

Tenant Insolvency – The Legal Consequences

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The vast majority of businesses in the Island occupy premises which are leased from third parties. Commercial leases are thus of central importance to the ability of businesses to trade. Moreover, the ability to let premises to business occupiers is what underlies investment in, and development of, commercial property.

The insolvency of a business tenant is therefore a matter of great seriousness. For the tenant, this evidently marks the point at which creditors, including the landlord, cannot be paid, and trading must come to an end. For its part, the landlord, with its income stream cut off, faces potential financial problems, particularly if the property has been financed with a bank loan which requires for its servicing the ongoing receipt of rental income.

In some cases, a consensual solution may be available. Another business may be keen to take the premises in question, and the change of tenant may be able to be effected either by an assignment of the lease or by an agreed surrender of the lease

and the grant of a new lease by the landlord to the new tenant. Any such solution will require negotiation between the landlord and the insolvency official dealing with the affairs of the insolvent tenant, that is to say (i) the Viscount in the case of a *désastre* (bankruptcy), (ii) the liquidator in the case of a creditors' winding up under the **Companies (Jersey) Law 1991** or (iii) a foreign insolvency official; in the case of the latter, the official's ability to transact in Jersey will be subject to recognition by the Royal Court under Article 49 of the **Bankruptcy (Désastre) (Jersey) Law 1990**.

If no such consensual solution can be found, there are two potential courses of action which require to be considered, namely (a) cancellation and (b) disclaimer.

Commercial leases will typically provide for the landlord to be able to seek an order from the Royal Court cancelling the lease in various 'default' scenarios, which will usually include

désastre, winding up and various other insolvency situations, as well as simple failure to pay the rent due under the lease and other material breaches of covenant. The Royal Court has consistently made clear that cancellation is a remedy of last resort, which will not be ordered where the landlord can be adequately compensated for the tenant's breach. However, where the ground for cancellation is the tenant's insolvency, the Court would be unlikely to refuse cancellation, unless, perhaps, it considered that there was value in the lease which could be realised for the benefit of the insolvent tenant's creditors.

Cancellation brings the term of a lease to an early end. One consequence of this, which a landlord will need to bear in mind, is that any guarantors of the tenant's obligations will themselves be freed of ongoing contingent liability. A guarantor will not, however, be freed from liability in respect of a demand which has already been made under the guarantee.

The effect of cancellation on any sub-leases also needs to be considered. The position under Jersey law is not free from doubt, but the effect of cancellation of a lease is probably that any sub-leases granted by the tenant will themselves come to an end. Sub-tenants could be prejudiced by being left with no contractual right to continue to occupy the sub-let premises and thus at a disadvantage in negotiations with the landlord. By the same token, however, the situation could be attractive to a sub-tenant whom the landlord wished to continue in occupation but who had alternative premises available and could exploit the circumstances to negotiate more favourable lease terms.

Turning now to disclaimer, this is the ability (conferred on the Viscount by the **Bankruptcy (Désastre) (Jersey) Law 1990** and on liquidators by the **Companies (Jersey) Law 1990**) to repudiate an onerous contractual relationship.

Repudiation of a lease brings the lease to an end, and releases the insolvent company from liability, but "except so far as is necessary for the purpose of releasing the company from liability" this does not "affect the rights or liabilities of any other person". What this means has not been considered by the Royal Court, but clear guidance is available from English case law on the equivalent legislative provisions. Where a lease is disclaimed, a guarantee will remain in place, as will any sub-lease provided the sub-tenant continues to pay rent to the head landlord. Clearly this is conceptually strange – we enter a hypothetical world where the disclaimed lease is deemed for certain purposes to have an ongoing existence – but the intention and effect of the legislation is to limit the contractual fall-out from the disclaimer of a lease.

The insolvency of a business tenant can give rise to a host of difficulties and legal issues, to say nothing of the human cost in redundancies and other financial hardship. For all parties concerned, the importance of obtaining clear professional advice at an early stage cannot be overstated.

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