The Rights of Owners, Lessors and Chargees in a Voluntary Administration

Paul Nicols and Matthew McLennan

This paper should not be treated as providing any definitive advice on the law. It is recommended that readers seek specific advice in relation to any legal matter they are handling.
The Rights of Owners, Lessors and Chargees in a Voluntary Administration

Paul Nicols and Matthew McLennan
3 April 2002

1. Introduction

The objectives of a voluntary administration are to maximise the chances of the company, or as much as possible of its business, continuing in existence or, if that is not possible, to obtain a better return for the company’s creditors than would result from an immediate liquidation.\(^1\) In order to achieve that objective Part 5.3A of the Corporations Act 2001 (Cth) (the Act) establishes a statutory moratorium which restricts the actions which creditors or other persons can take against the company and its property.\(^2\) The purpose of this paper is to describe briefly the ways in which that moratorium affects the rights of:

- owners of property used or occupied by, or in the possession of the company;
- lessors of property used or occupied by, or in the possession of the company; and
- holders of charges over property of the company (chargees).

This paper does not address the effect of voluntary administration on owners, lessors and chargees in their capacity as creditors or their status where the company has executed a deed of company arrangement.

2. Enforcement action: a model for decision making

When a company goes into voluntary administration all creditors are anxious to secure payment of the company’s debts to them. Unlike an ordinary unsecured creditor, however, an owner, lessor or chargee normally has the benefit of a powerful legal weapon to improve its return – the right to take or recover possession of property. The taking of such enforcement action can lead to a disorderly and distracting grab for the assets of the company which might prejudice the interests of the creditors as a whole and jeopardise the possibility that the business of the company might be continued under a company deed of arrangement or otherwise with the support of the creditors.\(^3\)

Part 5.3A of the Act seeks to avoid this state of affairs by regulating enforcement action by owners, lessors and chargees. To understand how the Act does so it is helpful to consider the analytical process which one must follow in order to determine whether a particular enforcement action can be taken. There are 6 key steps in that process:

Step 1 Identify the proposed enforcement action.

Step 2 Decide whether the Act might restrain the proposed enforcement action.

Step 3 If a restraint might apply, decide whether there is any applicable exemption.

Step 4 If there is no exemption, seek the administrator’s consent to the enforcement action.

Step 5 If the administrator refuses his or her consent, apply to the Court for leave to take the enforcement action.

Step 6 If the Court grants leave and the enforcement action requires legal proceedings against the company, seek leave to bring those proceedings.

The following sections of this paper address steps 2 to 6 in detail. A flow chart illustrating the steps and their interaction is annexed to this paper.

3. Might the Act restrain the enforcement action?

3.1 Enforcement action by chargees – s440B

The most important enforcement action available to a chargee is the right to take possession of charged property, sell it, and apply the proceeds of sale to payment of the company’s debts. Section 440B of the Act restrains the exercise of this key right. It provides that:

During the administration of a company, a person cannot enforce a charge on property of the company, except:

(a) with the administrator’s written consent; or
(b) with the leave of the Court.

The application of s440B depends in the first instance on the existence of a charge. It has been decided that:

- a contractual right to consolidate bank accounts by way of set-off;  
- a pledge or lien; and
- a retention of title clause;

are not charges for the purposes of s440B.

Assuming that a charge exists, the next issue is whether the proposed enforcement action is enforcement action for the purposes of s440B. The term enforce is defined in s9 of the

---

Act. That definition includes the obvious measures which a chargee may take: appoint a receiver and/or assume control of the charged property etc. The definition also includes something of a catch-all provision which applies to the exercise, as a chargee or as a receiver, of a right, power or remedy existing because of the charge.

3.2 Enforcement action by owners and lessors – s440C

The most important enforcement action available to an owner or lessor is the right to recover possession of property. Section 440C of the Act restrains the exercise of this key right. It provides that:

*During the administration of a company, the owner or lessor of property that is used or occupied by, or is in the possession of, the company cannot take possession of the property or otherwise recover it, except:*

(a) with the administrator’s written consent; or

(b) with the leave of the Court.

A mortgagee in possession of rented premises is a lessor for the purposes of s440C.

Section 440C applies to a supplier of goods who claims a right to recover them under a retention of title clause. Even though title to the goods will not have passed they are property of the company in administration because, at least, it has an equity of redemption in them.

One judge has doubted, without deciding, whether s440C applies to proceedings for enforcement of intellectual property rights because such proceedings are not proceedings to take possession of property or otherwise recover it. Leave to bring such proceedings against a company in administration, however, would still be required (see below).

4. Does an exemption allow the enforcement action?

4.1 Enforcement action by chargees

The restraint on the rights of a chargee in s440B is subject to 3 exemptions in favour of substantial chargees, pre-administration chargees, and chargees of perishable property respectively.

---

7 The precise scope of this element of the definition is unclear. It probably requires that the chargee do something which affects the company’s legal interest in the charged property. The exercise of an ordinary contractual right under the charge is probably not enforcement: see, albeit in a different statutory context, *Australian Innovation Ltd v Dean-Willcocks and Purchase* (as joint administrators of Powerline Gases Pty Limited) (2001) 40 ACSR 521 at 526-7.

8 *Tynray Pty Limited (administrator appointed) v Mercantile Mutual Life Insurance Co Limited* (1994) 13 ACSR 111 at 113.


10 *Barrymore Pty Limited v Harris Scarfe Limited (Administrators Appointed)* (2001) 162 FLR 258 at 273. The definition of property in s9 of the Act includes such equitable interests.

(a) **Substantial chargees – s441A**

Section 441A exempts the holder of a charge over the whole, or substantially the whole, of the property of the company (a **substantial chargee**) provided the substantial chargee takes enforcement action before or during the decision period. The decision period is defined in s9 of the Act to mean the 10 business day period following the giving of notice to the substantial chargee under s450A(3) or the beginning of the administration. This broad exemption for substantial chargees exists because such creditors should be able to achieve the same kind of orderly management of the company’s affairs as an administrator.12

(b) **Pre-administration chargees – s441B**

Section 441B exempts the holder of a charge who began enforcement action before the beginning of the administration. The lodging of a caveat and the commencement of proceedings prior to the beginning of an administration have been recognised as sufficient to attract the exemption in s441B.13 Sending a letter to estate agents purporting to appoint them as agents to sell charged property, however, may not be sufficient (at least where the agents have not accepted the appointment before the beginning of the administration).14

(c) **Chargees of perishable property – s441C**

Section 441C exempts the holder of a charge over perishable property of the company.

4.2 **Enforcement action by owners and lessors**

The restraint on the rights of an owner or lessor in s440C is subject to two key exemptions:

- section 441F exempts recovery action taken to enforce the rights of the owner or lessor **before the beginning of the administration**; and
- section 441G exempts recovery action in respect of perishable property.

The cases on s441F which have been decided to date highlight the need for the owner or lessor to demonstrate that it has taken enforcement action rather than simply threatening enforcement action or taking a preliminary step. For example, a lessor will not attract the benefit of s441F simply by giving the tenant a notice to vacate and then bringing proceedings for possession of the land.15

---

12 Explanatory Memorandum to the Corporate Law Reform Bill 1992 at par 536.
13 *BBC Hardware Limited v GT Homes Pty Limited* [1997] 2 Qd R 123 at 126
4.3 Limitation on powers of administrator

The exemptions discussed above are supplemented by s442D. It provides, in effect, that where those exemptions apply the administrator’s powers are subject to those of the owner, lessor, chargee or their agent.

5. Will the administrator consent to the enforcement action?

If the Act prohibits the proposed enforcement action the owner, lessor or chargee should seek the administrator’s consent under ss440B(a) or 440C(a). Even if the giving of consent is highly unlikely it should be sought because the Court will expect that this is done before any application for leave is made.

Section 440E provides that an administrator is not liable for refusing to consent to enforcement action. Accordingly, even if administrators should act reasonably and fairly the law is unlikely to require them to do so.

6. Will the Court grant leave to take the enforcement action?

The final option for an owner, lessor or chargee whom the Act restrains from enforcement action is to seek leave from the Court under ss440B(b) or 440C(b). In considering an application for leave the Court’s task is to seek to give effect to the object of Part 5.3A while being mindful of the fact that the Act intrudes upon the rights of persons dealing with the company. The Court’s discretion is unfettered but it may have regard to the factors considered by English courts when exercising an equivalent discretion.

A recent decision of the Federal Court of Australia, Canberra International Airport Pty Limited v Ansett Australia Limited [2002] FCA 329, contains a more expansive statement of the principles governing an application for leave:

Leaves may be granted if the statutory restraint imposed on the lessor will occasion the lessor loss or detriment (financial or otherwise) of a relevant kind. The loss or detriment may be regarded as relevant to a grant of leave where the Court considers it is greater than any benefit or advantage that might ensue to creditors by reason of the statutory restraint. The outcome of a grant of leave may depend on the history of the administration, the conduct of the parties, and whether terms may practically be imposed on a grant or refusal of leave to protect competing interests.
The Court may be more inclined to grant leave where the applicant can show that the
taking of possession will not in any practical way affect the availability of the options for the
company which the creditors may consider. Thus, for example:

- leave was refused where losing possession of the company’s premises would
  make it difficult to sell the company as a going concern, thereby depriving creditors
  of the option of approving a deed which would achieve that outcome;

- leave was granted where the owner and lessor wanted possession of the property,
a Boeing 727, and possession could be granted on terms which preserved the
  administrator’s opportunity to include the aircraft in a sale of the business.

The length of time for which the rights of the owner, lessor, or chargee may be suspended
is also an important factor. Leave has been refused where the administration was due to
end in 48 hours, or a creditors’ meeting was scheduled to take place in 6 days time.

7. **Is leave to bring proceedings against the company required?**

Section 440D prohibits the commencement or continuation of proceedings against the
company or its property without the administrator’s consent or the leave of the Court.
Leave under s440D is required whenever enforcement action involves legal proceedings,
even if:

- that enforcement action is exempted from the statutory moratorium by the Act (for
  example, ss441A, 441B, or 441F); or

- the Court has given the owner, lessor, or chargee leave to take enforcement action
  under ss440B(b) or 440C(b).

While the granting of leave under s440D is separate from the granting of leave under
ss440B or 440C we expect that in practice the two applications will normally be made and
resolved concurrently and that leave under 440D will almost certainly be granted when
leave under one of the other provisions is granted.

Many owners and lessors and all chargees will be secured creditors. It should be much
easier for secured creditors to obtain leave under s440D than for other creditors (at least
where the company is subject only to administration).

---

23 Re Ansett Australia Limited (administrators appointed); Intrepid Aviation Partners VII LLC v Ansett Australia Limited
25 Re Java 452 Pty Limited (administrator appointed) (1999) 32 ACSR 507 at 518. See also Canberra International Airport
   Pty Limited v Ansett Australia Limited [2002] FCA 329: creditors’ meeting in about a week.
26 Re Java 452 Pty Limited (administrator appointed) (1999) 32 ACSR 507 at 518; BBC Hardware Limited v GT Homes Pty
   at 758.
27 BBC Hardware Limited v GT Homes Pty Limited [1997] 2 Qd R 123 at 127.
The cases concerning leave under s440D indicate that the Court will be concerned to avoid distracting the administrator or causing the administrator to incur substantial costs.\(^{29}\) Consistently with those decisions, leave has been granted where most of the steps in the legal proceedings were taken before the administration began and there is no evidence that other creditors would be prejudiced by their completion.\(^{30}\)

A patentee has been granted leave, subject to conditions, to apply for an injunction restraining a company from infringing its intellectual property rights. In granting leave the Court noted that an injunction was probably the only effective remedy for the patentee because the company was unlikely to satisfy any award of damages.\(^{31}\)

8. Other fetters on the rights of owners, lessors and chargees

8.1 Limiting enforcement action – ss441D and 441H

The exceptions in:

- ss441B and 441C of the Act (pre-administration chargees and holders of charges over perishable property); and
- ss441F and 441G of the Act (owners and lessors who take enforcement action before the beginning of the administration and owners of perishable property),

are subject to the making of orders under ss441D and 441H. These sections empower the Court, on the application of the administrator, to limit the powers which the owner, lessor, chargee or their agent may exercise in respect of the property. The Court may only make such an order if it is satisfied that what the administrator proposes to do during the administration will adequately protect the interests of the owner, lessor or chargee. It has been held that this requires that a chargee’s rights be protected at least to the extent they are protected under the general law.\(^{32}\)

8.2 Floating charges

Charges often take the form of a floating charge over unspecified or ‘floating’ assets of the company such as stock. On the occurrence of a certain event, such as insolvency of the company, the floating charge crystallises into a fixed or specific charge. At this point the company (and administrator) would be unable to sell the property. Section 442B(2) of the Act undermines the chargee’s position and, subject to certain limitations, allows the administrator to deal with the property as if it were still subject to only a floating charge.

The administrator’s freedom to deal with such property is limited by s442C(1), which prohibits the administrator from disposing of the property. That subsection is in turn subject to s442C(2), which enables the administrator to dispose of charged property in the

---


\(^{29}\) Pioneer Water Tanks (Australia 94) Pty Limited v Delat Pty Limited (1997) 25 ACSR 757 at 759.

\(^{30}\) Albert v Namba Pty Limited (1997) 24 ACSR 577 at 580.


\(^{32}\) Fekala Pty Limited v Cenbond Pty Limited (2001) 37 AC SR 613 at 615.
ordinary course of the company's business. It has been held that charged property cannot be sold in the ordinary course of the company's business where the chargee has demanded its return.\(^3\)

The administrator is entitled to be indemnified out of the company's property for his or her remuneration and the debts of the administration (s443D). The administrator's claim has priority over debts secured by a floating charge (s443E(1)) except for:

• debts secured by a floating charge enforced before the beginning of the administration (s443E(2)). This is consistent with the preservation of the rights of pre-administration chargees under s441B; and

• debts secured by a floating charge enforced during the administration in accordance with the Act once the administrator is notified of the enforcement action (s443E(3)). This exception preserves the rights of substantial chargees under s441A and chargees who have obtained the Court's leave or administrator's consent to take enforcement action.

8.3 Administrator's liability for rent and other such payments

Section 443B limits an administrator's liability for rent and other such payments owing to the owner or lessor of property used or occupied by or in the possession of the company. The administrator is only liable for so much of the rent or other such payment as is attributable to the period from the beginning 8th day of the administration and, even then, he or she is only liable for so long as the company continues to use or occupy, or to be in possession of, the property. Further, during the first seven days of the administration, the administrator may notify the owner or lessor that the company does not propose to exercise its rights in relation to the property. This effectively relieves the administrator of any liability for rent or other such payments.

8.4 Section 442C – added benefit to owners, lessors and chargees?

Section 442C prohibits an administrator from disposing of charged property or the property of an owner or lessor other than in the ordinary course of business, with consent, or with leave of the Court. It has already been discussed in the context of floating charges. Subject to the exceptions in s442C(2), s442C(1) could, at least in theory, prevent an administrator from disposing of property which the company would normally be entitled to dispose of: for example, property subject to a retention of title clause which could be sold other than in the ordinary course of business. In addition, the possibility of the administrator being personally liable for contravening s442C should give owners, lessors and chargees the comfort of knowing that the administrator has an incentive to respect their proprietary rights.

9. Does the Act strike the right balance?

In order to assess whether or not the Act strikes the right balance one must address 3 questions:

• what balance does the Act aim to strike;
• is that the right balance to aim for; and
• does the Act in fact strike that balance?

The Act aims to suspend the rights of owners, lessors and chargees but only to the extent necessary to achieve its objectives: maximising the company's chances of rehabilitation or the return to creditors. This requires that those rights be suspended where suspension is necessary to:

• allow the company's affairs to be managed in an orderly manner;
• maximise the options available to creditors when considering the future of the company; and
• maximise the return to creditors.

The question of whether this is the right balance to aim for is a broader question of policy which is outside the scope of this paper. We note only that some commentators believe the Act successfully respects the commercial expectations of creditors whereas others think that the Act places an inordinate weight on the possibility of rescuing the company.

The remaining question is whether the Act in fact strikes the balance it aims for. The Act seeks to achieve its objective by a combination of the statutory moratorium, fixed exemptions such as those contained in ss 441A, 441B, 441C, 441F and 441G, and discretionary exemptions: the administrator's consent or the leave of the Court.

In our opinion the balance struck by the fixed exemptions is appropriate. Substantial chargees can stand outside the statutory moratorium without obstructing the rehabilitation of the company. Owners, lessors or chargees who take enforcement action before the beginning of the administration should have their rights preserved. If their rights threaten the company's rehabilitation it is open for the administrator to seek tailored relief under ss441D or 441H.

To the extent that the fixed exemptions do not cater for the legitimate interests of owners, lessors and chargees the existence of the discretionary exemptions is important. Of the discretionary exemptions the granting of leave by the Court is probably more significant from a creditor's perspective. While the option of obtaining consent from the administrator is practically useful, the fact that he or she is not under any legal pressure to act reasonably means that the option is of limited value to creditors. Accordingly, the critical

---


issue is whether the principles governing the granting of leave by the Court strike the right balance.

The Court’s discretion to grant leave is unfettered and the decided cases show that the range of factors which the Court might take into account is very wide. Ultimately, the decision is a practical one which depends on the particular circumstances of the company. The flexible nature of the discretion makes it impossible to state generally whether the law strikes the right balance in practice. In our opinion, however, there is at least one context in which the Court’s exercise of its discretion may be unjustifiably weighted in the company’s favour.

While the object of the Act is relevantly to maximise the company’s chances of rehabilitation there is no legal requirement that this objective be achievable. An administration may be commenced when the company is insolvent or likely to become insolvent even if there is no chance of rehabilitation. When there is no such chance, or at least no evidence that such a chance exists, we think the Court should be reluctant to refuse leave for enforcement action. This means that, in resisting an application for leave, at least when he or she has had a reasonable opportunity to investigate the company’s position and prospects, an administrator should be required to demonstrate that he or she has a realistic plan for the company’s future and that plan might be thwarted if enforcement action were taken.

In *Fekala Pty Limited v Cenbond Pty Limited* (2001) 37 ACSR 613 Young J considered an application by administrators under s441D to restrain enforcement action. The administrators could only put forward a speculative proposal that they would take steps to procure a buyer for the company’s business and the property in issue. His Honour’s response was to restrain enforcement action for about 2 weeks but only on condition that the administrators submitted a firm proposal concerning the property within that time. The evidence before the Court indicated that a 2 week delay would not prejudice the chargee. If there had been a risk of prejudice it appears that Young J would have declined the administrator’s application. With respect, that would have been the correct course to take. A merely speculative proposal should normally be insufficient justification for a suspension of a creditor’s legal rights.

In *Re Java 452 Pty Limited (administrator appointed)* (1999) 32 ACSR 507 Byrne J considered a lessor’s application for leave under s440C to take possession of the premises from which the company in administration operated a café. The lessor had found a potential new tenant who was prepared to improve the property. The administrator resisted the application for leave on the basis that, without possession, the company could not be sold as a going concern. Byrne J refused the lessor’s application. In doing so the judge pointed to a number of considerations, especially the fact that a creditors’ meeting was scheduled to take place in 6 days time and in the interim the lessor would not suffer any material prejudice. Byrne J also emphasised the importance of giving the company’s

37 ss436A and 436B of the Act. Note also s436C where a person has the right to enforce a charge over the whole or substantially the whole of the company’s property.

creditors the opportunity to consider the company’s future on the basis that it still had possession of property which was important to its business. There is no doubt that this was a legitimate factor to point to. In our respectful opinion, however, at this point the Court reached the outer limits of a fair balance between the rights of creditors and the object of the Act. In the absence of a realistic plan involving the property in question, the mere possibility that the possession of property may cause creditors to vote one way or another at a meeting should not be given great weight when considering an application for leave in circumstances where the administrator has had a reasonable opportunity to investigate the company’s position and prospects.

Finally, we refer to the passage from *Canberra International Airport Pty Limited v Ansett Australia Limited* [2002] FCA 329 which is quoted in section 6 above, in particular the sentence in which Kenny J states *The loss or detriment [of the lessor] may be regarded as relevant to a grant of leave where the Court considers it is greater than any benefit or advantage that might enure to the creditors by reason of the statutory restraint*. This sentence posits a comparison of the cost to the individual owner, lessor or chargee with the benefit to the creditors as a whole. The difficulty with such a majoritarian approach is that it can lead to the administration being conducted for the benefit of unsecured creditors at the expense of those who are seeking to exercise their proprietary rights. We doubt that this is the intention of the Act. Rather, we think it should be sufficient for the owner, lessor or chargee to demonstrate that the statutory restraint will cause what is for them a significant loss, regardless of whether the creditors as a whole stand to gain more.

§§§