



Corporate Turnaround and Insolvency

Escrow funds and administration – who is entitled?

What happens to funds held in escrow when the paying entity goes into administration?

The background

Escrow mechanisms are familiar territory for most practitioners. The case of *Bristol Alliance Nominee No. 1 Ltd and others v Neil Andrew Bennett and others* [2013] EWCA Civ 1626 explores what happens when funds are held in escrow at a time when the paying entity goes into administration.

A|Wear traded from premises in Bristol and Leicester. It suffered trading difficulties and negotiated the surrender of the leases which would take effect by way of a deed of variation under which the parties' mutual obligations under the leases. On completion a surrender premium (equivalent to one year's rent) would be released to the landlords' solicitors to be held in escrow. In time the landlords served notices to complete the surrenders, and shortly afterwards A|Wear went into administration. The administrators refused to complete the surrenders or to consent to the issue of legal proceedings against the company, instead applying to court for directions.

The issues

The administrators wanted to know which of the company and its landlords were entitled to the funds held in escrow. If the landlords were not entitled to the monies, the question of whether they should be permitted to bring an action for specific performance of the surrenders was also raised. In the High Court, the judge decided that the landlords were not yet entitled to the monies, and that specific performance was not necessary since the landlords could recover the premises by way of forfeiture for non-payment of rent. In addition, an order for specific performance would deprive A|Wear (and its creditors) of the future right to those monies. Particular attention was paid to the fact that the monies were held by the landlords' solicitors as "stakeholders" rather than as trustee, and that under the terms of the stakeholder arrangements the company was entitled to the return of the surrender premiums at the end of the lease term should the landlord not serve a notice to complete the surrenders before that time. The landlords appealed to the Court of Appeal.

What did the Court of Appeal decide?

The Court of Appeal decided that - although the escrow monies were held by the solicitors as stakeholders - the landlords had correctly issued notices to complete the surrenders. The payment condition

in the escrow arrangements had therefore been fulfilled and the landlords were entitled to the escrow monies. That being the case, the monies no longer formed part of the company's assets and were not available for distribution to its creditors. The court would grant specific performance since A|Wear had not fulfilled the agreements' terms. Refusal of such an order would promote the interests of A|Wear's creditors over those of its landlords in circumstances where there was no good reason to do so.

What does this mean for practitioners?

Fundamentally this concerns the delivery of property which is then held in limbo until some further condition is fulfilled. Until such time as the trigger condition occurs ownership of the property will normally remain with depositor. This can cause problems in insolvency as - until such time as the escrow condition is fulfilled and title passes - the asset in question will still form part of the depositor's estate and hence will be available for distribution to its creditors. The landlords in this case were lucky in that the escrow condition had been fulfilled and entitlement to the money had passed **before** A|Wear entered administration. It could easily have gone the other way. When structuring these arrangements therefore, practitioners would be well advised to couch the arrangement in terms of a trust, which (provided the trust is properly constituted) has the effect of removing the assets from the insolvent estate of the depositor, regardless of whether or not the escrow/vesting condition has been fulfilled.

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