Whose rent deposit?

From a landlord's viewpoint, granting a lease to a tenant can be a risky business. There is always the danger that the tenant may not perform its obligations under the lease including primary obligations such as payment of rent and repair. If a landlord does not have a rent deposit and the tenant goes into administration, the landlord will be an unsecured creditor for any sums due for the period prior to the start of the administration process.

In the current economic climate, in particular, taking a rent deposit from a tenant is good practice. Most landlords will require a rent deposit as a mandatory obligation where they are dealing with a newly formed company. This is for the simple reason that the new company may not have substantial assets.

Rent deposits are taken as security in addition to the normal payment of rent in advance. A sum of money is put into a separate designated account and is expressly charged to the landlord (this is known as a charged rent deposit) to ensure that third party creditors cannot access this money.

When a tenant goes into administration, the Insolvency Act 1986 applies a suspension known as a "moratorium" on actions that can be taken against a company which is in administration. For example, nothing can be done to enforce a charge over a company's property. The moratorium also prevents creditors exercising any rights they may have over the company's assets without the consent of the court or the consent of the administrator. At first glance, it would seem that this prevents a landlord taking money from the rent deposit without the administrator's or the court's permission. However, the Financial Collateral Arrangement (No 2) Regulations 2003 (the 'Regulations') disapply this moratorium in relation to any 'financial collateral arrangement'.

The previous consensus was that the Regulations should only apply where either the landlord or the tenant is a specified type of financial institution or public authority. This was based on the fact that the aim of the Regulations when they were introduced was to implement an EU Directive which was limited to such bodies. However, in a recent case (*R (Cukurova Finance) v HM Treasury* [2008] ERHC 2567) it was held that the Regulations apply to everyone (except individuals). Following the decision in this case, it appears that a charged rent deposit will be construed as a 'financial collateral arrangement'. Landlords should note that the rent deposit must be in the 'possession or control' of the landlord. If the landlord has sole drawing powers (as is usually the case) and if the account is in the landlord's name, it would be considered to be in the possession or control of the landlord.

In summary, most commercial landlords will be pleased with this outcome. They will be able to take money from a charged rent deposit in the event that their commercial tenant goes into administration without having to account to preferential creditors or any ring-fenced fund for unsecured creditors.

"This case could prove to be crucial for landlords when their tenants enter administration and also obviously for administrators in terms of what monies they can utilize", said Hawkins Hatton's Laura Raby. She added, "Landlords would be wise to act with caution because it is unlikely that this will be the final word by the Courts on this point."

If you would like any further information or advice on this matter please contact Laura Raby at Hawkins Hatton LLP on (01384) 216840 or lraby@hawkinshatton.co.uk.