

# Linen Case Cleans-Up Uncertainty Surrounding Repudiation of Leases In Examinerships.

By Brian McEnery

In December 2009 the Supreme Court made a landmark judgment regarding the repudiation of leases in an Examinership which removed the uncertainty around whether leases could be repudiated as part of a scheme of arrangement in an examinership. This uncertainty was primarily caused by conflicting judgments made by the Courts – e.g. in the Chartbusters case the Courts approved the repudiation of leases as part of the Examiner’s scheme of arrangement. Ultimately this allowed the company to successfully exit examinership and continue trading. While the subsequent O’Briens Sandwich Bars case, where the repudiation of leases was also a feature in the Examiner’s scheme of arrangement, Justice Ryan examined the relevant legislation and held that it could not be used to permit the wholesale repudiation of over 40 leases. The examinership failed and the company entered liquidation. Hence there remained confusion as to whether leases could be repudiated in an examinership process - until the recent Supreme Court judgment in the case of Linen Supply of Ireland.

In this case, as part of his scheme of arrangement, the Examiner attempted to repudiate five leases which the company had entered into. The High Court (under Justice Brian McGovern) initially held that upon review of the relevant legislation it was not permissible to repudiate leases as part of an examinership scheme. Linen Supply of Ireland appealed the judgment to the Supreme Court, as a test case in order to get a definitive ruling.

The relevant legislation referred to above concerns Sections 20 and 25B of the Companies (Amendment) Act 1990. Section 20 of the Act states that: “where proposals for a scheme of arrangement or compromise are to be formulated in relation to a company, the company may, subject to the approval of the court, affirm or repudiate any contract under which some element of performance other than payment remains to be rendered by both the company and the other contract party or parties.”

The Supreme Court judgment confirmed that a lease falls into the meaning of “any contract” (as referred to in Section 20) and not only that but, by their very nature, leases require the performance of other obligations aside from payment and hence unreservedly comply with Section 20 of the Companies (Amendment) Act 1990. Leases can now be repudiated in an examinership process, subject to Court approval.

In making its ruling the Supreme Court also referred to Section 25B of the 1990 Act, which sets out various prohibitions on varying the terms of a lease. The argument had successfully been made in the past that the wording of Section 25B meant that leases did not come within the term of “any contract” and hence could not be repudiated. In this ruling the Supreme Court specifically rejects this argument.

The ruling puts to bed, once and for all, the uncertainty surrounding the repudiation of leases in examinerships and it now opens the door for trading, retail and other companies with loss-making / over burdensome leases to apply for Court protection and repudiate such leases.

Not only did the landlords in the above case find their lease agreements repudiated as part of the Examiner’s scheme, but it was also ruled that the future rent lost by virtue of the repudiation could be included as part of the scheme. This saw the landlords’ compensation / value of future rent lost, receiving a dividend on par with other unsecured creditors.

What are the commercial implications of this landmark ruling? I believe we will now see many more companies apply for examinership, with their main objective being to repudiate over-burdensome leases. Additionally the ruling, by proxy, significantly strengthens the hand of the Examiner when negotiating rent reductions with uncooperative landlords. While Section 25B of the 1990 Act prohibits the reduction of future rent attaching to a lease, save where the lessor consents in writing to such a reduction, I believe we will now see Examiners threatening landlords with repudiation unless they “volun-

tarily, in writing” agree to significant rent reductions.

Given the exorbitant rents (in light of current market conditions) payable under many leases, especially those entered into during the boom years, this ruling now offers a lifeline to many Irish businesses. It offers them the opportunity to restructure their leasing obligations to more appropriate levels and align them with current market expectations.

In summary it is fair to say that sometimes it pays to wash your dirty linen in public and I am sure there will be many companies and advisors thankful that Linen Supply of Ireland decided to do so!

## About the Author:



Brian McEnery

Brian McEnery (FCCA) is a Rescue & Insolvency Partner with Horwath Bastow Charleton in Limerick. He is the President of ACCA Ireland and a member of the ACCA’s global Council. Brian is one of the leading business rescue and insolvency advisers in the country and has just launched the Horwath Bastow Charleton National Insolvency Unit in Dublin.

He is a member of the Consultative Committee of Accounting Bodies - Ireland CCAB-I (Insolvency), a member of the London Court of Arbitration, a member of the Turnaround Management Association and The Institute for Turnaround. Brian and his team can be contacted at 061 310 311 or email [brianmcenery@hbcl.ie](mailto:brianmcenery@hbcl.ie) Website: [www.hbcl.ie](http://www.hbcl.ie)