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Receivers and commercial leases: to evict or not to evict?

Published: 21st May 2018

Introduction

While most of the headlines over the past decade have been concerned with residential mortgage defaults - the danger of people losing their family homes - we should also remember that businesses have struggled too. In both types of mortgages, residential and commercial, people often tend to forget about the "silent victims" of repossession, namely the tenants occupying the property. The aim of this article is to explore the position of tenants of commercial property where the landlord has defaulted on the mortgage and a receiver is appointed by the bank. Similar considerations apply in the case of residential tenancies, save that those are complemented by the safeguards contained in the Residential Tenancies Acts, which do not apply to commercial tenancies.

A common scenario

The scene has been enacted thousands of times over the past decade: landlord defaults on mortgage, receiver is appointed, receiver allows the business-tenant to stay a few months while paying rent, business is suddenly told to vacate the property, business vacates, property is sold with vacant possession. But it does not always happen this way. Sometimes it is not so easy for a business to simply vacate its property and move elsewhere. It may, for instance, have entered into a lease of several decades with the original landlord. It may, relying on that lease, have equipped the premises with specialist furniture and fittings, sometimes at enormous cost. It is not so easy to untangle all of this without suffering considerable financial loss, not to mention loss of business reputation (customers and creditors of the business may mistakenly conclude that the business is the one defaulting on its mortgage obligations). A number of such tenants have asked for my advice in relation to their legal rights and remedies. The position is not as black-and-white as receivers seem to think it is.

The lease

A commercial lease is a contract between the landlord and the business-tenant. The receiver is not a party to the contract and neither is the bank. Under the ordinary law

of contract, therefore, a tenant cannot have any contractual rights or remedies against the receiver or the bank in the event of the terms of the lease being breached. He can, of course, seek redress against the original landlord for his failure to ensure that the premises was available for the period he had promised it would be. The tenant may sue the landlord for damages. That may seem futile in circumstances where the landlord does not even have enough money to pay the mortgages. What chance is there that he will be able to meet a claim for compensation? However, it should be remembered that we are talking here about commercial leases. It is not unusual for landlords with significant personal assets to simply abandon a loss-making commercial property in the hope that a bank will not pursue him for the balance after selling it. In a commercial context, therefore, it is not necessarily the case that the landlord is not a good mark for compensation.

But what if the tenant does not want compensation, or if the landlord is indeed insolvent? What if the tenant wants to remain in the property? Can it enforce the terms of its commercial lease against the receiver?

The bank's consent

The ordinary position is that a tenant may enforce the terms of its lease against a bank after the latter has taken control of the property. That rule is contained in section 18 of the Conveyancing Act 1881 and applies to all leases which meet certain formal criteria (including that the landlord obtained the best rent reasonably obtainable, that there has been formal execution of the lease and its terms include an express right of re-entry if the rent is not paid). However, section 18(13) provides that the section applies only insofar as a contrary intention is not expressed by the parties in writing. Therein lies the problem. Most commercial mortgages contain a specific clause to the effect that the mortgagor (the landlord) is not permitted to enter into any lease of the property without the written consent of the bank. This is the case notwithstanding that the sole purpose of purchasing the property (and therefore entering into the mortgage in the first place) is to rent it out. In practice, banks are very slow to provide the written consent and most landlords either never request it or, if they do, never actually obtain it. Invariably then, when the tenant attempts to rely on section 18 in a receivership situation, the bank responds by saying that the section does not apply because it never consented to the tenancy, contrary to the intention of the parties as expressed in the mortgage deed.

That is exactly what happened in the case of *Fennell v. N17 Electrics Limited [2012] IEHC 228*. The tenant in that case raised a number of arguments in order to get around the fact that the bank had evidently never provided express consent to the tenancy, as required by the terms of the mortgage. They argued, for example, that the bank knew at all times that they (the tenants) were in occupation of the premises

but nevertheless remained silent as long as the mortgage was still being paid. In other words, the tenant argued that the bank had consented by its silence - or acquiesced - to the tenancy. Dunne J cited a number of English decisions in rejecting that argument. Mere silence was not sufficient in the circumstances to amount to consent. She also rejected the tenant's second argument, namely that the landlord had used the rent monies to pay the mortgage and, by accepting those funds knowing that they came from the rent, the bank was consenting to the tenancy. Again, it appears that a failure to object to the tenancy is not the same thing as consenting to it.

N17 was followed in a number of subsequent cases. See, for example, *Stafford v. McCourt [2017] IEHC 726*, *Ferris v. Meagher [2013] IEHC 380*, *Delaney v. AIB [2014] IEHC 47*, *Murphy v. Hooton [2014] IEHC 266*

A new tenancy?

In assessing the authorities in the N17 case, Dunne J appeared to approve of the following passage in the English decision in *Taylor v. Ellis* [1960] 1 Ch. 368:

> "I think that it must be taken that to begin with, this tenancy was not binding on the plaintiff. Then the question arises: did the mortgagee become bound by the tenancy by reason of subsequent events? It is, of course, quite common for a mortgagee who was not previously bound by a tenancy to consent to take the mortgagor's tenant, whom he could have treated as a trespasser, as his own tenant. The commonest way in which that happens is when a mortgagor fails to pay the mortgage interest and the mortgagee serves a notice on the tenant to pay the rent to him. Then, a new tenancy is created between the mortgagee and the mortgagor's tenant."

Dunne J agreed, albeit *obiter*, that a new tenancy may be said to come into existence where a bank - which presumably includes its receiver, although this is not altogether clear - demands rent from the tenant instead of immediately evicting it. Dunne J concluded as follows:

> "It is also clear that in certain circumstances, the lease may be binding on the mortgagee in circumstances such as those described in the authorities referred, where, for example, the mortgagee serves a notice on the tenant to pay the rent to him."

There is a small, but important, difference between the two passages quote above. The first passage states that, where a bank serves a demand for rent on the tenant then this has the effect of creating a "new tenancy" between the bank and the tenant.

The second passage seems to state that, in fact, the bank simply adopts the existing lease. The distinction is important insofar as it may help in identifying the precise terms of the relationship between the bank and the tenant. If the bank merely adopts the existing lease then the nature of that relationship - including the term of the tenancy - is defined in the existing lease. But if a new tenancy is created then it is anybody's guess as to what the terms of that tenancy are (although one could certainly argue that they should be the same as the terms of the former lease).

The new position

The 1881 Act applies in circumstances where the mortgage (as distinct from the lease) was entered into prior to the 31st December 2009. Where the mortgage was entered into after that date then the applicable law is contained in the Land and Conveyancing Law Reform Act 2009. Section 112 of that Act states that a mortgagor may enter a lease which shall be effective against the bank (and every other incumbrancer) only if the bank consents in writing to the tenancy. In other words, it no longer matters in respect of leases entered into after December 2009 whether the mortgage itself contains a clause requiring consent - such consent is now required as a matter of law. However, the new section proceeds to state that the required consent may not be "unreasonably withheld" and, even then, a lease entered into without the bank's consent may be avoided by the bank only if it can show that (a) the tenant had actual knowledge of the existence of the mortgage at the time of entering the lease and (b) the lease had somehow prejudiced the interests of the bank. Since most commercial mortgages are signed on the basis that the property will be leased, it is certainly arguable that the bank will struggle to show that it was prejudiced by the tenancy even where no consent was obtained from it. As such, the new provision should assist business-tenants in enforcing leases against banks long after the landlord has dropped out of the picture.

Conclusion

Tenants of commercial properties may be happy to vacate the property upon being requested to do so by a receiver. But for those who are not in a position to do so, who have continued to pay the rent to keep their business going, it is worth noting that they do have some legal basis for remaining in the property. The receiver may still sell the property of course, but it must be sold subject to the lease. It is for this reason that purchasers often insist on receiving assurances from the vendors of such properties that the tenant has not been served with a demand for the payment of rent by the receiver or any agent of the bank.

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Where the mortgage was entered into prior to the commencement of the 2009 Act then the key considerations are whether (a) the mortgage deed required the landlord to obtain the bank's consent before entering a lease, (b) whether the consent was obtained and (c) whether, if the consent was not obtained, the receiver nevertheless continued to make rental demands on the tenants. From a receiver's point of view, it is obviously advisable to avoid the latter course of action if it is intended to sell the property with vacant possession. It does place him in a difficult situation - if he asks the tenants to immediately vacate the property then, unless the property is immediately sold, it exposes the receiver to the charge that he is not obtaining the realisable income of the property, contrary to his duties at common law Yet if he allows the tenants to remain in place, he risks being forced to sell the property subject to the tenancy.

Where the mortgage is entered into after the commencement of the 2009 Act then a bank will struggle to show that it was prejudiced by a failure to obtain its consent to the tenancy and, as such, will almost invariably take the property subject to the lease.

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Important Note

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