

Australia's property industry

Creating for Generations

15 September 2021

Manager
Market Conduct Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: MCDInsolvency@treasury.gov.au

Improving schemes of arrangement to better support businesses

The Property Council welcomes the opportunity to respond to Treasury's Consultation Paper *Helping Companies Restructure by Improving Schemes of Arrangement*.

The Property Council of Australia champions the industry that employs 1.4 million Australians and shapes the future of our communities and cities. Property Council members invest in, design, build and manage places that matter to Australians: our homes, retirement villages, shopping centres, office buildings, industrial areas, education, research and health precincts, tourism and hospitality venues and more.

We support the Government's commitment to facilitating the successful restructuring of companies so that they can continue trading. However, as with the initial draft *Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020*, we have some concerns about the sanctity of the lease under both the scheme of arrangement and a moratorium period while the scheme is formed. We recommend that the unique status of a lease is afforded necessary protections in any changes to the existing scheme of arrangements regime.

Our submission argues for the importance of the sanctity of the lease and ensuring fairness in the schemes of arrangement regime, covering:

- The introduction of a moratorium risks prejudicing the rights of landlords, particularly where it is introduced without appropriate protections for certain classes of creditors
- If a moratorium is introduced, it should not be automatically applied, rather subject to Court approval and continued supervision
- Landlords should not be prohibited from enforcing rights under the lease
- Landlords should be entitled to rent owing during the scheme period
- Changes to rent obligations must be specifically voted for by landlords and not be subject to a general determination of other creditors or the courts

Ensuring sanctity of lease contracts

A lease agreement gives rise to contractual rights and obligations for both landlords and tenants throughout the term of the lease, in particular, the exclusive use of premises is provided by the landlord in exchange for the tenant agreeing to pay rent and keeping the premises in good order.

The relationship between property owners/landlords (creditors) and tenants (debtors) is unique insofar as the owner/landlord is providing an essential service for the business that is applying to restructure. Unlike suppliers of goods to a business who can change their service conditions dependent upon the current 'at time' situation of the business (moving to cash on delivery, withholding goods until invoices are paid), the situation for the landlord is very different.

We note that there have been only six scheme administrators appointed in recent years.¹ We understand that The Productivity Commission recommended in its 2015 report 'Business Set-Up, Transfer and Closure' that a moratorium be introduced, and this moratorium be in line with the approach used in voluntary administration.

The proposed schemes of arrangement changes and the introduction of a moratorium could give rise to significant impacts for commercial property owners – many of whom are also small businesses – including for example, loss of cash flow, risks of breaches in debt covenants and in extreme situations, loan defaults and forced asset sales. Commercial property is a critical part of the Australian economy and financial system, and the proposed reforms should not inadvertently jeopardise the stability of our markets. We therefore propose landlords be considered as a special category and afforded necessary protections.

Landlords should not be prohibited from enforcing rights under the lease

We seek to ensure that landlords and owners are provided with equivalent protections currently expressed in the *Corporations Act* for the voluntary administration regime. That is, a scheme of arrangement can only bind a dissenting landlord in respect of its personal claims against a company (i.e. claims for rent, including future rent) and not its proprietary rights (such as its rights to take possession of the leased property) (section 444D(3) of the *Corporations Act*) in circumstances where a landlord does not vote in favour of the scheme of arrangement. Similar protections were also recently adopted in recent amendments to the recent amendments to the *Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020*.

The sanctity of the lease covenant is undermined if there is no protection to ensure that landlords can enforce their rights under a lease where they have not voted in support of the restructure. Unlike other creditor classes, who may be under no obligation to continue to supply to the debtor company and may change their service terms during the restructuring process (for example to delivery on payment terms), a landlord is obligated to provide exclusive use of premises to the tenant throughout the lease term, and could therefore be forced to accept materially lower rent to their detriment. The need for landlord protection is even more significant where there is any proposal of a cross-class cram down powers.

Landlords should be entitled to rent owing during a moratorium

The formation of a scheme of arrangement can take a minimum of three to six months and it is unclear whether the landlord has rights to claim any unpaid rent during the moratorium period once a scheme of arrangement has been proposed. This situation could be amended through Treasury providing clarity on how any debt that may accrue after the proposal for a scheme of arrangement is to be mitigated.

In addition, the moratorium on enforcement of arrears should only be available for companies which declare themselves insolvent, or likely to become so, and it should not absolve the company of its ongoing contractual obligations – such as the payment of rent during the scheme period.

Role of the Court

Any moratorium should be subject to court approval. An application must be made by the company, and all lessors' should be given an opportunity to apply to the court for relief – this includes a lessor

¹ ASIC, Insolvency Statistics, <https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/>.

applying for termination of the lease. It is important to recognise that lessor's bear a greater burden than most other suppliers in such circumstances due to their longer-term lease arrangements. A moratorium should only be granted where it can be evidenced to a Court that not to do so would be detrimental to the scheme of arrangement process.

Changes to future rent obligations should require landlord consent

We do not advise situations arising wherein the lease conditions could be rewritten without the agreement of the landlord. This would fundamentally override the sanctity of lease contracts and could result in adverse financial consequences for landlords.

The operation of a scheme of arrangement should ensure that property leases are protected from alteration without the express consent of the owner/landlord and, additionally, that the scheme ensures there are provisions for the ongoing payment of rent through the restructure. These are critical parts of the administration process for owners of properties that small businesses occupy. Any curtailing of landlord rights must be specifically voted for by the landlord, it should not be subject to the general creditor determination.

Conclusion

We recognise the challenge in constructing this new regime is ensuring that the debtor can continue to trade while forming a scheme of arrangement in such a way so that any outstanding debts can be repaid in a timely and cost-effective way for creditors. However, it is vitally important that in creating such a scheme that there is a recognition of the vital service that the landlord plays in providing a property from which a business seeking to restructure can continue to trade.

It is critical that the operation of a scheme of arrangement recognises the rights of owner/landlords in respect of their properties and the rights of owners/landlords to continue to receive rents from businesses that are in the situation of requiring restructure.

For this regime to function in the manner with which the government desires it must take these matters into account so that small businesses can continue to trade throughout this difficult economic time without also undermining lease contracts and the broader commercial property sector.

We are available to meet at your convenience to the issues raised in our submission. Please do not hesitate to contact me on 0400 356 140 or at bnngo@propertycouncil.com.au or Adele Lausberg on 0415 225 638 or at alausberg@propertycouncil.com.au.

Yours sincerely



Belinda Ngo
Executive Director – Capital Markets