

RESPONDING TO COVID-19

25 March 2020

Practice Group(s):

COVID-19

Real Estate

*Restructuring &
Insolvency*

COVID-19: (Australia) Real Estate: Key Considerations in the Face of Corporate Tenant Insolvencies

By Michael Hain and Jason Opperman

**This information is accurate as of 9.00 am Wednesday 25 March 2020 and is subject to change as this situation evolves.*

A tenant's solvency, or its risk of insolvency, is not a novel concern for landlords and tenants alike. But, the unprecedented COVID-19 pandemic is putting corporate tenant solvency risk into the hot spotlight arguably like never before, and for good reason.

So, it is timely we share six key considerations for landlords and tenants who are looking to successfully address corporate tenant solvency risks, and quickly.

A reference table is included below to compare and contrast headline differences between the legal impacts of a corporate tenant receivership versus a voluntary administration versus a liquidation.

Key Considerations

1. Commonwealth, State and Territory governments are announcing new COVID-19 recovery and relief response plans daily, even hourly. It is reasonable to expect there will be some significant changes directed at moderating and potentially even suspending many of the usual legal rights and principles that govern the landlord and tenant relationships.

In his media release on 20 March 2020, Prime Minister Scott Morrison MP confirmed that the states and territories are "*working to identify how relief can be provided for tenants in both commercial tenancies and residential tenancies*" and it can be expected that the states and territories will develop specific relief proposals for both corporate and residential tenants. Click [here](#) for details.

An example of COVID-19 relief measures has been the [announcement](#) that the directors of corporate tenants will be allowed a six months 'grace' period in which to trade without exposure to personal risk of liability for insolvent trading for debts incurred during that period.

2. It is usually in the landlord's best interests to work with the tenant, and then with an insolvency practitioner if one is ultimately appointed to be a tenant's receiver, voluntary administrator or liquidator. Landlords fundamentally need tenants, and vice versa. Being proactive and open to potentially novel proposals may potentially deliver win-win solutions. For example, the retail market is already seeing larger retail landlords looking to work cooperatively with retailers. Click [here](#) for details.
3. Where there are bank guarantees and/or personal or corporate guarantees, carefully consider and take professional advice whether and when they can be called upon or enforced. Rushing to call in a bank guarantee without a valid right to do so can result in serious consequences for both the landlord and the tenant.

COVID-19: (Australia) Six key Considerations for Landlords and Tenants in the Face of Growing Risks of Corporate Tenant Insolvencies

4. Where a tenant has gone into external administration, the landlord is a creditor of the tenant and should continue to stay engaged and be prepared to attend creditors meetings, ask questions and seek out answers to better understand the prospects for the tenant to continue in business and how that might be facilitated.
5. Consider if there are any personal property interests under the lease that could have been, but were not registered on the Personal Property Security Register (PPSR) (since non-registration may put these interests at risk of being 'trumped' by other subsequently registered claims). It may still be possible and useful in appropriate situations to register such unregistered PPSR interests and landlords should consider obtaining advice whether late registration may still assist in some circumstances.
6. It goes without saying that a tenant's insolvency can trigger a complex chain reaction of significant challenges and potential losses for landlords and tenants alike to manage. This will now be greatly amplified by added COVID-19 impacts. Landlords and tenants should obtain professional advice, once a tenant's insolvency or potential insolvency is suspected, as this assistance and experience can help to preserve rights whilst developing strategies for reaching optimal outcomes.

What are the Legal Impacts?

	Receiver appointed to the tenant	Voluntary Administrator appointed to the tenant	Liquidator appointed to the tenant
Who appoints the insolvency practitioner as the Receiver, Voluntary Administrator or Liquidator?	<p>Typically, a company enters receivership as a result of a secured creditor appointing a receiver.</p> <p>The receiver's role is typically to collect and sell enough of the company's secured assets to pay back the debt owed by the company to that secured creditor.</p> <p>A receiver may sometimes be court appointed.</p>	<p>Voluntary administration involves the appointment of an insolvency practitioner (administrator) to take control of a company in order to provide the company with breathing space to maximise the company's chances of continuing to trade or providing a better return to shareholders and creditors than a winding up.</p> <p>Typically, a voluntary administrator is appointed by a company's directors after they decide the company is insolvent or is likely to become insolvent.</p> <p>An administrator may instead be appointed by:</p> <ul style="list-style-type: none"> • the court • a liquidator (or provisional liquidator) • a party entitled to enforce security over the whole or substantially the whole of the tenant company's property. 	<p>Liquidation of an insolvent company involves the appointment of an insolvency practitioner (liquidator) to wind up the company's affairs in an orderly and equitable way for the benefit of all creditors.</p> <p>Liquidation almost invariably brings about the end of the company.</p> <p>A company may be placed into liquidation in several ways, and these can include by:</p> <ul style="list-style-type: none"> • a creditors voluntary liquidation - where creditors resolve to liquidate or • a court appointed liquidation - where the court orders that the company be wound up. <p>It is not unusual for landlords to recover only a fraction of rent and other amounts owed under leases in circumstances where corporate tenants are liquidated.</p>
Who takes on the tenant's lease obligations arising after appointment (such as to pay rent and outgoing)?	<p>Within the first seven days after entering the landlord's premises, the receiver can give the landlord notice that the receiver doesn't intend to exercise any rights in relation to the landlord's premises. If the notice is given, this means the receiver isn't personally</p>	<p>Within the first five days after the appointment, the administrator can give the landlord a notice [Corporations Act 2001 - Section 443B(3)] that the administrator doesn't intend to exercise any rights in relation to the landlord's property. If the notice is given, this means the</p>	<p>At any time, the liquidator can disclaim the lease and vacate the landlord's premises with the result:</p> <ul style="list-style-type: none"> • the liquidator is <i>not</i> personally liable for rent or other amounts payable under the lease during

COVID-19: (Australia) Six key Considerations for Landlords and Tenants in the Face of Growing Risks of Corporate Tenant Insolvencies

	Receiver appointed to the tenant	Voluntary Administrator appointed to the tenant	Liquidator appointed to the tenant
	<p>liable for rent or other amounts payable under the lease during his or her occupation of the landlord's premises. However, the tenant company will still be liable for any unpaid rents.</p> <p>If the required notice is not given by the receiver within the first seven days, the receiver is personally liable for rent and other amounts payable under the lease until:</p> <ul style="list-style-type: none"> the receiver retires from his or her appointment the company ceases to occupy the landlord's premises <p>or</p> <ul style="list-style-type: none"> the court excuses the receiver. <p>Note: If the lease has not been terminated by the time the receiver retires, the tenant generally remains liable for rental and outgoing arrears.</p>	<p>administrator isn't personally liable for rent or other amounts payable under the lease during his or her occupation of the landlord's premises. However, the tenant company will still be liable for any unpaid rents.</p> <p>A notice where given will cease to have effect if:</p> <ul style="list-style-type: none"> the administrator revokes the notice in writing <p>or</p> <ul style="list-style-type: none"> the company exercises, or seeks to exercise rights in relation to the landlord's property (eg continues to trade from the premises). <p>If no [Corporations Act 2001 - Section 443B(3)] notice is given, the administrator is personally liable for rent or other amounts payable under the lease from five days after the administrator's appointment for so long as:</p> <ul style="list-style-type: none"> the company continues to use or assert a right to occupy or possess the premises (but merely continuing occupation or possession may not be enough) the administration continues the administrator does not give notice that the company is vacating. <p>The administrator may also seek a court order excusing him or her from liability even where they have not given a notice to the landlord.</p>	<p>the liquidator's occupation of the premises</p> <ul style="list-style-type: none"> the landlord can (provided this is permitted by the lease), re-enter and re-take possession of the premises the landlord remains a creditor of the tenant and can claim for the landlord's loss as an unsecured creditor over the whole lease term. <p>If the lease isn't disclaimed by the liquidator, and the liquidator chooses to stay in the premises, the liquidator still isn't personally liable for rent or other amounts payable under the lease. But the landlord's right to receive rent during that period of liquidation will be treated as an expense of the liquidation to be paid out of the proceeds realised in the sale of the company's assets and in priority over the debts of unsecured creditors [Corporations Act 2001 - Section 556(1)(a)].</p> <p>If the lease isn't disclaimed and the liquidator is still not disclosing his or her intentions, the landlord can issue a notice asking the liquidator to confirm the position which means the liquidator then has 28 days to respond [Corporations Act 2001 - Section 568(8)].</p> <p>In limited circumstances, on the application of the landlord:</p> <ul style="list-style-type: none"> a liquidator's disclaimer of lease may be set aside by the court [Corporations Act 2001 - Section 568B(1)] the court may allow the lease to be ended when the liquidator decides not to disclaim it [Corporations Act 2001 - Section 568(9)].
<p>Who takes on the tenant's lease obligations arising before appointment (such as to pay any rental and outgoing arrears)?</p>	<p>The tenant company remains liable.</p>	<p>The tenant company remains liable.</p> <p>Note: If the tenant enters into a deed of company arrangement (DOCA) then the unpaid full rent for the remaining lease term may be claimed under the DOCA.</p>	<p>The tenant company remains liable.</p>

COVID-19: (Australia) Six key Considerations for Landlords and Tenants in the Face of Growing Risks of Corporate Tenant Insolvencies

	Receiver appointed to the tenant	Voluntary Administrator appointed to the tenant	Liquidator appointed to the tenant
Can the Landlord still enforce its rights under the terms of the lease during the appointment?	The receivership <i>does not</i> affect the rights of creditors - so the landlord <i>can move</i> to take possession or enforce the terms of the lease or start legal action against the tenant for say rent arrears (legal advice should however be obtained beforehand).	The administration <i>does</i> affect the rights of creditors - the landlord <i>cannot move</i> to re-take possession of the premises, or enforce the lease, or start legal action against the tenant for say rent arrears without: <ul style="list-style-type: none"> • the administrator's consent or • leave of the court [Corporations Act - Section 440D(1)]. 	The liquidation <i>does</i> affect the rights of creditors - the landlord cannot start legal action against the tenant for say rent without leave of the court. The landlord <i>can</i> however move to re-take possession of the premises (legal advice should however be obtained beforehand).
IpsO facto terms	Leases will often contain ipso facto clauses, which create a right to terminate if certain defined events occur (usually the event will be an insolvency type event occurring to a tenant). However, recent legal reforms have significantly limited the use of such ipso facto clauses to terminate leases, for example where an administrator is appointed to a corporate tenant. Although the ipso facto reforms generally do not prevent landlords from exercising other separate rights to terminate leases for a breach such as the non-payment of rent, some care still needs to be taken when terminating for a breach not to offend anti-avoidance provisions. For this reason, rights should be reserved when breaches occur but are not being presently pursued. There are a number of exceptions to the ipso facto regime. Importantly, the date that any lease agreement was entered into or renewed may affect a landlord's ability to enforce certain rights.	Same applies as for receivers.	Same applies as for receivers.
Are personal guarantees still enforceable after appointment?	Personal guarantees under the lease <i>can</i> be enforced by the landlord during the receivership.	Personal guarantees under the lease <i>cannot</i> be enforced by the landlord during the administration period (unless the guarantor is an unrelated third party or with Court approval) [Corporations Act 2001 - Section 440J].	Personal guarantees under the lease <i>can</i> be enforced by the landlord during liquidation.

COVID-19: (Australia) Six key Considerations for Landlords and Tenants in the Face of Growing Risks of Corporate Tenant Insolvencies

	Receiver appointed to the tenant	Voluntary Administrator appointed to the tenant	Liquidator appointed to the tenant
Are bank guarantees able to be called on <i>during</i> the period of appointment?	<p>If permitted by the terms of the lease, a bank guarantee can be called on during the receivership.</p> <p>When a bank guarantee is proposed to be called on, special care is required to ensure there is a valid right to do so. Serious consequences can otherwise result for both the landlord and the tenant</p> <p>A bank guarantee does not create a security interest under the PPSA.</p>	Same answer applies as for Receivers.	Same answer applies as for Receivers.
Are security deposits able to be applied <i>after</i> appointment?	<p>The receipt of a cash security bond under a lease may create a security interest in favour of the landlord where the landlord becomes a secured party under the Personal Property Securities Act (PPSA). In order to perfect the security interest in the cash security bond, the landlord must register a financing statement on the PPSR.</p> <p>But watch out! If the landlord fails to register, and so perfect the security interest in the cash security bond, the landlord may subsequently find it ranks behind any other person who has perfected their security interest. For example, if the tenant's bank has perfected an all-assets security interest, then the bank will have priority and may be able to claim the cash security bond and gain priority ahead of the landlord.</p>	<p>Same answer applies as for receivers.</p> <p>If the security over the deposit is not properly PPS registered and perfected, then the deposit may vest in the voluntary administrator.</p>	<p>Same answer applies as for receivers.</p> <p>If the security over the deposit is not properly PPS registered and perfected, then the deposit may vest in the liquidator.</p>

Authors:

Michael Hain

Partner
Perth
Michael.Hain@klgates.com
+61 8 9216 0964

Jason Opperman

Partner
Sydney
Jason.Opperman@klgates.com
+61 2 9513 2435

K&L GATES

K&L Gates is a fully integrated global law firm with lawyers located across five continents. The firm represents leading multinational corporations, growth and middle-market companies, capital markets participants and

COVID-19: (Australia) Six key Considerations for Landlords and Tenants in the Face of Growing Risks of Corporate Tenant Insolvencies

entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organisations and individuals. For more information about K&L Gates or its locations, practices and registrations, visit www.klgates.com.

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

© 2020 K&L Gates LLP. All Rights Reserved.