

Property Update

November 2010

The impact of insolvency on leases

This is the second article in a series of three which considers the impact of insolvency on leases. As most tenants of commercial or retail premises are companies, we will deal with corporate insolvency rather than insolvency of individuals. In this article we deal with company receivership. In the final article we will deal with company liquidation.

The issue of insolvency and leases is not new. However, like most fundamental issues, it goes through cycles of importance.

Steadily increasing interest rates coupled with the recent economic downturn, the current lack of credit and softness in consumer and business spending pose challenges for landlords of corporate tenants. Corporate entities are succumbing to the pressure of creditors and the repercussions of excessive debt, and the number of corporate entities entering into a form of external administration is increasing.

Insolvency of tenants has consequences with respect to the ability of landlords to:

- ensure payment of rent and recovery of arrears;
- recover possession of leased premises; and
- institute and continue legal proceedings in relation to any breaches of the lease by the insolvent tenants.



What is 'insolvency'?

Section 95A(1) of the *Corporations Act* states that a person is 'solvent' if, and only if, the person is able to pay all that person's debts as and when they become due and payable. Section 95A(2) states that a person who is not solvent is 'insolvent'.

Receivership

A company is in 'receivership' where a person (who must be a registered liquidator) is appointed over that company by a secured creditor in order to collect and sell any asset or assets to repay the debt owed to the secured creditor.

In other words, the receiver is appointed to

realise enough of the assets subject to the creditor's security in order to repay the debt owed to the secured creditor.

The person appointed is either a 'receiver' or a 'receiver and manager'.

A 'receiver and manager' is a receiver who has, under the terms of his or her appointment, the power to manage the insolvent company's affairs.

A receiver may be privately appointed:

- by a statutory right (for example, section 58 of the *Property Law Act 1969*); or
- pursuant to the terms of a mortgage or charge over the assets and undertaking of the company.

About Lavan Legal

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The Property Services Group, a division of Lavan Legal, pride themselves on being the leaders in property and planning law. Advising on all aspects of property acquisition, disposals and developments including syndications, we have one of the few accredited leasing experts available to clients who has significant Australia-wide experience on very large and complicated leasing developments.

At Lavan Legal we believe in building long lasting relationships with our clients. We provide the best legal advice and service and continue to improve our understanding of our clients' needs, staff, history, motivations and directions. We provide clients with regular industry insights, updates on changing technology and business strategies in an effort to take the relationship to a more successful position. We are committed to increased efficiency through continuous innovation and process improvement.

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Less commonly, a receiver may be appointed by a court to protect the company's assets or to carry out specific tasks.

Priority of debts

A landlord will usually be an unsecured creditor. Employees of the company are a special class of unsecured creditors. In a receivership, in certain circumstances, some of their entitlements are paid in priority to the debt of the secured creditor. Priority is then given to secured creditors after employee entitlements are paid out.

As an unsecured creditor, the landlord ranks behind both the administrative costs in continuing to run the business (such as wages), and secured creditors. However, the process by which the landlord is entitled to recover any rent is outlined below.

Will the landlord continue to receive rent?

A receiver is not required to pay rent for seven days after that receiver is appointed. During the seven day period the receiver may serve a notice on the landlord indicating an intention not to exercise any rights in respect of the leased premises and therefore they are not liable for rent for the period specified in that notice, in addition to the initial seven day grace period.

If the receiver does not give the landlord such a notice, the receiver becomes liable for rent once the seven day period ends, until:

- the receiver gives the landlord notice that the company is vacating the premises;
- the company actually leaves the premises; or
- the receivership ends (whether the company actually continues to occupy the premises or not).

Does the receiver have to keep the landlord informed of what it is doing?

Strictly, a receiver has no obligation to keep the landlord informed of its actions or intentions. Similarly, a receiver is under no obligation to notify a landlord upon a receivership coming to an end. It is, however, common for the landlord to be kept informed.

Can the landlord recover possession of the premises?

Provided there is a proper basis, a landlord may terminate a lease and re-take possession of the leased premises except in circumstances where the receiver continues to pay rent. In circumstances where the receiver is still paying rent under the lease and is in possession of the premises (pursuant to a registered security) the receiver has a right to retain possession. However, it is not unusual that a lease will contain a provision that the appointment of a receiver will entitle the landlord to terminate the lease. Of course, such a provision would have to comply with any legislation regarding the termination of a lease.

There is no statutory moratorium against recovery of possession of the premises during a receivership. In many situations of company receivership there is also the appointment of administrators at the same time. In those circumstances there will be a statutory moratorium on taking possession during administration. Whether a receiver has been appointed 'over the top' of an administrator will not preclude the effect of the statutory moratorium.

Can the landlord commence legal proceedings against guarantors?

A landlord is entitled to commence or continue legal proceedings during a tenant's receivership. A landlord may also commence legal action against guarantors

of the tenant's obligations under the lease.

Lavan comment

It is clear that the implications for a landlord of an insolvent tenant are significant. Landlords need to be aware of their rights and entitlements should such a situation arise. Insolvency can be a complicated process. Landlords should obtain appropriate professional advice as soon as the landlord becomes aware of the insolvency (or potential insolvency) of a tenant to ensure its position is fully protected as best as possible.

In many situations of receivership, the receiver will often seek to sell the business of the company as a going concern. This will often include a proposed assignment or novation of the lease to the purchaser. Rather than adopting the usual course of terminating the lease upon insolvency of the tenant, a landlord is often wise to communicate openly with the receiver with a view to negotiating a smooth transition to a new tenant.

The best outcomes in insolvency situations are reached if the landlord and the tenant regard each other as partners in the enterprise. The landlord needs tenants in its buildings or shopping centres. Tenants need the landlord's premises to run their businesses and earn income.

If there is openness between the landlord and the tenants as to how their respective businesses are travelling and there is a lot of mutual good faith and understanding between them, tough economic times can be navigated quite successfully.

If you have any queries about the issues with insolvency and leases, please contact Inge Lauw, Senior Associate, on (08) 9288 6905 or email inge.lauw@lavanlegal.com.au

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Tim is a Solicitor in the Property Services Group.

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