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Lehman Waterfall Application and Game Station Decision

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LEHMAN BROTHERS INTERNATIONAL (EUROPE) - WATERFALL DECISION

In another judicial decision springing from Lehman Brothers, as a result of the likely surplus in the estate of Lehman Brothers International (Europe) (in administration) (LBIE) after all the provable debts have been paid, Mr Justice Richards has issued a 'statement of conclusions' in what is called the Waterfall Application. A more detailed judgement is expected in late March 2014. We summarise the conclusions below.

Ranking and Contributions of Shareholders of Unlimited Companies

LBIE's shareholders (Lehman Brothers Limited (LBL) and LB Holdings Intermediate Limited (LBHI) both are in administration) have substantial unsecured claims against LBIE. One of the issues for consideration was whether the claims of LBL and LBHI were subordinated to the claims of the creditors of LBIE to be paid post-administration statutory interest. David Richards J concluded that the unsecured claims of LBIE's shareholders were subordinated not only to provable debts but also to statutory interest and liabilities that can't be 'proved' in the insolvency. This decision is welcome news to ordinary unsecured creditors of LBIE as their recoveries will not be diluted by the claims of LBL and LBHI.

With respect to the obligation of members of a company to contribute under section 74(1) of the Insolvency Act 1986 (up to the amount to make good the debts of an insolvent company; shortfall paid on the shareholders' shares in a limited company), David Richards J concluded that this obligation extends not only to provide for provable debts but also for statutory interest on those debts and un-provable liabilities. For shareholders of unlimited companies this decision shows that their obligation to contribute under section 74(1) of the Insolvency Act 1986 can be far-reaching.

Creditors with Claims that are Denominated in a Foreign Currency

David Richards J also addressed the question of whether creditors with a contractual entitlement to be paid in a currency other than sterling had a claim against LBIE for any shortfall suffered by them. He concluded that creditors of LBIE are entitled to make claims against LBIE for any currency losses suffered by them as a result of a decline in the value of sterling as compared to the currency of the claim between the date of the commencement of the administration of LBIE and the date or dates of payment or payments of distributions to them in respect of their claims. These currency conversion claims rank as un-provable liabilities, payable only after the payment in full of all provable debts and statutory interest on those debts.

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JERVIS V PILLAR DENTON LIMITED (GAME STATION) AND OTHERS [2014] EWCA CIV 180 – “GAME STATION DECISION”

As a result of the decisions in *Goldacre (Offices) Ltd v Nortel Networks UK Ltd* [2011] Ch 455 (“*Goldacre*”) and *Leisure (Norwich) II Ltd v Luminar Lava Ignite Ltd* [2013] 3 WLR 1132 (“*Luminar*”), it was common practice for companies to be placed into administration immediately following a quarter day avoiding liability to pay full rent even if they retain possession and use of the property for the purpose of the administration. This was because where rent is payable in advance (which is usually the case) and an administrator is appointed after the rent date has passed, the outstanding rent will be deemed to be an unsecured debt and the landlord will rank among the insolvent company’s unsecured creditors. As a result, a landlord was unlikely to recover the entire sum owed. Consequently administrators would commonly use the insolvent company’s premises until the next rent date without having to pay rent to the landlord. From the perspective of the landlord, its position was made even worse after a pre-pack sale of the business to a new company as the new owner could, in effect, use the premises rent free for the remainder of first three months.

Conversely, if an administrator was appointed before the rent falls due, and was still in occupation when the next rent day came around, the rent would be treated as an expense of the administration and therefore given priority over the other debts of the company.

The Decision

Overruling *Goldacre* and *Luminar*, the Court of Appeal held that the question of whether quarter rent due under a lease was an administration expense or a provable debt depended not on whether the rent fell due during the period of the administration, but whether the property had been used for the benefit of the administration.

The Court of Appeal also made the following important observations:

- a) where an administrator or liquidator makes use of leasehold property for the purposes of the administration or winding up, then the reserved rent is payable as an expense for the period during which the property is so used, and will be treated as accruing from day to day for that purpose. This is true whether the rent is payable in arrears or in advance; and
- b) that the date upon which a quarter’s rent becomes due and payable, and whether that is before, during or after the period during which the property is used for the purposes of the administration or liquidation, is irrelevant.

The *Game Station* decision is good news for commercial landlords and effectively reinstates the historic position on rent in administration, as it was before *Goldacre* and *Luminar*, namely that the administrator should pay rent, as an expense, for any days that the administrator uses or occupies leasehold premises. This is the same approach as applied to the question of whether other costs incurred in an administration or liquidation should be treated as expenses to be paid in priority to other debts.

For administrators and liquidators, the *Game Station* decision creates uncertainty. Administrators and liquidators alike now have to consider whether landlords in historic cases who were adversely affected by the *Luminar* or *Goldacre* decisions may now seek to reclaim the rent from administrators and liquidators. If a landlord is successful in its claim, it is unlikely that the administrator or liquidator will now be able to recover monies distributed to other creditors, with the result that any rental payment will have to come from the administrator’s or

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liquidator's pockets (unless the administrator or liquidator has the benefit of indemnity from a purchaser which would cover such a claim).

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