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# CREDIT ISSUES

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## WOODGATE & CO.

Chartered Accountant

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### A LIQUIDATOR MAY TERMINATE A TENANT'S LEASE

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#### Snapshot

In December 2013 the High Court of Australia handed down its decision in *Willmott Growers Group Inc v Willmott Forests Limited (Receivers and Managers Appointed) (In Liquidation)*. The High Court ruled that a Liquidator may disclaim a lease that a company has granted to a tenant, leaving the tenant to prove for its loss in the winding up.

#### Background

Willmott Forests Limited ("Willmott") was the responsible entity or manager of eight registered managed investment schemes ("MIS") and 21 unregistered MIS. Willmott and its nine subsidiaries operated in New South Wales, the Northern Territory and Victoria. The MIS conducted forestry operations on land either owned by Willmott or leased by Willmott from third parties. The investors in the MIS (known as growers) had rights to grow and harvest trees on the land. The project documents included lease and licence agreements with Willmott for occupation and use of the land. Some grower leases were for 25 years and provided that all rent was

paid in advance. Each grower leased an area on which trees were to be grown and entered into a forestry management agreement with one of the companies in the Willmott Group. The forestry management agreements provided for the planting, maintenance and harvesting of the trees. Most forestry management agreements provided for the grower to pay the relevant company an initial fee and nothing further until the trees were harvested. The land used in a particular MIS was not always a single block. For example, the forestry operations of one of the MIS were conducted on 105 different plantations. Further, a grower's lot might be adjacent to one or more lots leased to growers in other MIS. The growers' lots were identified by GPS co-ordinates.

In September 2010 most of the Willmott Group companies went into voluntary administration. Receivers and Managers were also appointed to certain charged properties. In March 2011 most of the Willmott Group companies went into liquidation. The Liquidators concluded that Willmott's MIS could not continue to operate, as it was very unlikely that a third party would assume the liabilities of Willmott to fund the MIS, without any

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contributions from growers until harvest. Further, the Liquidators concluded that it would not be practical to maintain separately, or harvest separately, the trees on any individual lot leased to a particular grower. Therefore, the growers' right to maintain and harvest their own trees was a theoretical right which, in a practical sense, could not be exercised.

In conjunction with the Receivers and Managers, the Liquidators sought to sell the assets of Willmott, including the freehold land and leasehold interests. The sale campaign was run on the basis that parties could either purchase the assets unencumbered or encumbered by the Willmott MIS. Of the 229 expressions of interest received by the Liquidators, none expressed interest in buying the assets with an encumbrance.

### **Supreme Court of Victoria**

Normally when a Liquidator disclaims a lease, it is the company in liquidation that is the lessee. The effect of the disclaimer is to release the lessee company of its obligations to the lessor. The lessor then proves for any loss in the winding up.

The Liquidators of Willmott made an application to the Supreme Court of Victoria for directions as to whether they were able to disclaim the growers' leases with the effect of extinguishing the growers' leasehold interest. The Liquidator's strategy was novel, as it was intended to improve the value of Willmott's assets, by removing encumbrances; not just seeking to relieve it of existing obligations. At first instance Justice Davies considered Section 568D of the *Corporations Act* and ruled that:

- (a) a lease creates both contractual and proprietary rights;
- (b) the effect of a disclaimer under Section 568D(1) of the *Corporations Act*, was to terminate the company's rights and liabilities in respect of the disclaimed property, but this did not affect any other person's rights or liabilities;
- (c) there was a distinction between a Liquidator's disclaimer of a lease agreement as a lessee and the disclaimer of the lease agreement as a lessor;
- (d) a leasehold interest is property of the lessee. The Liquidator's disclaimer only terminates the lessor's rights and liabilities. Therefore, the disclaimer did not bring the lessee's proprietary interest in the land to an end; and,
- (e) a leasehold interest cannot be described as a liability or encumbrance upon the property of the lessor.

Her Honour held the Liquidator's disclaimer did not have the effect of extinguishing the leasehold interests of the lessees in the land.

### **Court of Appeal**

In April 2012 the Liquidators appealed to the Court of Appeal of the Supreme Court of Victoria. The majority of the Court of Appeal ruled that it was clear from the wording of Section 568D that third party rights and interests may be affected by a disclaimer, and this may affect the most innocent of parties.

The Court of Appeal noted that the ongoing requirement of a lessor to provide a lessee with possession and quiet enjoyment was an obligation of Willmott. It continued for the duration of the lease. The obligation to provide

such tenure was therefore a liability of Willmott which arose directly from the lease. The Court of Appeal held that if Willmott was to be relieved of its obligation to provide quiet enjoyment, which was a liability, the tenure of the growers had to be extinguished. It was necessary to affect the growers' rights of tenure, in order to release Willmott from its liability to provide possession and quiet enjoyment. The Court noted that the notion that a commercial lease was a demise, that conferred an interest in land and which survived the termination of the contract, was to ignore recent significant developments in the law.

### **High Court of Australia**

A representative body of the Willmott growers then sought leave to Appeal the judgment of the Court of Appeal to the High Court of Australia. In May 2013 that leave was granted.

The High Court considered Section 568(1) of the *Corporations Act* which permits a Liquidator to disclaim onerous property. This includes property that is unsaleable or not readily saleable and also a contract.

The Applicant submitted that a disclaimer did not bring the tenant's rights to an end. The majority of the High Court rejected that submission. The High Court ruled that from the date of the disclaimer, the company's liability to provide the tenant with quiet enjoyment of the leased property and the tenant's rights to quiet enjoyment of the property were terminated.

The High Court noted that the definition of property within the *Corporations Act* was very broad and included any legal or equitable estate

or interest (whether present or future and whether vested or contingent) in real or personal property of any description. Therefore, property could be understood as referring to the company's possession of any number of a wide variety of legal rights against others, such as a lease.

The majority of the High Court determined that the rights and duties which a landlord and a tenant have under a lease, are bundles of rights and duties which together can be identified as property. There was no reason why the disclaimer provisions in Section 568(1) should be limited to leases granted to the company in liquidation. Further, it was not possible to bring the company's rights, interests and liabilities in respect of the leases to an end, without also bringing to an end the interests and rights of the lessees. The lessees were left with the rights to prove in the winding up, as ordinary unsecured creditors, for any damage thereby inflicted.

The majority of the High Court also held that a lease was a contract for the purposes of Section 568(1) of the *Corporations Act*.

The High Court noted that, on application pursuant to Section 568B of the *Corporations Act*, a Court may set aside a Liquidator's disclaimer, in very limited circumstances.

### **Implications**

The High Court's decision provides important clarification on the extent of a Liquidator's power to terminate tenants' rights under a lease. It was apparent from the transcript of the judgment that the growers' leases were not registered with the Land Titles Office.

However, it is not clear from the Willmott decision whether the registration of a lease would affect the Liquidator's disclaimer of a lease.

The High Court's determination highlights risks to tenants and their financiers. One implication of the High Court's decision is that if a landlord

company goes into liquidation and the Liquidator determines that commercially it would be better to sell the property with vacant possession, than encumbered with the existing leases, then there is no legal impediment to doing so. The ability to lodge a Proof of Debt in the winding up is small recompense.

## **WOODGATE & CO.**

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