COVID-19: (AUSTRALIA) LIABILITY OF ADMINISTRATORS FOR RENTS DURING COVID-19 CRISIS

Date: 1 May 2020

By: Alex Smith, Ian Dorey, Jennifer Degotardi

Under Australian law, voluntary administrators usually become personally liable to pay rents for leased property which they cause the company in administration to retain and use after the initial five business day grace period. The Courts have been willing to extend the period for which the administrators will not become personally liable for rents and also to permit administrators to defer the actual payment of the rents for leased premises and assets. This in turn has the effect that landlords' creditor claims are potentially significantly increased.

We examine the Courts' latest decisions on this topic below.

APPLICATION TO THE FEDERAL COURT IN THE COLETTE GROUP ADMINISTRATION

The Colette Group, a mid-market bag, jewellery and accessories retailer, was placed into administration on 31 January 2020. The administrators proceeded with the potential sale or recapitalisation of the Group until 26 March 2020, by which point, the uncertainty surrounding COVID-19 made all of the interested parties withdraw from the process.

The administrators were liable to pay rent for 93 of the Group's Australian stores (having already closed and vacated 31 underperforming stores). The administrators' view, as put to the Federal Court, was that paying rent would greatly deplete the resources of the Group and cause detriment to its creditors. It was their view also that if the Colette Group could 'mothball' the business until the COVID-19 crisis dies down, then the administrators are likely to achieve the greatest value for the Colette business.

The administrators applied to the Federal Court for relief from personal liability for the rents for the stores that had closed in light of the COVID-19 crisis but did not wish to give possession back to the landlords. They also applied for an order that they were justified in not paying any rents to the landlords for those stores, with the effect that the landlords' unsecured claims would increase by the additional accrued (but unpaid) rents.

Further reasons argued by the administrators for not paying the rent amount included that:

- paying rent would deplete the Colette Group's cash resources which were already diminished by forced store closures due to COVID-19
- other retailers had taken steps to close stores and not pay rent
- the leases for the 93 stores could possibly be renegotiated, and
- legislative intervention was/is a possibility.

The administrators were successful in getting orders on both counts on 1 April 2020 with those orders having a two week duration. Those initial periods of relief were extended for an additional three weeks to 6 May 2020 by further orders on 14 April 2020. It remains to be seen whether the landlords reach agreement with the administrators prior to that date. If so, the Court may not be required to give further consideration to balancing the interests of the landlords with the administrators' stated preference of adopting a "mothballing" strategy for the Group.

PREJUDICE TO LANDLORDS

The power to excuse administrators from personal liability for rents has been exercised on a number of previous occasions by the Courts on application by administrators. Historically, administrators have needed to demonstrate how any possible prejudice to landlords will be addressed, in order to justify the exercise by the Court of the power to vary the application of the usual legislative regime.

For example, in the decision in 2019, in the administration of 2nds World, the administrators obtained relief from personal liability for store rents in circumstances where the administrators had insufficient funds available to pay the store rents for the period of time which it was expected to take to sell the business. In that instance, the prejudice that would otherwise have been caused to landlords was mitigated by the Court sanctioning a priority return of compensation to landlords (essentially for lost rents for the duration of the short extended period) out of the proceeds of sale of the company's business.

ORDERS MADE IN VIRGIN ADMINISTRATION

Consistent with the orders made in the Colette Group administration, the administrators of Virgin Australia obtained, on an ex parte basis on 24 April 2020, orders which excuse them for personal liability for lease payments (including under aircraft leases and real estate leases) for the period to 26 May 2020. In the case of the Virgin administration, the administrators have indicated that they require that period of time to consider the ongoing use and value of the leased property to the business and to confer with the lessors. Lessors have the ability to bring the matter back before the Federal Court in the event that they oppose the orders made.

APPLYING THE PREJUDICE QUESTION TO THE CURRENT COVID-19 CRISIS

The question in the current COVID-19 crisis is whether it will, in the main, be impossible for landlords to demonstrate that they are prejudiced by being unable to take possession of the leased premises or items. Where landlords are unable to demonstrate prejudice, will they have any ability to oppose a situation being forced on them whereby their claims against the insolvent company increase significantly, against their will? It will be likely impossible where the tenant is an SME covered by emergency powers legislation enacted by the states to give effect to the *National Cabinet Mandatory Code of Conduct—SME Commercial Leasing Principles During COVID-19* adopted on 7 April 2020. The Code prevents landlords from terminating leases or recovering possession for unpaid rent during the COVID-19 pandemic and a reasonable recovery period (neither of which is defined). The legislation to give effect to the Code is still being enacted in each state but in NSW is six months from the date the regulation was made (ie. to 24 October 2020).

WHAT CAN LANDLORDS DO NOW?

In circumstances in which landlords are facing significant losses, their appetite to oppose the relief sought by administrators may be limited. However, there may be circumstances in which a landlord might want or need to take back possession of the leased premises or assets sooner, in order to refit or upgrade the premises or asset, or to ensure its proper care and maintenance. Landlords who cannot reach an acceptable agreement with administrators may need to act swiftly, for example, by commencing court proceedings to obtain authority to take back possession of their assets (and as noted above this may not even be an option for SME tenants). There can be no guarantee that administrators will not oppose recovery of possession by landlords where they believe there is an alternate proposal which may benefit the interests of creditors across the board.

Another angle for landlords to consider is whether they should be pushing for the deferred rentals to be afforded priority status by order of the Court and agreement of the administrators, given that the rent deferral may be a key source of funding for the administration trading or holding period.

Where administrators understandably and legitimately require additional time to address complex situations before recommending a course to creditors, time will tell whether any prejudice which is ultimately suffered by landlords is addressed and rectified when restructuring solutions come to be implemented. It remains to be seen in each case whether landlords will have any commercial leverage to negotiate compensation for leaving their leased assets on the table and thus facilitating implementation of a broader restructuring solution.

KEY CONTACTS

ALEX SMITH
PARTNER

SYDNEY
+61.2.9513.2434
ALEX.SMITH@KLGATES.COM

IAN DOREY
PARTNER

BRISBANE
+61.7.3233.1236
IAN.DOREY@KLGATES.COM

JENNIFER DEGOTARDI
PARTNER

SYDNEY
+61.2.9513.2414
JENNIFER.DEGOTARDI@KLGATES.COM

