

Alert

PROPERTY

COVID-19: Mandatory Code for Commercial Tenancies

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On 7 April 2020 Scott Morrison announced a series of commercial leasing principles designed to assist commercial tenants whose businesses have been adversely impacted by COVID-19. These principles, legislated in the National Cabinet Mandatory Code of Conduct ("**the Code**"), came into effect from 3 April 2020. The principles have been applied as additional measures in support of the Government's 'Hibernation Strategy', and they are based on the set of principles previously set out in our article '[Coronavirus: Commercial Landlords and Tenants](#)'. The principles significantly change the laws, which would usually regulate the rights and obligations of landlords and tenants.

Purpose of the Code

The purpose of the Code is stated to "*impose a set of good faith leasing principles for application to commercial tenancies (including retail, office and industrial) between owners/*

operators/other landlords and tenants where the tenant is an eligible business for the purpose of the Commonwealth Government's JobKeeper programme."¹ The intention is to provide a legal framework for tenants and landlords to negotiate a proportionate distribution of the financial risk and cash flow due to the impact of the COVID-19 pandemic.

While the Code aims to balance the interests of tenants and landlords, it is clear that the application of the Code will significantly impact some landlords due to a significant proportion of their tenants registering for the JobKeeper programme.

Application of the Code

The Code will be passed into legislation by each of the states and territories, and they will be responsible for regulating the new set of principles. The Code

¹ <https://www.pm.gov.au/sites/default/files/files/national-cabinet-mandatory-code-of-conduct-sme-commercial-leasing-principles.pdf>

is treated in the same manner as legislation while we wait for it to be passed. It is therefore mandatory for landlords to engage in negotiations with their tenants in accordance with the Code.

The Code will remain in place while the JobKeeper programme is in operation.

The Code provides rent relief to all commercial tenancies (including retail, office and industrial) where the tenant has signed up to the JobKeeper Programme except for tenants that have a turnover exceeding \$50 million per annum.

Businesses looking to register for the JobKeeper Programme must establish the following:

- their business has a turnover of less than \$1 billion, and their turnover has fallen by more than 30 per cent (of at least a month); or
- their business has a turnover of \$1 billion or

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more, and their turnover has fallen by more than 50 per cent (of at least a month); and

- they are not subject to the Major Bank Levy.

In circumstances where businesses have a turnover of more than \$50 million per annum or are not registered for the JobKeeper programme, the terms of the lease, as well as the standard legal principles under the *Retail and Commercial Leases Act 1995* (SA), will apply.

Leasing principles

Before the introduction of the Code, landlords and tenants were bound by the terms of the lease as well as the *Retail and Commercial Leases Act 1995* (SA). In general terms, a landlord was able to terminate the lease for breach of the terms of the lease. Most commonly non-payment of rent gave rise to a breach capable of terminating the lease if not rectified. This recourse is no longer available to landlords subject to the below.

The Code imposes a number of leasing principles to be applied and enacted in agreeing to temporary leasing arrangements to existing leases, namely:

1. Landlords **must not terminate leases** due to non-payment of rent during the COVID-19 pandemic or reasonable subsequent recovery period.
2. Landlords **must not draw on security provided by their tenants** during the COVID-19 pandemic period

or a reasonable period of recovery after the pandemic concludes.

3. Tenants **must remain committed to the terms of their lease** subject to any amendments negotiated in accordance with the Code. If tenants do not abide by the terms of their lease, the landlord can terminate the lease unless the breach is due to non-payment of rent.
4. Landlords must offer tenants proportionate **reductions in rent payable by way of waivers or deferrals** of up to 100% of the rental amount ordinarily payable based on the reduction in the tenants' trade during the pandemic and subsequent recovery period.
5. **Rental waivers** must constitute no less than 50% of the total reduction in rent payable. A higher percentage should be applied where failure to do so would compromise the tenant's ability to fulfil their obligations under the lease. This, however, is to be balanced with the Landlord's financial ability to provide such a waiver. Therefore, the parties can agree to a waiver of less than 50%.
6. Payment of the **rental deferrals** must be amortised by the greater period of not less than 24 months or the balance of the lease term, again unless otherwise agreed.
7. No **fees, interest or other penalties** should be applied with respect to rent waived or deferred.
8. Any reduction in **statutory charges (e.g. land tax and council rates) or insurance** will be passed onto the tenant in the appropriate proportion applicable under the lease.
9. A landlord should seek to share with its tenant any **benefit received from a loan payment from the Bank or another COVID-19 related initiative**, again in the proportionate amount.
10. The right to recover any **expense or outgoing** from a tenant by a landlord should be waived where appropriate during the period the tenant is unable to trade.
11. **Repayments from tenants to landlords should occur over an extended period** to avoid undue financial burden. Further, any such repayment should not commence until the earlier of the COVID-19 pandemic ending (to be determined by the Federal Government) or the existing lease expiring and taking into account a reasonable recovery period.
12. Tenants should be provided with an opportunity to **extend leases** for a period equivalent to the rent waiver and/or deferral period.
13. Landlords agree to **freeze rent increases** (except for retail leases based on turnover rent) for the duration of the COVID-19 pandemic and a reasonable period of recovery after the pandemic concludes.
14. Landlords **may not apply any penalties** if tenants reduce their opening hours or cease to trade as a result of the COVID-19 pandemic.

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15. There will be a **binding mediation process** implemented by each of the States and Territories. This processes must not be used to prolong or frustrate the dispute resolution process.

The above principles are to be assessed on a case-by-case basis.

Challenges and how we can help

While the Code is designed to assist all parties to negotiate through this challenging and unprecedented economic crisis, it is apparent that negotiations giving effect to the principles imposed by the Code may present further challenges because of their subjective nature. The number of principles to be applied may also result in complex and protracted negotiations.

Some examples of inconsistencies and subjective principles imposed by the Code which we have identified so far include:

- “Reasonable recovery period” is not defined and will likely differ from tenant to tenant. It is easily envisaged that a tenant may argue a longer reasonable recovery period in order to secure more favourable lease terms while a landlord will push against this. Many of the principles are premised on a reprieve to the tenant during the unspecified ‘reasonable recovery period’ and may, therefore, be difficult to implement failing agreement by the landlord and tenant on the recovery period.

- Similarly, the downturn in the tenant’s business caused by the COVID-19 pandemic will likely be disputed and may require a report from a qualified accountant. Without agreement as to the impact of the pandemic on the tenant’s business, it is impossible to agree on the proportionate reductions to be passed onto the tenant.

- Principles 4 to 6 and 11 listed above are unclear and somewhat inconsistent as to when a tenant is to make payment (or repayment) to the landlord of monies owing pursuant to the lease.

Whether you are a landlord or a tenant, we can assist you in negotiating satisfactory terms that will comply with the new set of principles and prevent costly disputes arising in the future.

Negotiations between tenants and landlords will likely involve Banks and accountants to calculate the financial impact on the affected business due to the COVID-19 pandemic. Take note, Scott Morrison provided a strong message to all banks, including international banks operating in Australia, that the Federal Government expects the banks to provide support to landlords and tenants as they work to implement the Code.

Where landlords and tenants are unable to reach an agreement, the dispute is to be referred to the Small Business Commissioner for a binding mediation. Either party can enact this process, and as stated above, it must not be used to prolong or frustrate the

dispute resolution process. The utilisation of the Small Business Commissioner is consistent with the *Retail and Commercial Leases Act*.

It is apparent that the Code is only intended to apply to those tenants whose businesses have been directly impacted by COVID-19. It is not intended to be utilised for another purpose such as to negotiate more favourable lease terms and, further, any mediation must not be used to prolong or frustrate the dispute resolution process.

South Australian legislated commercial tenancy relief

The South Australian Government has already passed the *COVID-19 Emergency Response Act 2020* (SA) (‘Act’). Part 2 of the Act provides some modifications to legislation operating during the COVID-19 pandemic with respect to various matters including, the operation of commercial leases.

The Act provides that ‘prescribed actions’ cannot be taken by lessors against lessees who are suffering financial hardship as a result of the COVID-19 pandemic and who have breached the terms of their lease by:

- a. a failure to pay rent;
- b. a failure to pay outgoings;
- c. the business operating under the lease not being open for business during the hours specified in the lease; or

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d. any other act or omission of a kind prescribed by the regulations for the purposes of this subsection.²

The 'prescribed actions' are set out in Part 2 of the Act and include such things as taking action, seeking orders or issuing proceedings in respect of, for example, evictions, exercising rights of re-entry, termination of leases and damages. Please note, these are only some examples, and the full list is set out in Part 2 of the Act.

In addition, the Act provides protection to lessees required to take actions, or who may not be able to operate as a result of the laws of the State such that a lessee will not be in breach of their lease and any such acts or omissions will not be grounds to terminate. There is also a rent freeze in place for any lessees suffering financial distress as a result of the COVID-19 pandemic and a restriction to the recovery of land tax.³

In the event of disputes, the Act provides for mediation and appeal processes in respect of disputes arising in relation to the COVID-19 pandemic. Some ongoing disputes or actions may also be stayed or suspended until after

² COVID-19 Emergency Response Act 2020 (SA) s 7(3).

³ COVID-19 Emergency Response Act 2020 (SA) s 7(4) – 7(6).

the end of the pandemic period.⁴

What about residential tenancies?

It is anticipated that similar relief will be afforded to residential tenants whose income has been adversely impacted by COVID-19, however that is to be addressed by the State and Territory Governments. We will provide you with information regarding that regime once it is to hand.

Where to from here

The COVID-19 pandemic is an evolving situation, and we expect other issues will arise in relation to commercial tenancy arrangements. We will continue to keep you updated as information becomes available. If you would like some assistance in understanding your rights and obligations, and how the Code impacts them, please contact one of our property experts via the details provided below.

⁴ COVID-19 Emergency Response Act 2020 (SA) s 7(12).



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