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## DEALING WITH TENANTS IN FINANCIAL CRISIS: How it can Affect you as a Landlord

### Introduction

The current economic climate has caused significant pain for various parts of the economy and no less so for landlords and tenants.

It is important for landlords (and tenants) to understand the different types of insolvency administrations that may affect them.

This article will look at how insolvency (such as receivership, administration or liquidation) of a corporate tenant may affect landlords.

### Payment of rent and other monies payable pursuant to the lease

A tenant's failure either to pay rent and outgoings, or when a tenant becomes subject to a form of insolvency administration, inevitably results in a default under a lease. These situations give the landlord various rights, including re-entry and repossession of the premises.

If an administrator is appointed, he will become personally liable to pay the rent and other monies payable under the lease to the landlord after five business days from the commencement of the administration through to its completion, **unless** he serves a notice on the landlord before the five business days period that he does not propose to exercise his rights over the premises. The administrator's liability to pay the rent and other monies payable under the lease ceases from the date the notice is served upon the landlord.

There may be additional monies owing under the lease other than that for which the administrator is personally liable, including:

1. any monies owing pursuant to the lease before the fifth business day after the administrator's appointment;
2. any monies owing under the lease by the tenant after the administrator has served the notice; and
3. any monies owing under the lease by the tenant after the end of the



administration period.

The tenant will remain liable for these amounts. However, the landlord's ability to recover such monies depends on what the tenant's creditors resolve to accept by way of repayment at a second meeting of creditors. Accordingly, the landlord may only receive a proportion of monies owing to it (other than those amounts for which the administrator is personally liable).

In a receivership or liquidation, the receiver or liquidator may need to negotiate with the landlord about payment of rent and length of stay in the premises to preserve the value of the tenant's business or assets. Where there is no need for preservation, the landlord can exercise its rights to remove the tenant from the premises (assuming the tenant has not already vacated).

A receiver is not bound to pay a landlord for unpaid rent and outgoings as at the date of appointment. In the case of liquidation, the landlord will be an unsecured creditor for unpaid rent and outgoings and will

only receive a payment if the liquidator makes a dividend distribution to creditors.

## The effect of voluntary administration on a landlord

Voluntary administration may impact on a landlord in ways other than those already mentioned. If a landlord has acted against a tenant to take possession of premises before the tenant enters voluntary administration, the law does not restrain the exercise of such right or power. Similarly, the law does not prevent the exercise of a right to terminate a lease during administration.

However, during administration, a landlord cannot act to terminate the lease by recovering possession of the premises or suing for rent without the consent of the administrator or a court order.

If a deed of company arrangement (**DOCA**) is proposed for creditors to vote on at a second creditors' meeting, a landlord must think carefully about how to vote at that meeting. If a landlord votes in favour of the DOCA, the landlord will be bound by its terms and no longer entitled to exercise rights that would otherwise be available to terminate the lease. If the landlord considers the 'reconstructed' tenant remains a bad financial risk, it may be better for the landlord to vote against or abstain from voting on the DOCA.

The success of a DOCA will often depend on the landlord's attitude to it. It may be crucial for the administrator to have time to 'rebuild' the tenant's business to sell it to a third party with an assignment of the lease of the premises.

If a landlord refuses to co-operate, the administrator can seek a court order to prevent the landlord from taking possession of the property or otherwise recovering it. The court will only make such an order if

permitting the landlord to act would have a material adverse effect on achieving the purposes of the DOCA. The court, in making such an order, must ensure the landlord's interests are adequately protected and can fashion an order with conditions to achieve this purpose. Such an order is a most unfortunate result for a landlord.

## Legal proceedings against guarantors

A corporate tenant will often be required to provide personal guarantees by third parties (usually the directors of the tenant) to secure the performance of the lease obligations.

However, on the appointment of an administrator, there is moratorium that lasts until the second meeting of creditors on taking action against directors (of a corporate tenant) and their spouses who have provided personal guarantees for the debts of the company.

While proceedings cannot be issued against directors during the moratorium, it is important for the landlord to determine its losses quickly so there is no delay in issuing enforcement action if necessary at the end of the moratorium.

In determining potential loss, a landlord should consider mitigation (ie, attempts to re-let the premises), the financial strength of the guarantor, the prospects of successfully enforcing the guarantee, the costs that may be incurred in removing the fit-out, rectification and make good costs, and the rent and outgoings that would have been payable if the lease had run to expiry.



## Fixtures and fittings

Generally speaking, if a landlord terminates a lease by re-entry, the tenant is required to remove its property, including fixtures and fittings, within the timeframe stipulated in the lease. The tenant is invariably required to reinstate the premises to the condition it was in before any fit-out occurred.

Tenants will often vacate leaving fixtures and fitting and other goods behind. Landlords should exercise caution if they treat the tenant's property as abandoned and elect to dispose of it. The primary risk is where the tenant's property is owned by a third party or, alternatively, is subject to the rights of a financier. Wrongful disposal may result in a claim for compensation by the third party or financier.

Should an incoming tenant wish to use the outgoing tenant's property, it is advisable such negotiations be conducted directly between the outgoing and incoming tenants. Alternatively, should an incoming tenant require vacant possession of the premises, the landlord may elect to remove the outgoing tenant's property and store it safely at the outgoing tenant's expense at least for a period until it can safely be said the tenant's property has been abandoned.

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