Neutral Citation Number: [2009] IEHC 465

THE HIGH COURT

2009 557 COS & others

IN THE MATTER OF O'BRIEN'S IRISH SANDWICH BARS LIMITED (A COMPANY IN EXAMINERSHIP UNDER THE COMPANIES (AMENDMENT) ACT 1990 (AS AMENDED) AND UNDER THE PROTECTION OF THE COURT)

AND

IN THE MATTER OF SECTION 20 OF THE COMPANIES

(AMENDMENT) ACT 1990 (AS AMENDED)

JUDGMENT of Mr. Justice Ryan delivered on the 16th day of October, 2009

1. O'Brien's Irish Sandwich Bars Limited was a successful business until recent times when its business declined and it became insolvent, resulting in a successful application for examinership in July 2009. It operates a franchise business whereby the company licences franchises to operate under its name. A feature of the business was, and is, that the company itself obtained leases of suitable premises and then sublet them to the franchisees. This was not invariably the case but it was in a substantial majority of the franchises. When the company ran into difficulties, it was saddled with the primary obligation to pay rent in respect of premises where the business operated. Some of those were unoccupied, and thus producing no income, and in other cases, the company's franchisee had fallen into arrears of rent under their subleases from the company, but the head lease remained a matter for the company to service. The rent reserved by the sub-lease was generally the same as that in the head lease, so the company did not make any profit on this arrangement. These problems of vacant premises and shortfall in rental payments were a major feature of the financial difficulties encountered by the company that led to its having to seek court protection.

2. The independent accountant who reported at the time of the examinership application highlighted this element. The examiner has also done so in his report. During the course of the examinership, negotiations took place with possible investors with a view to rescuing the company. Ultimately, the examiner entered into an agreement with a company named AIL, under which it is proposed to invest a substantial amount of money into the business, in an arrangement which the examiner is satisfied represents a sound business proposition and which, in fact, is the only available option whereby the company can survive. AIL's investment, however, comes with conditions. One of them is that the company has to get out of its leases, whether by surrender or by repudiation, so that the business will become a strictly franchise operation with no leasing obligations. Another condition imposed a time limit, but there would have been time pressure, in any event, because of the statutory limit on the period of examinership.

3. It was clear that this issue of the company's position as lessees of most of the premises where the business operated was going to have to be dealt with. To that end, the company notified its franchisees, firstly, in a letter of 9th September, 2009, from Mr. Sweeney, a director of the company, and, secondly, in a memorandum dated 15th September, 2009, that was circulated to the franchisees. In this memorandum, which was in question and answer form, the company sought to explain the position and reassure the franchisees that their positions would not be adversely affected by reason of the proposal that was then being made, whereby the company would extricate itself from the leases and, as it was intended, leave the franchisees in direct relationship as lessees with the landlords of the various premises.

4. It may be worth mentioning that whereas the financial problems of the company had been attributed in substantial part to a problem with payment of rent under leases of premises, that obviously applied only in cases where the premises were vacant and thus producing no income, and to premises where the franchisee was in arrears in the payment of rent under his sublease. In other words, the original problem was not with the business model of the company whereby it took the leases, but with circumstances where the sublease was yielding no payment or less than full payment. The proposal envisaged the alteration of the business model so that the company would thenceforth operate simply as a franchise company with no involvement by way of legal holding in the premises.

5. There was great urgency about the matter. The company made its position clear to its franchisees. The company was in deep financial trouble and would be put into liquidation if it could not be salvaged and the only way out of the difficulties was the agreement with AIL, conditional as described. The company wanted the franchisees to agree to take over the company's liability under the leases and to step up to become direct lessees. That was obviously the first problem that the company had. It also had to deal with the lessors because they had, up to the time of the company's difficulties, the security of a substantial and successful company as a tenant, and obviously, they might be less willing to accept the franchisees as their tenants in place of the company without having some security for the payment of rent, and they might also have other objections and options whereby they could refuse to accept the tenants or accept them, subject to conditions. Some of the parties agreed to the proposed arrangement, but others had not done so as the deadline for the completion of the agreement with AIL approached. The company then moved, as it had said it would, to apply to the court for approval of a scheme whereby it would repudiate the leases and the company made application to the court to that effect and gave notice to its lessors and franchisees. This is how the matter came before me for hearing on 28th September, 2009.

6. The company brought some sixty motions in which the same relief was sought. The primary relief was for the approval of the repudiation of all the leases that it held and in respect of which there had not been agreement. There were more than sixty motions. The parties most directly affected were the landlords/lessors of all the premises. Notice was also served on the franchisees who appeared and made submissions. Although the legal interests of the franchisees in respect of the motions are not by any means clear, it is apparent that their business interests were indeed to be affected in a significant manner by the proposed changes. It appears that the motions were notified or served on 24th and 25th September, 2009, which gave affected parties very little time in which to prepare their responses and submissions. Although some of the parties complained of the shortness of time that they had, which had practical relevance in at least one respect which I shall discuss, namely, in preparing a case for assessment of loss and damage, counsel dealt with the application and did not make the case that they had had insufficient time in which to prepare legal arguments. Perhaps, inevitably, in the circumstances of urgency that obtained, there were some errors and omissions and failures in respect of service of notice and these were pointed out in the course of argument, but I do not think that they materially affect the issues that I have to decide.

7. Another consequence of the urgency of the matter and the speed with which the motions were brought to court was that negotiations were continuing during the course of the hearings between the company and its lessors and agreement was reached in a number of cases, with the result that the number of unresolved cases fell to a little over forty motions which I had to rule upon. In

fact, it did not make any difference whether there were forty or sixty motions because the agreement with the AIL required that all the leases be disposed of. In the result, all the motions were heard together, with submissions made on behalf of the company by Mr. Shipsey S.C., on behalf of the franchisees, by Mr. Hayden S.C., and on behalf of various lessors by different counsel who will forgive me if I do not name them all, but mention only Mr. Buttanshaw, Mr. Lewis and Mr. Beatty, who made particular submissions to which I will refer in considering the arguments. Something of the urgency of the occasion will be gathered from the fact that some counsel, including Mr. McDermott, made submissions on a provisional or conditional basis, because their clients were still in negotiation with the company and hoped to reach agreement, so their contributions were made on the basis that agreement might not be reached.

8. When Mr. Shipsey S.C. opened the case on the motions for the company on 28th September, 2009, he explained that the agreement with AIL and the examinership time limit, made it a necessary and inescapable condition that the whole matter be heard and disposed of by close of business on 30th September, 2009. It was clear, in these circumstances, that if a decision were to be made in favour of the company and in the time permitted, the agreement would proceed and the examiner would be able to prepare a scheme of arrangement. On the other hand, if it happened either that the matter were to be decided against the company or that it proved impossible to dispose of it in the time allowed, then the proposed repudiations would fail, but, more importantly, the agreement would fall and a decision would be otiose. It followed that all of the features of the statutory provision on which the company relied had to be complied with within the time permitted. This has relevance to a particular feature of the statutory basis of the application to which I shall return. Because of the extreme urgency of the matter, I gave my decision on 30th September, 2009, refusing the applications sought in the motions and in view of the importance of the issues raised, I outlined in general terms my views on those issues in the course of an *ex tempore* judgment which I delivered from notes. I said that I would subsequently deliver a formal written judgment embodying my views and this is what I am now doing.

9. Each motion sought similar relief under s. 20 of the Companies (Amendment) Act 1990 (as amended) in the form of four orders, namely:

> 1. an order under s. 20(1) approving the repudiation by the company of its lease in respect of the particular premises;
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> 2. an order under s. 20(5) vesting the term of the lease in the lessor with the intent that the term should merge in the lessor's superior interest and be extinguished therein;
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> 3. an order under s. 20(3) determining the amount of the loss or damage suffered by the lessor as a result of the repudiation;
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> 4. such other orders as might be thought fit pursuant to s. 20(5).

10. Section 20 of the Act is as follows:

> (1) Where proposals for a compromise or scheme of arrangement 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 both by the company and the other contracting party or parties.
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> (2) Any person who suffers loss or damage as a result of such repudiation shall stand as an unsecured creditor for the amount of such loss or damage.
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> (3) In order to facilitate the formulation, consideration or confirmation of a compromise or scheme of arrangement, the court may hold a hearing and make an order determining the amount of any such loss or damage and the amount so determined shall be due by the company to the creditor as a judgement debt.
>
> (4) Where the examiner is not a party to an application to the court for the purposes of subsection (1), the company shall serve notice of such application on the examiner and the examiner may appear and be heard on the bearing of any such application.
>
> (5) Where the court approves the affirmation or repudiation of a contract under this section, it may in giving such approval make such orders as it thinks fit for the purposes of giving full effect to its approval including orders as to notice to, or declaring the rights of, any party affected by such affirmation or repudiation.

11. The company's argument, in short, was that the agreement with AIL was necessary for its survival, that it would be embodied in a scheme of arrangement prepared by the examiner, that the agreement required the repudiations sought, that such repudiations were permitted by the section, that there would be no adverse effect on either the lessors involved or on the franchisees, and that it was just and reasonable in the circumstances that these steps should be approved by the court. As to the issue of loss of damage suffered by each lessor by reason of the repudiation, the company put forward a report by an expert surveyor and valuer which it said should be used by the court in determining the amount of any such loss or damage. On the importance of the issue for the company's survival, it argued that the agreement with AIL was the only available option and that if it failed, the result would be liquidation.

12. It was inevitable, in the circumstances, that a great deal of the debate in the course of the motions was on the impact of the proposed repudiations on the lessors and on the franchisees. The immediate and direct effect would be on the lessors but, of course, the franchisees would also be affected by an alteration in their relations with the company and by the proposed new status that they would have as direct lessees of the landlords.

13. The company argued that s. 20 is part of a legislative scheme designed to protect companies that have a reasonable prospect of survival. The interpretation and the effect of s. 20 give rise to questions that are relevant to the motions and I propose to consider them later. At this stage, I consider the cases on the basis that the section is applicable and to look at the consequences that would follow from a repudiation of the leases, as proposed by the company.

14. The company contends that the net effect of repudiation would be to put each lessor and franchisee in a direct relationship of lessor and lessee on the terms of the existing subleases. In its written submissions, the company argued, by analogy with bankruptcy and liquidation, that the validity of any sublease was unaffected, but submitted that an ancillary order needed to be made under sub-section 5, vesting each repudiated lease in the lessor "with the intent that it

should merge and be extinguished" in the superior interest. In a supplemental submission, the company returned to the effective repudiation and relied, in addition, or in the alternative, on s. 78 of the Landlord and Tenant Amendment Act 1980. The result, on this argument, is that the franchisee would step in to the direct relationship of lessee on the terms of the sublease but subject to the higher of the rents of the sublease or the lease in the event of a difference.

15. The broad objections by the different counsel for the lessors were based on the analysis of the effective repudiation of a lease. Mr. Buttanshaw, for one landlord, contrasted the proposed repudiation with recognised methods of terminating the relationship of lessor and lessee, namely, surrender, which would be a matter of agreement; forfeiture, which would occur in circumstances of breach of the terms of a lease, and statutory disclaimer, such as provided for in a liquidation where relief is available for an onerous obligation, in accordance with s. 290 of the 1966 Act, sub-section (8) of which relates specifically to a lease.

16. Mr. Lewis, for another lessor, argued that repudiation was wholly different from surrender but was analogous to forfeiture. The key point, as he argued, was that repudiation effected a complete release of the non-repudiating party from his obligations under the contract. He cited relevant extracts from *'Chitty on Contracts'* in support of this proposition, which, in my view, is a correct understanding of the consequences in general that flow from repudiation of contract. If that is the correct analysis in the present case, it would seem to follow that the lessors would not have to accept the franchisees as their direct lessees, but that conclusion would appear to be inconsistent with the terms of s. 78 of the Landlord and Tenant Amendment Act 1980, and I do not see how that can come about. He also relied on s. 25(B) of the 1990 Act, and I think that sub-section (1) is of relevance.

17. In short, these arguments were that the consequences of repudiation were extremely complex and they could not be considered as effecting the simple transfer of obligations suggested by the company. Moreover, however it came about, the result, if it protected the franchisee, would foist upon the landlord a tenant that he did not want to have.

18. Mr. Beatty, on behalf of another landlord, drew attention to his client's difficulty in presenting his case for loss or damage that on his instructions was far in excess of the at pro[posed in the expert report by Mr. Goode for the company.

19. For the franchisees, Mr. Hayden S.C. contended that the business that his clients was engaged in was not a simple franchise, but was a combined franchise and lease arrangement, and that the proposal would fundamentally change the business arrangement to the detriment of the franchisees. The two contracts of lease and franchise were to be considered together, and each referred to provisions in the other, and this set of interlocking obligations and relationships was intended to be dismantled by the repudiation. The proposal would, in a word, make a radical change to the business arrangement between the company and the franchisees and to the business model on which the company was based, which was impermissible under the legislation. He submitted that the company was insolvent and that it should be wound up. He said that the need for change had been known by the company for some considerable time, but it had not been proposed until the last minute, and he also pointed out specific issues in different cases to show how difficult it would be, in those instances, for the proposal to have its intended effect, and also that that there were failures and confusions over service, indicating general confusion in the presentation of the proposal.

20. Other submissions were made based on some factual circumstances that were said to arise in different cases. These included some sub-leases which had not been executed or had not had relevant details inserted in the drafts and one case where the term of the lease substantially differed from the sub-lease.

21. In reply to these arguments, Mr. Shipsey S.C., on behalf of the company, understandably, accepted that the position was not as clear as it might be, but he contended that the overall issue was clear, the peril of the company's position was dire, the solution was necessary and legitimate, and the urgency of the situation arose from events and not from any default on the part of the company or of the examiner.

22. I do not find it necessary or, indeed, possible, to decide in any definitive manner on the basis of the arguments that were made as to what the precise effect in law would be in the event of repudiation taking place, or as to the mechanism whereby that would occur. It seems to me that there is real force in the argument put forward by Mr. Lewis. It is by no means a simple matter of promoting, so to speak, the franchisees/subtenants into the position of lessees. For one thing, the specific terms of each lease may or may not be the same and I have not heard argument on that. Nor have I had the benefit of submissions as to any terms that would normally appear whereby the landlord would have a right to refuse an assignment or otherwise oppose having a new lessee put in position, whether for reasons of good estate management or reasonable objection otherwise, or in any other circumstance. If repudiation had automatic effect and put the franchisee into the position of the company, it would obviously interfere with any of those entitlements on the part of the lessor. I think that the position is probably covered by s. 78 of the Landlord and Tenant Act 1980, but I am troubled by the argument as to the legal consequences that follow in the normal way from repudiation of contract. In the circumstances, and with some relief, I content myself with concluding that the matter is one of considerable complexity which it is impossible to decide definitively at this point, and on the basis of the relatively limited argument that it has been possible to make in the course of these motions, and because of other conclusions that I have come to in respect of the issues, it is sufficient for the purpose that I should arrive at this tentative and provisional conclusion.

23. In this context, I think it relevant to contrast the terms of s. 20 with those of s. 290(8) of the 1963 Act, dealing specifically with the lease, and to note the absence of any such provision in section 20. This does not, of course, exclude the application of s. 20 to a lease, but it is a significant omission, as I see it, which has a bearing on the application of s. 20 to a case such as the present motions.

24. I also think that the undoubted complexities and uncertainties of the consequences that would follow from repudiation are relevant in considering whether the section is actually applicable to the company's leases in these cases.

25. If repudiation is permitted under the section, sub-sections (2) and (3) have to be followed. This matter seems to me to give rise to a real difficulty. The section expressly envisages a hearing in each case to assess the amount of loss or damage. It is obvious that a person alleging a loss must be given an opportunity of formulating and presenting his claim, which may require professional advice being obtained. Before a court could determine the amount of loss or damage, it would have to have a basis for its assessment. A report presented by one party - in this case, the repudiating party - however competently prepared, cannot be a sufficient basis for such determination. Neither could it be said that reading such a report amounts to a hearing of the claim. If that procedure were to be adopted by an inferior tribunal, it would be extremely likely to give rise to proceedings for judicial review. There are some situations where compulsory purchases, for

example, have taken place in advance of the assessment of compensation, but a hearing, whenever it happens, must accord with fair procedures.

26. In this case, the company properly accepts that it is legally permissible, in accordance with the section, to arrange for a postponed determination of loss or damage, in compliance with sub-section (3), but it is not possible in these cases because of the time constraints. In the result, the court is in the position that it has to make determinations in over forty cases without any evidentially-tested analysis, if the repudiation is permitted and the required determinations are to be made in time. For the High Court to adopt such an unsatisfactory procedure would seem to me to put business exigencies, even though they are undoubtedly very important, above the fundamental requirements of justice and even constitutionally mandated protections.

27. In fairness to the company, it was anticipated that the question of valuation would require independent assistance. See Mr. Sweeney's letter of 15th September, 2009.

28. It seems to me that the following questions arise for decision in these cases:-

1. Does s. 20 of the 1993 Act, permit repudiation of the leases in these cases?]

2. If so, should the court exercise its discretion in all the circumstances to approve the proposed repudiations?

3. If so, can the provisions of sub-sections (2) and (3) of the Act be complied with in a manner that respects fair procedures?

29. As to the first question, although, as I have mentioned above, the section does not make any particular provision for a lease nor even mention such a contract, neither does it exclude a lease. Sub-section (1) is the relevant provision. It seems to me that the primary purpose of this is to deal with a situation where the company in protection and another contracting party have contractual obligations that do not involve the payment of money. The company may repudiate a contract where "some element of performance other than payment remains to be rendered, both by the company and the other contracting party or parties". The primary purpose of the section is to deal with those obligations that are due by and to the company in protection and the words "other than payment" are key to the understanding of the statutory purpose. If the matter is one of payment, a sum that is owed by the company is dealt with in the normal way, with the creditor receiving such payment as may result from the scheme that is formulated. But, where a person is contractually engaged with an insolvent company and there are residual performance obligations, other than money payments, the section provides a mechanism whereby the person is, in effect, put in the same position as a money creditor, if the balance of the obligations is in the creditor's favour. In other words, if the obligations of performance due by the company are greater than the reciprocal duties, the contracting party is in credit, but that performance has to be valued. That is provided for by sub-sections (2) and (3). In order to facilitate the formulation of a scheme of arrangement, for example, under sub-section (3), the court may hold a hearing and make an order determining the amount of the loss or damage and such sum is then due by the company to the creditor as a judgment debt.

30. There may well be circumstances where non-pecuniary obligations under a lease remain to be performed by an insolvent company, and the loss or damage resulting from repudiation can be determined by a court under sub-section (3) of section 20. However, I do not think that s. 20 permits the repudiation of entire contracts with all elements of performance, including money payments, because that would, in my view, be to ignore the restriction that is contained in sub-section (1) to residual performance elements other than payment. In the present cases, I do not think that the section can be read as permitting the wholesale repudiation of these more than forty leases, including all their performance elements, including payment. It seems to me, in the circumstances, that the applications to repudiate all these leases do not come within the terms of section 20(1).

31. If my interpretation of the section is not correct and it is permissible in law to repudiate the leases in these cases, I do not think that as a matter of discretion, approval should be granted for the wholesale repudiation of all obligations under more than forty leases, in circumstances of great uncertainty as to the legal consequences that would ensue; where the company would continue to have contractual obligations under its subleases, unless they are going to wither away, which is another matter on which I am wholly unclear; where it has not been possible to consider in detail individual circumstances, and where the time for all of the respondents to consider the implications of repudiation on their own situations has been so very short.

32. Finally, the business exigencies of the application make it impossible for the court to comply with its obligations under sub-section (3) and the constitutional requirements of fair procedures in determining the amount of loss or damage suffered by parties by reason of the repudiation.

33. For all these reasons, I refused the applications made in the motions.