

COVID-19: PRESSURE POINTS: MANDATORY CODE OF CONDUCT FOR COMMERCIAL TENANCIES (AUSTRALIA)

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Legal Briefings - By **Jane Hodder, Dinh Ptok and John Slater**

On 7 April 2020, the National Cabinet approved a Mandatory Code of Conduct for SME commercial leasing principles during the COVID-19 pandemic (the **Code**). The Code provides a binding framework for resolving the fraught question of how the financial burden of the COVID-19 pandemic should be shared between landlords and their small-to-medium sized business tenants. In summary, the Code achieves this by requiring landlords to negotiate with tenants amendments to existing lease arrangements during the COVID-19 pandemic, including reductions to rent, in accordance with a set of good faith leasing principles.

Below we outline some of the key features of the Code and what they mean for landlords and tenants. For information on the other legal issues facing landlords and tenants as they navigate the COVID-19 environment, please see [our guide to commercial leasing and COVID-19](#).

WHICH TENANTS ARE PROTECTED BY THE CODE?

The Code applies to 'SME tenants', defined as businesses who:

1. have an annual turnover of up to \$50 million; and

2. are eligible for the Commonwealth's JobKeeper program.¹

The \$50 million threshold will apply at the retail corporate group level for retail tenants and the franchisee level for franchises.² As the threshold is not assessed at the individual retail outlet level, this will exclude a significant number of well-known retailers and major national businesses from the Code's protection.

To be eligible for the Commonwealth's JobKeeper program, a business must have suffered a fall in turnover of more than 30 per cent for at least a month. Notably, businesses only need to demonstrate their *eligibility* for the program, meaning it is not necessary that a business already be receiving JobKeeper payments for the Code protections to apply.

One of the overarching principles of the Code is that landlords and tenants will act in an open, honest and transparent manner, and will each provide sufficient and accurate information (which is defined to include information generated from an accounting system and/or received from a financial institution) within the context of negotiations.³ Accordingly, landlords will be within their rights to request that tenants verify they are covered by the Code by providing access to their business financial records.

WHAT REDUCTION IN RENT ARE TENANTS ENTITLED TO?

The foundation of the Code's approach to rental relief is a principle of proportionality which seeks to balance the financial risk and cashflow impact of COVID-19 between landlords and tenants. In essence, tenants are entitled to a reduction in rent proportionate to the decline in the tenant's turnover during the Coronavirus pandemic period and a reasonable subsequent recovery period. Rent reductions may consist of a combination of waivers and deferrals in accordance with the following requirements:

- rental waivers must comprise no less than 50 per cent of the total rent reduction allowed to the tenant under the proportionality principle (unless waived by the tenant);⁴ and
- payment of rental deferrals must be amortised over the balance of the lease term and for a period of no less than 24 months, whichever is greater (unless otherwise agreed by the parties).⁵

The Code is expressly designed so that landlords and tenants can tailor their approach to rent relief to their own circumstances. However, the Leasing Principles impose a range of conditions on such arrangements aimed at striking an appropriate balance between the interests of both parties, which notably include:

- repayments should avoid placing any undue financial burden on tenants and should only commence until the earlier of the Coronavirus pandemic period ending, or the lease expiring, taking into account a reasonable subsequent recovery period;⁶
- tenants should be provided with an opportunity to extend their lease for an equivalent period of the rent waiver and/or deferral period to provide additional time to trade, on existing lease terms, during the recovery period after the COVID-19 pandemic ends;⁷
- rental waivers should constitute a greater proportion of the total reduction in rent payable in cases where failure to do so would compromise the tenant's capacity to fulfil their ongoing obligations under the lease agreement (while having regard to the landlords ability to provide such waivers);⁸ and
- no fees, interest or other charges may be applied to waived or deferred rent.⁹

One of the key issues for landlords approaching these negotiations will be how to account for the potential of fluctuations in the tenant's revenue during the COVID-19 pandemic. Given the uncertainty around how long restrictions on certain businesses and industries will remain in place, landlords may consider requesting a mechanism that allows agreed rent reductions to be adjusted as trading conditions change.

WORKED EXAMPLE OF PROPORTIONATE RENT REDUCTION

A tenant paying weekly rent of \$3,000 that suffers a 60 per cent decline in turnover will be entitled to a \$1,800 reduction in their weekly rent, consisting of:

- a rental waiver of no less than \$900 per week; and
- a deferral of the balance of the rent reduction, to be repaid over at least a 24 month period.

If the tenant only has three months remaining on their lease, they would still be entitled to pay off the deferred rent over a 24 month period, beginning on the earlier of the end of the pandemic period or the lease expiring.

PROTECTIONS FOR TENANTS

Tenants who are covered by the Code will be protected from the following during the COVID-19 pandemic period (which may include a reasonable subsequent recovery period):

- termination of their lease for non-payment of rent (lockouts and eviction);¹⁰
- rent increases (except for turnover leases);¹¹
- penalties for tenants who stop trading or reduce opening hours during the COVID-19 pandemic period;¹² and
- landlords making a claim on a bank guarantee, cash deposit, personal guarantee or other security for non-payment of rent.¹³

HOW DO LANDLORDS BENEFIT?

The most significant benefit for landlords under the Code is that tenants covered by the Code will not be able to terminate their lease. Notably, the Code makes clear that the protections afforded to tenants are not a get out of jail free card, reaffirming that tenants must remain committed to the terms of their lease. Material failures to abide by the substantive terms of their lease will see tenants forfeit any protections provided to the tenant under the Code.¹⁴

LANDLORDS MUST PASS ON SAVINGS

In keeping with the Prime Minister's statement that in commercial leasing "there will be a burden for everyone to share", the Code requires landlords to pass on to tenants the benefit of loan deferrals and relief from statutory charges such as rates and land tax.¹⁵

Specifically, Landlords are required to share with tenants:

- any benefit from the deferral of loan payments provided by a financial institution as part of the Australian Bankers Association's COVID-19 response in a proportionate manner;¹⁶ and
- any reduction in statutory charges or insurance in the appropriate proportion applicable under the terms of the lease.¹⁷

Remember, as noted above, one of the overarching principles of the Code is that parties must act in an honest and transparent manner and will each provide sufficient and accurate information within the context of negotiations.” Accordingly, landlords should consider whether it may necessary to provide tenants with details of any relief they receive in relation to tax or loan repayments.

WHAT IF THE PARTIES CAN’T AGREE?

Where the parties are unable to agree on what relief should be available during the COVID-19 pandemic, either party may refer the matter for binding mediation by the applicable state or territory dispute resolution process, which may include Small Business Commissioners/ Champions/ Ombudsmen.¹⁸

We expect further details on the mediation of disputes under the Code will become available as the state and territory governments move to implement the Code in the coming weeks.

WHEN DOES THE CODE TAKE EFFECT?

The Code will take effect on a date to be determined by each state and territory government following 3 April 2020, and will operate for the same period as the Commonwealth’s JobKeeper program.¹⁹

We expect further details such as the exact commencement date, and the status of pre-existing rental arrears, to come to light as more becomes known about the Code’s implementation by the state and territory governments.

LANDLORDS TO WAIVE OUTGOINGS AND REDUCE SERVICES WHERE APPROPRIATE

Where appropriate, landlords should waive recovery of other expenses, such as outgoings, during the period that tenants are unable to trade. In these circumstances, the Code notes that landlords reserve the right to reduce services as required.²⁰

As noted above, landlords who plan to shut down a building or stop providing certain services should check their lease to ensure they are not in breach of any covenants, and seek waivers from tenants where appropriate.

WHAT ABOUT TENANTS WHO AREN’T COVERED BY THE CODE?

Although the Code is only mandatory for businesses eligible for the JobKeeper program with a turnover of up to \$50 million as set out above, it does note that the principles of the Code should nevertheless apply in spirit to all leasing arrangements for affected business.²¹ This reflects the Prime Minister’s remarks when announcing the Code that it is designed for “smaller tenants [who will] have the protections they need to be able to sit down with their landlords” and that “larger retailers and the big landlords [will] sort it out” through their own arrangements.²²

ENDNOTES

1. SME Commercial Leasing Principles During COVID-19, page 1.
2. SME Commercial Leasing Principles During COVID-19, page 1.
3. SME Commercial Leasing Principles During COVID-19, Overarching Principles and Definitions.
4. SME Commercial Leasing Principles During COVID-19, Leasing Principle 4.
5. SME Commercial Leasing Principles During COVID-19, Leasing Principle 5.
6. SME Commercial Leasing Principles During COVID-19, Leasing Principle 9.
7. SME Commercial Leasing Principles During COVID-19, Leasing Principle 12.
8. SME Commercial Leasing Principles During COVID-19, Leasing Principle 4.
9. SME Commercial Leasing Principles During COVID-19, Leasing Principle 10.
10. SME Commercial Leasing Principles During COVID-19, Leasing Principle 1.
11. SME Commercial Leasing Principles During COVID-19, Leasing Principle 13.
12. SME Commercial Leasing Principles During COVID-19, Leasing Principle 14.
13. SME Commercial Leasing Principles During COVID-19, Leasing Principle 11.
14. SME Commercial Leasing Principles During COVID-19, Leasing Principle 2.
15. Prime Minister’s press conference, 27 March 2020.
16. SME Commercial Leasing Principles During COVID-19, Leasing Principle 7.
17. SME Commercial Leasing Principles During COVID-19, Leasing Principle 6.

18. SME Commercial Leasing Principles During COVID-19, Binding Mediation.
19. SME Commercial Leasing Principles During COVID-19, page 1.
20. SME Commercial Leasing Principles During COVID-19, Leasing Principle 8.
21. SME Commercial Leasing Principles During COVID-19, page 1.
22. Prime Minister's press conference, 3 April 2020.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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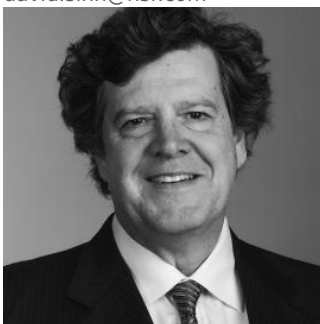
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