make an order vesting the disclaimed lease in it, Sterling Estates, as landlord, with the consequence that, so it is said, Sterling Estates becomes entitled to the benefit of the existing subleases; in other words, the argument is that a landlord can obtain a vesting order from the court without clearing off the interests of those categories of interested or potentially interested persons identified in s 182.

Miss Ife, for Sterling Estates, submits that the court has jurisdiction to make such an order under s 181. I do not think this can be correct. To come within s 181 Sterling Estates has to show (1) that it is a person claiming 'an interest in the disclaimed property' (see s 181(2)(a)); and (2) that it is 'a person entitled to [the property]' (see s 181(3)(a)). In those events, the court would have power to vest the disclaimed property in Sterling Estates.

As to (1), the Victorian cases referred to above show that a landlord is a person claiming an interest in the disclaimed property. As to (2), however, the crucial words are:

> '. . . the court may . . . make an order . . . for the vesting of the disclaimed property in or for its delivery to—(a) a person entitled to it . . .'

The 'it' must refer to the property in question.

Lord Nicholls' analysis of the consequences of disclaimer on insolvency on a subtenant makes it plain that the subtenant does not, by virtue of the disclaimer of the interest of the tenant in the property, lose his, the subtenant's, interest in the property itself. He remains entitled to possession of the property; the landlord is not therefore entitled to it. He can only become entitled to possession of the property as against the subtenant by invoking the mechanism contained in s 182. In cases where the economic implications are the same as in the present case, where a landlord puts a subtenant to his election and the subtenant elects not to accept an order under s 181, he is excluded from all further interest in the property. His

sublease then goes and with it the subtenant's right to continue in possession of the property.

Conclusions

For over 110 years the legislation dealing with disclaimer on insolvency has been in essentially the same form. There is no reported decision in which a landlord has attempted to do what Sterling Estates seek to do in this case. So far as the researches of counsel go, none of the standard textbooks, nor precedents, suggest that the court has jurisdiction to make an order of the type sought by Sterling Estates.

Recession is a part of the economic cycle. There have been a number of recessions over the last 110 years. It does not appear to have occurred to those advising landlords in former recessionary times that they could obtain from the court an order of the type made by the registrar in this case.

These matters are, of course, only indicators as to the likely presence or absence of the asserted jurisdiction.

For the reasons which I have endeavoured to give above, I am satisfied that the court has no jurisdiction to make the order sought by Sterling Estates in this case. The order made by Mr Registrar Buckley, so far as concerns Paxus and Solution 6, must therefore be discharged.

Appeal allowed. Order made by Mr Registrar Buckley discharged.

Dilys Tausz Barrister.