Landlord v Administrator
A Bare Knuckle Brawl

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Perceptive readers may have sensed my antipathy towards the retail lease legislation.

In order to show that I am not just a one trick pony, this article will give the legislation a rest. Instead we will touch on one of my other interests: the interaction of lease and insolvency law when a tenant goes belly up. (I know, I know: I have to get out more).

For a lawyer, there is nothing more elemental than a bare knuckle fight between an administrator and a landlord over rights to a failed tenant's fitout.

What I have found surprising is that landlords do not always have a detailed grasp of their rights and obligations on tenant insolvency. And when you get belly-to-belly with a hungry administrator, you need to understand the rules of the fight.

Section 440B of the *Corporations Act 2001* (Cth) says that if an administrator adopts the lease, the landlord is not entitled to recover possession of the premises during the administration. I have seen landlords pop an O ring when advised of this constraint. They calm down a little when told that the administrator is personally liable for the rent for the period the administrator has control of the premises, but again turn purple when they learn that the administrator is not liable for arrears.

This issue can play out in cases where the administrator seeks to sell the business conducted from the leased premises.

In that case, the administrator will seek landlord consent to an assignment of the lease. Under section 39 of the *Retail Leases Act 1994* (NSW), the landlord is only entitled to withhold consent if the assignee has inferior retailing skills or financial resources to those of the assignor. (Similar provisions operate in other jurisdictions). Given that the assignor is an insolvent trader, the landlord does not really have any grounds on which to withhold consent.

But the landlord might still be able to leverage payment of the arrears out of the transaction. This is because when the lease is assigned, the assignee assumes the leasehold estate of the assignor, subject to all of the rights and obligations caught up in the lease. One of those obligations is the obligation to pay all of the rent, including arrears. In other words, the obligation to pay the arrears, moves to the assignee.

When the landlord points this out to the assignee, the assignee will tend to make it a commercial requirement of the purchase of the business from the administrator that the arrears are paid. This has the effect that part of the proceeds from the sale of the business are deflected from the administrator to the landlord. When the discussion moves in this direction, the landlord gets his swagger back, but the administrator starts to froth at the mouth.

But don't think that this is a knock-out punch. The administrator is down, but not out, and will come back swinging. There are a few more rounds left in the bout, and the landlord has to stay sharp in order to remain in the contest.

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It is also round about this time that the landlord will start to wonder if it can cash the tenant's bank guarantee. There is clear authority that the appointment of an administrator does not affect the landlord's right to cash a bank guarantee. This is because the obligation to pay on the bank guarantee is an obligation of the bank, not of the tenant. The insolvency of the tenant has nothing to do with the solvency of its bank. So if there are arrears, the landlord should seriously consider converting the bank guarantee into cash. The landlord can then have a conversation with the assignee about the need for a replacement bank guarantee.

It is obviously important for the landlord to ensure that it does not withhold consent to assignment on these payment and performance conditions, because these are not permissible grounds for withholding consent under the *Retail Leases Act*. An assignee, however, is not subject to the statutory obligations imposed on landlords in relation to assignment. So a savvy landlord would be looking only to load the bullets.

You would think it reasonable that a landlord should be able to withhold consent to an assignment on the ground that the assignee is barely solvent, but the retail legislation, in its wisdom, does not permit this ground. (Don't get me started on that hobby horse: we are supposed to be giving the legislation a rest!).

If the administrator is unable to sell the tenant's business, he or she will want to realise the value of the tenant's fixtures and fittings in the premises. This opens up a whole new fracas, particularly if the landlord has financed some of the tenant's fitout.

If the landlord has simply thrown money at the tenant to spend on fitout, it will be a no-contest. In that case, the fitout will be tenant's property, and the administrator will be in control of the premises. There is not much the landlord can do to stop the administrator from removing the fitout and then disposing of it.

However, if the landlord has retained ownership of the fitout and registered a security interest on the Personal Property Security Register, or if the tenant owns the fitout on a financed basis, subject to a registered security interest in favour of the landlord, then the landlord can rumble.

While the fitout is a tenant's fixture, the *Personal Property Security Act 2009* (Cth) (**PPSA**) will not apply. Section 8 of the PPSA says that the Act does not apply to fixtures. Tenants fixtures are, by definition, fixtures.

But if the administrator exercises the contractual right of the tenant to remove tenants fixtures, they become chattels, and subject to the jurisdiction of the PPSA.

If the landlord has a registered security interest, you would expect the administrator to roll over. This is because the landlord holds the joker, whether the fitout is in the form of a fixture or a chattel. A first-ranking, perfected (ie. registered) security interest will trump the administrator's interest.

The fight becomes more of a mud-wrestle when the landlord retains ownership of fitout, registers a security interest, but fails to identify by inventory the property to which the security interest applies. In that case, you would expect the administrator to ask the landlord to identify the property over which it claims dominion. If the landlord is unable to do this, then the landlord might have to kiss its security interest goodbye.

So, as with most things, attention to detail is the difference between a rooster and a feather duster. The landlord which backs up its registered security with an inventory of the fitout it owns will trump the administrator. The landlord without an inventory might end up with a face like a beaten favourite.

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