Commercial Rent Arrears Recovery and Administration: Questions as to Timing, Security and Priorities

James Morgan QC
Barrister, St Philips Chambers and Radcliffe Chambers

Devinder Singh
Partner, Squire Patton Boggs (UK) LLP

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Introduction

Distress was an ancient common law remedy only available to landlords in respect of the non-payment of rent. It was regarded by many as an outdated and draconian approach to debt enforcement, long in need of reform.[1] It was abolished with effect from 6 April 2014 by Pt 3 of the Tribunals, Courts and Enforcement Act 2007 (TCEA 2007) and replaced with the Commercial Rent Arrears Recovery (CRAR) scheme, which applies to commercial premises only.

Paragraphs 317 and 318 of the Explanatory Notes to Pt 3 respectively state that the TCEA 2007 "unifies the law governing the activities of enforcement agents when taking control of and selling goods" and "abolishes the common law right to distrain for rent arrears and replaces it with a new, more limited right and a modified 'out of court' regime for recovering rent arrears due under a lease of commercial premises".

Schedule 12 of the TCEA 2007 contains much of the detail and it applies to writs of control (formerly writs of fieri facias) and warrants of control (formerly warrants of execution) as well as to CRAR.[2] The rights of commercial landlords are therefore to be considered as part of a unified structure for the use of enforcement agents to take control of goods and sell them to recover a sum of money.

A landlord who wishes to use CRAR is required to use the same basic three-stage process under Sch.12 as other types of creditors:

1) Service of a notice on the debtor (Stage 1: Notice).
2) Taking control of the goods by the enforcement agent (Stage 2: Taking Control).
3) Sale of the goods and payment to the creditor (Stage 3: Sale and Payment).

A commercial tenant that is unable to pay its rent may also be subject to insolvency procedures and, particularly if it has a viable underlying business, administrators may be appointed over it. The appointment of administrators (or the making of an application for an administration order or the filing of a notice of intention to appoint) will bring into force the statutory moratorium under paras 43 or 44 of Sch.B1 to the Insolvency Act 1986 (IA 1986) and prevent a landlord from commencing or completing the CRAR process without the permission of the administrators or the court.[3]

This gives rise to the question as to what rights (if any) a landlord has at Stages 1 to 3 and in particular whether it has any secured or other rights in priority to those of the general body of creditors. This is an issue of particularly acuity for administrators who may wish to sell the tenant's business and assets to a third party, often as a matter of urgency through a pre-packaged sale, without exposing themselves to the risk of personal claims. A related issue is the priority between the landlord and a creditor of the company holding pre-existing floating charge security that extends to the goods.

Surprisingly, to the authors' knowledge, there is not yet any specific authority on the points notwithstanding that the CRAR provisions have now been in force for over six years. To consider the issues it is necessary first to understand something of the old regimes.

Old regimes

Distress entitled the landlord, in appropriate circumstances, summarily to seize goods found on the demised premises, sell them and recoup from the proceeds of sale any arrears of rent owed by the tenant. Relevantly for present purposes, when a person distrained for rent he or she took a pledge of the goods by taking possession of the goods in question. The distrainor therefore took security over the goods seized and had the right to sell them. This security interest could take priority over the interest of a debenture-holder having a floating charge.[4]

The position with regard to execution was different. Focusing for illustrative purposes on writs of fieri facias, the process was: (a) delivery of the writ to the sheriff; (b) seizure of the goods; (c) possible payment; and (d) if no payment, sale of the goods to meet the creditor's claim.[5]

[1] *Woodfall: Landlord and Tenant* (London: Sweet & Maxwell), Vol.1, para 9.001.
[2] It also applies to distraint for taxes, which has not been abolished. See further fn.29 below.
[3] Which is unlikely to be granted if the landlord is simply an unsecured creditor: *Re Atlantic Computer Systems Plc* [1992] Ch. 505; [1992] 2 W.L.R. 367 CA (Civ Div).
[4] See G. Lightman et al, *Lightman & Moss on the Law of Administrators and Receivers of Companies*, 6th edn (London: Sweet & Maxwell, 2017), para.14-029.
[5] See *Lloyds and Scottish Finance Ltd v Modern Cars and Caravans (Kingston) Ltd* [1964] 3 W.L.R. 859; [1966] 1 Q.B. 764 at 780E-F QBD.

Prior to the coming into force of the TCEA 2007, s.138 of the Senior Courts Act 1981 (1981 Act) relevantly provided that (emphasis added)[6]:

> "(1) Subject to subsection (2), a writ of fieri facias or other writ of execution against goods issued from the High Court *shall bind the property in the goods of the execution debtor as from the time when the writ is delivered to the sheriff to be executed.*
>
> (2) Such a writ shall not prejudice the title to any goods of the execution debtor acquired by a person in good faith and for valuable consideration unless he had, at the time when he acquired his title—
>
> (a) notice that that writ or any other such writ by virtue of which the goods of the execution debtor might be seized or attached had been delivered to and remained unexecuted in the hands of the sheriff…".

Section 183 of the IA 1986 provides that (emphasis added):

> "(1) Where a creditor has issued execution against the goods or land of a company or has attached any debt due to it, and the company is subsequently wound up, he is not entitled to retain the benefit of the execution or attachment against the liquidator unless he has *completed execution* or attachment before the commencement of the winding up.
>
> …
>
> (3) For the purposes of this Act—
>
> (a) *an execution against goods is completed by seizure and sale*, or by the making of a charging order under section 1 of the Charging Orders Act 1979;
>
> (b) an attachment of a debt is completed by receipt of the debt."

So delivery of the writ to the sheriff "bound" the goods, but execution was not complete until "seizure and sale". At the point of delivery of the writ to the sheriff, the property in the goods was not changed and the debtor remained free to deal with them (by selling or charging) subject to the right of the sheriff to continue execution against the goods save insofar as the excepted circumstances applied. As stated by Lord Leggatt in *365 Business Finance Ltd v Bellagio Hospitality WB Ltd*[7]:

> "… although the delivery of a writ of execution to the sheriff / enforcement officer does not affect the title to the debtor's goods, it renders the goods liable to be seized by the officer and sold to satisfy the debt".

Even after seizure, title to the goods remained with the debtor but the common law has long been that the sheriff/enforcement officer who has taken control of goods is entitled to sue for conversion someone who removes the goods from the officer's control.[8]

The question arises what security (if any) was created in favour of the creditor prior to completion of execution. Similar questions arise in relation to the process of attachment of debts, which is unaltered by the TCEA 2007, and has always been considered a form of execution.[9]

There is authority which suggests that a creditor acquires a security interest in goods prior to completion of execution. In *Re Clarke*,[10] Lindley MR stated (emphasis added):

> "It is very true that the property in goods seized under a fi. fa. remains in the execution debtor until sale … But it is no less true that *after seizure and before sale* the execution creditor is as regards those goods in the position of a secured creditor: see *Ex parte Williams* L.R. 7 Ch. App 314 … He had a legal right as against the execution debtor … to have the goods sold and to be paid out of the proceeds of sale."

This dictum was applied by Martin Mann QC in *Re a Debtor (No.10 of 1992)*[11] in concluding (at 528E) that (emphasis added):

> "I infer that the security right which an execution creditor has under a fi. fa., *which has been acted upon by seizure, is not unlike a lien, which is a security right* expressly contemplated by s. 383(2). The fact that such a security right has not been enforced is nothing to the point. It is enough that the debtor's property in the goods is bound. It is clearly irrelevant that the property has not yet passed out of the debtor's hands as on completion of the execution by sale."

In that case, seizure had taken place prior to the purported approval of an IVA. As to the position *prior* to seizure, at 528C-D the Deputy Judge had reasoned as follows (emphasis added):

[6] See now para.8(1) of Sch.7 to the Courts Act 2003, which is in similar terms in respect of the new regime of writs of control. Similar wording has been consistently used in the relevant statutory provisions since the Statute of Frauds 1677: see *365 Business Finance Ltd v Bellagio Hospitality WB Ltd* [2020] EWCA Civ 588 at [31].
[7] *365 Business Finance Ltd v Bellagio Hospitality WB Ltd* [2020] EWCA Civ 588 at [31].
[8] See *365 Business Finance* [2020] EWCA Civ 588 at [61]. Further, the proviso previously contained in s.138(2) of the Senior Courts Act 1981 does not apply where an actual seizure of goods has already been effected: *Lloyds and Scottish Finance* [1966] 1 Q.B. 764 at 781B-D.
[9] See *Day's Common Law Procedure Acts*, 3rd edn (London: Sweet, 1868), pp.xxii-xxiv. Cited in *Relwood Pty Ltd v Manning Homes Pty Ltd (No.2)* [1992] 2 Qd. R. 197 Sup Ct (Qld).
[10] *Re Clarke* [1898] 1 Ch. 336 at 339 CA.
[11] *Re a Debtor (No.10 of 1992)* [1995] B.C.C. 525 Ch D (Bankruptcy Ct).

> "*Ex parte Williams*, cited above,[12] was not read to me in argument and I shall not cite it here, but I have found it instructive as to the nature of the security right since it explains that at common law the execution creditor *had security* from the teste of the writ of fi. fa. but that this was changed as regards third parties by the Statute of Frauds to the date of the delivery of the writ to the sheriff (which, in the sense that a writ binds the property in the debtor's goods, is the position today by virtue of s. 138(1) of the Supreme Court Act 1981). The sheriff obtained a qualified property in the goods *upon seizure* like that of a factor, albeit distinct from that of a legal mortgagee, *but until then he merely had a right of seizure*. This right, Sir G Mellish LJ decided, *could not properly be called a security* (pp.317–318 of the judgment)."

The authors do not consider this to be the clearest passage, but the Deputy Judge appears to have followed earlier Court of Appeal authority in concluding that, at least prior to seizure, there was no "security" properly so called.

In *Lightman & Moss*,[13] in the context of what are now writs of control, it is stated that none of the processes up to and including seizure gives any charge over the goods.[14] The editors state that the decision of Martin Mann QC (at 528E) is thought not to be correct and they cite an Australian case, *Relwood Pty Ltd v Manning Homes Ltd (No.2)*,[15] in support of the contrary proposition.

In *Relwood*, the Supreme Court of Queensland had to consider whether the rights of a creditor under a garnishee order nisi (i.e. an attachment of a debt) had priority to the holder of a floating charge granted before but crystallising after service of the order. In answering that question in the negative, the majority judgment of McPherson SPJ (with whom Moynihan J agreed)[16] considered a number of English and Australian authorities to which Martin Mann QC was not referred. The following are the key points:

1) The 19th century statutory provisions in England provided that service of the garnishee order "shall bind such debts in his hands" but the presence of that word "bind" was held not to have the effect of charging the property or giving an equitable interest, but rather to put the debt in the same situation as the goods when the writ of fi. fa. was delivered to the sheriff.
2) Although there are authorities in which reference was made to this creating a form of "security" that is apt to mislead. These references, including in *Ex parte Williams* and *Re Clarke*, were in the special context of certain statutory definitions in bankruptcy legislation treating an executing creditor as in some sense "secured" against an assignee of an insolvent debtor.
3) These definitions do not translate across to different definitions of "secured creditor" that no longer treat an execution creditor as secured in the old sense.[17]
4) Consistent with that in *Re Combined Weighing and Advertising Machine Co*,[18] the Court of Appeal held that a garnishee order absolute effects no assignment either at law or in equity of the debt attached.
5) Accordingly, upon crystallisation of the floating charge (which occurred when a receiver was appointed), the chargee had the better right to the debt and therefore the garnishee order should not have been made absolute.

The fuller analysis in *Relwood*, as supported by the editors of *Lightman & Moss*, means that a court is likely to conclude that an execution creditor under the old regime did not acquire a "security" within the meaning of s.248 of the IA 1986 at the point of seizure. Moreover, a court is very likely to conclude that such an execution creditor had no such interest at the prior point of delivery of the writ to the sheriff.

New Regime

Section 62(1) of the TCEA 2007 applies Sch.12 where an enactment, writ or warrant confers power to use the procedure in that schedule, i.e. taking control of goods and selling them to recover a sum of money.

By s.71, the common law right to distrain for arrears of rent is abolished and s.72 gives landlords the right to use Sch.12 for CRAR. Section 65 provides that the new provisions replace "the common law rules about the exercise of the powers".

Schedule 12 is lengthy, but key parts include:

1) Using the procedure "to recover a sum" means "taking control of goods and selling them to cover that sum" (para.1(1)).
2) Only an enforcement agent "may take control of goods and sell them …" (para.2(2)).
3) As to when the property in goods becomes "bound": (i) a writ issued by the High Court "binds the property in the goods from the time when it is received by the person who

[12] *Williams, Ex parte* (1872) L.R. 7 Ch. App. 314.
[13] *Lightman & Moss* (2017), para.14-009.
[14] See further *Lightman & Moss* (2017), para.14-029: "Seizure of the goods is merely a step towards selling the goods and, thus, being paid."
[15] *Relwood Pty Ltd v Manning Homes Pty Ltd (No.2)* [1992] 2 Qd. R. 197 Sup Ct (Qld).
[16] Derrington J dissented on the point whether the garnishee order gave rise to an equitable charge, but arrived at the same result because he concluded that the crystallised charge took precedence over it.
[17] *McQuarrie v Jacques* (1954) 92 CLR 262.
[18] *Re Combined Weighing and Advertising Machine Co* (1889) 43 Ch. D. 99 CA.

is under a duty to endorse it" (para.4(2)); and (ii) where notice is given to the debtor under para.7(1) the notice "binds the property in the goods from the time when the notice is given" (para.4(4)).

4) Once the property in goods is bound, an assignment or transfer of any interest of the debtor in them is subject to the power of enforcement (para.5(1)) save this does not prejudice the title acquired by a person in good faith, for valuable consideration and without notice (para.5(2)).[19]
5) An enforcement agent may not take control of goods unless the debtor has been given a minimum period of notice (para.7).[20]
6) An enforcement agent may not take control of goods after the prescribed period (para.8).[21]
7) To take "control" of goods an enforcement agent must take one of the specified steps (para.13).
8) The sale of "controlled goods" is subject to various conditions (para.38).
9) Schedule 12 is subject to ss.183, 184 and 346 of the IA 1986 (para.69).[22]

In *Thirunavukkrasu v Brar*,[23] Marcus Smith J held (at [21]) that CRAR is not a statutory modification of the law relating to distress and it cannot be said, without more, that CRAR is the equivalent of distress. At [24] he rejected the contention that CRAR maintained the status quo except in those cases where a change was expressly made. At [25] he held that a court should

> "approach the question of the effect of CRAR by construing the 2007 Act, and not by presuming that certain aspects of the old and abolished common law regime of distress have been carried forward in the new statutory regime".

Stage 1: Notice

Against that background, the question arises whether a landlord who has only got as far as serving a notice under para.7(1), Sch.12 has any security interest in the goods which are the subject of the notice. This is very unlikely for a number of reasons.

First, the common law right to distrain for rent (which gave rise to security in the form of pledge) was abolished and replaced with a new regime which has to be interpreted afresh.

Secondly, part of the background to the new legislation, which took a long time to be enacted, was the *Landlord and Tenant: Distress for Rent* publication.[24] At paras 3.2 and 3.5, it was noted that one of the factors that made reform of distress necessary was that it gave priority to landlords over other creditors. It is therefore consistent with that for landlords no longer to have the ability to create "security" properly so called.[25]

Thirdly, there is nothing in the new regime to indicate that the position of execution creditors was to change: they remain unsecured creditors and their right—if execution is completed—is to be paid their debt out of the proceeds of sale of the goods. By the use in para.4(2) of Sch.12 of the established phrase "binds the property", it is very likely that at the point of receipt of the writ by the enforcement officer, an execution creditor was not intended to have any legal or equitable interest in the goods.

Fourthly, the similarity of language between para.4(2) and para.4(4) indicates that the same result should arise in respect of rent arrears when the notice is given under para.7 of Sch.12. It would be surprising if the phrase "binds the property" in para.4(4) gave rise to a form of security when that was not the case in respect of the same phrase in para.4(2).

Fifthly and relatedly, the provisions of para.5 of Sch.12 provide identical protection for execution creditors and landlords exercising CRAR. They are a modified form of the provisions in s.138(1) of the 1981 Act, which applied to execution.[26]

Sixthly, there is no indication that Sch.12 was intended to create a security interest in favour of the creditor on whose behalf the para.7 notice was served.[27] If Parliament had intended to create such an interest then established words to that effect could have been used. The provisions appear to have been drafted to the contrary.

Seventhly, whilst such an interpretation does put landlords in a vulnerable position by reason of the possible removal or sale of the goods within the seven-day period, the notice provisions were a compromise between the competing interests of creditors, landlords and debtors. The compromise included encouraging settlement at the compliance stage prior to a visit and the control of goods.

[19] In the case of para.7(1) "notice" means "notice that that notice had been given and that goods remained bound under it".
[20] Not less than seven clear days' notice—see para.6 of the Taking Control of Goods Regulations 2013 (SI 2013/1894) (2013 Regs).
[21] 12 months beginning with the date of notice of enforcement—see para.9(1) of the 2013 Regs.
[22] The references in the IA 1986 to "distress" must now be read as including use of the procedure in Sch.12 (s.436 of the IA 1986).
[23] *Thirunavukkrasu v Brar* [2018] EWHC 2461 (Ch); [2019] Bus. L.R. 2840. The point did not directly arise on appeal: [2019] EWCA Civ 2032.
[24] Law Commission, *Landlord and Tenant: Distress for Rent* (HMSO: 1991), Law Com. No.194, HC Paper No.138. See para.3 of the Explanatory Notes to TCEA 2007. Paragraphs 322–324 of the Explanatory Notes refer to the Law Commission's Report and the unjust features identified therein as a reason for abolishing distress (but with replacement by a modified regime).
[25] This is supported by a further part of the legislative background, namely, the White Paper, *Effective Enforcement* (March 2013). At para.205 it states: "The priority accorded to landlords in respect of distress for rent will be abolished. In keeping with Professor Beatson's recommendation 44, landlords using distress for rent will no longer have priority over other creditors. LCD sees no justification of priority for landlords as they alone will be able to take legal control of goods without prior court approval."
[26] And see now para.8, Sch.7 to the Courts Act 2003.
[27] cf. *Re Charge Card Services Ltd (No.2)* [1987] Ch. 150; [1986] 3 W.L.R. 697 Ch D (Companies Ct).

Eighthly, landlords have the right to pursue enforcement against the goods in the hands of a third-party recipient unless it falls within the exception in para.5 of Sch.12.[28]

Stage 2: Taking Control

If, as is suggested above, a landlord exercising CRAR is broadly in the same position as an execution creditor, then the taking of control is unlikely to give the landlord any priority over the general body of creditors.[29]

If a debtor wrongfully interferes with controlled goods[30] and the creditor suffers loss as a result, the creditor may bring a claim against the debtor in respect of the loss (para.67, Sch.12). This provides the creditor with a direct cause of action,[31] but one which is unsecured thereby underlining the conclusion immediately above.

Stage 3: Sale and Payment

Schedule 12 provides that if the enforcement officer sells the goods then he or she must use the proceeds to pay the amount outstanding (para.50(1)). After sale and payment, the process is clearly complete, and the creditor's debt is discharged to the extent of the payment. This does not involve the creation of any intermediate security interest in favour of the landlord.

Prior security interests

If the position of a landlord exercising CRAR is analogous to that of an execution creditor (and it has no security rights in respect of the goods) then the former is vulnerable to the crystallisation of a floating charge because the holder thereof will obtain priority if its security crystallises before the execution is completed. Indeed, it is likely that crystallisation prior to actual payment to the landlord (i.e. even after sale) will be sufficient for the floating charge holder to take priority to the landlord.[32]

It is usual for floating charges to provide for crystallisation in the event of the debtor company being unable to pay its debts as they fall due, notice being given of an application for an administration order and/or the appointment of administrators. If there are such terms then, absent prior completion of sale and payment under CRAR, the floating charge will take priority to any possible claim by the landlord.[33]

Conclusion

The authors suggest that CRAR puts landlords in a significantly disadvantageous position as compared to the old law of distress. They are unlikely to have the benefit of a security interest in the goods at any stage. Unless and until the goods are sold and payment made to the landlord, they are vulnerable to the imposition of the statutory moratorium under paras 43 or 44 of Sch.B1. Further, if there is a floating charge which crystallises prior to such payment then it is likely that this will take priority over any claim by the landlord.

It seems to the authors therefore, that administrators are able to dispose of the assets of a company in administration, free from any "security" claim in those assets (or their proceeds of sale) from landlords who have commenced, but not completed, the entirety of the CRAR process (i.e. by completion of Stage 3: Sale and Payment). That is not to say that the administrators are not at risk from a personal claim in conversion after Stage 2: Taking Control in a way that they are not at Stage 1: Notice.

[28] No claim in conversion lies prior to Stage 2: *365 Business Finance* [2020] EWCA Civ 588 at [63]–[68].
[29] There is a discussion in *Lightman & Moss* (2017), para.14-024 regarding distraint for taxes and the uncertainty as to whether the taking of possession of goods under Sch.12 for unpaid taxes gives rise to a pledge and therefore a security interest at that point (cf. *Herbert Berry Associates Ltd v IRC* [1977] 1 W.L.R. 1437 HL; and *Re Modern Jet Support Centre Ltd* [2005] EWHC 1611 (Ch); [2005] 1 W.L.R. 3880). But even if this is the law (as to which the authors do not comment), that is in relation to a discrete area of law that was not, unlike distress for rent, abolished and replaced with an entirely new scheme in the form of CRAR which was intended no longer to provide landlords with secured rights.
[30] i.e. those where there has been Stage 2: Taking of Control and the other conditions are satisfied—see paras 3(1) and 13, Sch.12.
[31] Rather than having to rely indirectly on the common law, which affords a claim in conversion to the enforcement officer. It may be noted that administrators can be personally liable in conversion and therefore a sale after Stage 2 may expose the office-holder to such liability depending on the facts of the case.
[32] *Lightman & Moss* (2017), para.14-012; *Relwood* [1992] 2 Qd. R. 197.
[33] The fact that the rules provide that: (a) notice of an application for an administration order; and (b) a copy of a notice of intention to appoint are each required to be given to any enforcement officer who to the knowledge of the applicant/person giving notice is charged with distress or other legal process (Insolvency (England and Wales) Rules 2016 (SI 2016/1024) rr.3.9 and 3.23(4)) is unlikely materially to assist the landlord in obtaining priority.