TENANTS UNDER ADMINISTRATION: CANVASSING THE OPTIONS FOR RELIEF AGAINST FORFEITURE

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Appointment of an administrator over company assets under the *Corporations Act 2001* (Cth) is a means by which company property may be protected for the benefit of creditors and shareholders in the face of actual or anticipated insolvency. Creditors' and shareholders' interests in or claims upon company property are often in conflict with those of third parties – such as lessors of real property who might seek to forfeit the company's lease and regain possession of property. In these circumstances, the tenant company in administration may make a claim for relief against forfeiture or call upon the application of a s444 moratorium. As two recent cases show, such a moratorium may be extended beyond the expiration or termination of a deed of company arrangement. This paper examines the decisions in *Kelly and Morris v Hedz Pty Ltd (voluntary administrators appointed) (receiver and managers appointed)* [2010] QSC (30 July 2010) and *Strazdins v Birch Carroll & Coyle* 178 FCR 300 to examine the extent to which s444 declarations can be considered to align with or augment equitable relief.

Last year my co-author ran a case in the Supreme Court in Cairns for administrators of a company that was also under receivership. The company was called Hedz Pty Ltd and its business was hotelier. The goal of the receivers was to continue to conduct the various hotel businesses leading towards a structured sale process. It was therefore important to have continued and uninterrupted possession of the premises used by the company. The deed of company arrangement was therefore subject to relief against forfeiture or relief under s444F of the Corporations Act.

The issue was that the company's landlord was objecting to the proposed deed of company arrangement. In fact, one of the company's landlords had purported to forfeit the lease based on the company's breach of the lease – because of the appointment of the receivers.

Relevantly, the lease commenced in 2007 for a term of 30 years with two 15 year options. The landlord purchased the freehold with the lease after Hedz had gone into

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receivership, and issued a statutory notice to remedy breach of covenant after it became the owner.

The primary secured creditor, ANZ, had undertaken to pay all rent and outgoings and to underwrite the obligations under the lease.

Insolvency practitioners are universally aware of the moratorium presently effected by section 440C of the Act. The moratorium prevents owners or lessors from interfering with possession of property that is in the possession of, or used by, the company. The moratorium lasts for the duration of the voluntary administration however section 444F provides an opportunity for that moratorium to be extended beyond the voluntary administration, and in some cases, beyond the expiration or termination of a deed of company arrangement ("DOCA").

It was this extended relief under s444F that was the focus of the administrators' application in Hedz.

There are two preconditions to an order being made under this section. First, the owner/lessor's actions would have a material adverse effect on achieving the purposes of the deed of company arrangement. Secondly, the interests of the owner/lessor must be adequately protected.

In Hedz, the landlord resisted the application on the basis that there would be no material adverse effect on achieving the purposes of the deed, and that the owner's interests were not adequately protected.

Before I look further into how the court treated these arguments, I'll briefly outline the circumstances in an earlier case that was relied on in Hedz. This is Strazdins v Birch Caroll & Coyle.

In this case, the tenant company had 9 years to run of its lease from BCC when administrators were appointed. The landlord issued notice of default pursuant to the appointment, but subsequently offered the tenant a new three year lease.

As occurred in Hedz, the administrators applied for an extended moratorium to protect the company's occupation of the business premises. The financial statements showed that the business was running profitably, and the financial obligations under the lease were secured by a bank guarantee.

The landlord however resisted the deed of company arrangement on the bases that there would be no material adverse effect on the company, and that the landlord's interests were not protected by the granting of the order.

Material adverse effect

In each case, the court found that there would indeed be a material adverse effect on the deed of company arrangement. If the lease were not protected, then the deed would fail and the company in each case would go into liquidation. In Hedz, the respondent argued that there would be no material adverse effect overall on creditors –even if the deed itself were frustrated. The judge disagreed. The main purpose of the deed of company arrangement was to continue the business operations and the loss of this would result in a poor outcome for employees and unsecured creditors.

Protecting interest of landlord/owner

Strazdins had some interesting argument about protecting the landlord's interests. The landlord argued that it had a right to choose its own tenant, and to grant a shorter lease if it wanted to. The court however found that it was the landlord's rights under the lease that were to be protected in terms of the section, not any broader commercial rights as owner.

In Hedz, the landlord's concern was securing the non-financial obligations under the lease, such as to repair, and the 'post-doca' situation where the landlord would be left with a tenant that was hopelessly insolvent. Neither of these arguments was successful. The receivers had given an undertaking to cause the company to maintain its obligations under the lease. In addition, the landlord had taken on the tenant knowing it was already under administration – so there was no material change to its situation.

Forfeiture

What we were interested in about these cases was the extent to which this remedy might mirror or deviate from an award of relief against forfeiture. We wondered whether there was any material difference in the considerations for an award. So if you were an administrator, would there be any benefit in selecting one form of relief against another?

Today I'll focus on a couple of aspects of relief against forfeiture that bear comparison with the relief under s444F. The first of these is the principle that underpins each form of relief. Secondly, is the nature of the relief itself – forfeiture is regarded as "an ultimate security mechanism to ensure compliance". Finally is the measure of protection of the leasehold interest afforded under each remedy.

The starting point was the statement of the key considerations annunciated in Shiloh Spinners v Harding. You will recall the relevant considerations in assessing whether to afford relief are:[1]

a) the conduct of the assignee (tenant);

b) whether or not the breach was wilful; and

c) the nature and gravity of the breach, and its relation to the value of the property which might be forfeited.

The principle underpinning relief against forfeiture is unconscionability. In considering the elements, the court will have an eye on whether the landlord would have a wholly disproportionate benefit. Obviously this is not a consideration in the s444F action – the relevant consideration here is simply that the landlord's interests are adequately protected. However this does seem an equivalent outcome of the two types of relief, albeit approached from a different direction.

In each case too, the courts are reluctant to 'reshape contractual obligations' to achieve something more fair. In Strazdins, the court discounted the landlord's right to rewrite the commercial arrangement – and said that all that would be protected is the landlord's right under the lease that existed at the time of the administration.

The focus of the relief appears on first blush to differ. Forfeiture is concerned with the landlord tenant relationship but administration and attendant relief is focused on the position of creditors under the deed of company arrangement. The landlord tenant relationship is secondary.

However there is case law to suggest that this is relevant in relief against forfeiture cases also – thus extending the traditional understanding of bases of relief.

[1] *Shiloh Spinners v Harding* [1973] 1 All ER 90 at 101.

The old (1895) case of Howard v Fanshawe held that relief was available regardless of how the tenant became unable to pay – provided the arrears were made good, then relief would be available.

In Hayes v Gunbola (1988, NSW) to give relief to an insolvent person "may be in the public interest because the benefit of the valuable property in the lease will inure for the creditors generally should he become bankrupt."[2]

In *MI Design Pty Ltd v Dunecar Pty Ltd* [2000] NSWSC 996 ("*MI Design*") relief was awarded "notwithstanding the Plaintiff's present insolvency". The basis for this decision was that "there is no real doubt that any prospect the tenant has of salvaging its position would be completely lost if re-entry were not allowed."[3]

In *Lindholm*, a 2011 federal court decision, the Court found that if relief were not given, unsecured creditors would be no worse off but that the secured creditor would "risk a substantial loss."[4] This informed its decision to award relief against forfeiture – that is to say, the public policy position of third parties is relevant in considering whether to award relief against forfeiture. This brings this form of relief closer to the rationale behind Corporations Act moratorium.

Finally, what is perhaps of most interest is the nature of the protection afforded by each form of relief. This was highlighted in *Lindholm, in the matter of Munday Group Pty Ltd (Receivers and Managers Appointed) (In Liquidation) v Tsourlinis Distributors Pty Ltd* [2011] FCA 195 (9 March 2011).

This case involved an application for relief against forfeiture or in the alternative, relief under s444F. The court didn't have to consider the latter, because it awarded relief against forfeiture. However in obiter it raised a number of concerns about the operation of s444F that confirm our own analysis of the two forms of relief.

While there is perhaps not much to separate these two forms of relief in whether to grant them, the effect of relief is somewhat different. In relief against forfeiture,

[2] *Hayes v Gunbola Pty Ltd* (1988) NSW ConvR ¶55-375, at 57,457.
[3] At [61].
[4] *Lindholm, in the matter of Munday Group Pty Ltd (Receivers and Managers Appointed) (In Liquidation) v Tsourlinis Distributors Pty Ltd* [2011] FCA 195 (9 March 2011) at [44].

As with relief against forfeiture, a s444F application will operate regardless of whether the lease has been terminated. In *Strazdins* the owner had submitted that the lease had been validly terminated, and that as a consequence s444F could not operate. Lander J addressed that argument.

> The power to make an order under section 444F(4) is not dependent upon a valid lease being in place but is dependent upon the property being used or occupied by the company being in possession of the property.

This implies a focus on retaining for the tenant a possessory rather than a proprietary right. Indeed, in contrast to the order upon a termination under relief against forfeiture, s444F "does not contemplate" an order reinstating the lease.[5] The order "will have the effect of requiring [the tenant] to comply in all respects with the lease as if it were on foot,"[6] but not it seems affirming the lease itself. As the Court pointed out in obiter in *Lindholm*, this opens questions about the landlord's rights and obligations. As there is no lease, the terms upon which the tenant holds its possessory rights and the landlord's rights to enforce the tenant's obligations are uncertain.

[5] *Strazdins v Birch Carroll & Coyle* (2009) 178 FCR 300 at 326.
[6] *Strazdins v Birch Carroll & Coyle* (2009) 178 FCR 300 at 326.