

National Cabinet's Code of Conduct in respect of Small-Medium Enterprise Commercial Leasing During the Covid-19 Pandemic Period



Mandatory Code of Conduct for Commercial Leases

On 7 April 2020, the Prime Minister released the National Cabinet's mandatory Code of Conduct for Commercial Leases (**the Code**), which forms part of the Federal Government's policy response to aid small to medium sized businesses adversely affected by the economic downturn caused by the Coronavirus pandemic (**Covid-19**). The Code outlines principles and specific mechanisms by which tenants and landlords may seek to enter agreements in respect of their tenancy arrangements to proportionally distribute the financial stress and hardship induced by Covid-19. In this article we will outline how parties may apply the principles outlined within the Code so as to protect their commercial interests, and alleviate the hardship caused by the current pandemic.

Commencement, Duration and Enforcement

The Code will be formally enforced through specific legislation and or regulation enacted at a State and Territory level ([further information on Covid-19 legislation in New South Wales can be found here](#)). In this regard, no detail has yet been released to outline the language, or timing of such legislative instruments. The Code will come into effect on a date to be specified by each Australian State and Territory and will apply for the duration that the Federal Government's JobKeeper program is operational (effectively while the Covid-19 pandemic occurs). At the date of the publication of this article, the JobKeeper program will be in force until 27 September 2020.

Eligible Parties and Leases

The Code applies to commercial leases in which the tenant is an eligible business under the Federal Government's Jobkeeper program and has an annual turnover of no more than \$50 million dollars (**Tenant**). It is noteworthy that for a business to be eligible under the Jobkeeper program it must have, among other things, experienced a minimum 30% reduction in revenue during Covid-19 as compared to the same period in 2019. Additionally, the \$50

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million annual turnover requirement will be applied to franchises at franchisee level, and to retail corporate groups at group level – as opposed to at a retail outlet level.

General Overarching Principles

The purpose of the Code is to enable Tenants and landlords to reach bespoke agreements on a case by case basis in respect of their tenancy arrangements. The arrangements sought are those that appropriately account for the interests of, and hardship experienced by, both tenant and landlord due to Covid-19. In this respect, the Code lists eleven “overarching principles” to guide parties in reaching these mutually beneficial arrangements. A brief summary of the most pertinent principles is set out below.

- Landlords and Tenants share a mutual interest in working together to endure the impacts of Covid-19. To that end, landlords and tenants must discuss relevant issues, negotiate in good faith, and provide accurate information to achieve mutually satisfactory temporary leasing agreements.
- Temporary leasing agreements will consider the impacts of Covid-19 on the Tenant with specific regard to revenue, expenses, and profitability. These agreements will be “proportional and appropriate” based on the impact of Covid-19 in addition to a “reasonable recovery period”.
- Parties will be of assistance to each other in respect of any individual party’s dealings with third parties including government, utility companies, and any financial institutions.
- Parties will have consideration to the fact that the landlord is always to bear the risk of default on commercial leases. To this end landlords must not seek to mitigate this risk in negotiating any temporary leasing arrangements.
- Leasing arrangements should be negotiated on a case by case basis considering the unique circumstances of the parties involved and the existing lease. Relevant considerations include among other things: lease expiration date, whether the Tenant is in administration or receivership, lease structure, period of tenure, and existing rent determination methods.

Specific Leasing Principles

In respect of the measures that landlords and Tenants may apply in their temporary leasing arrangements the Code provides that the following leasing principles should be applied “as soon as practicable on a case by case basis”. These principles have been explained below.

Termination of Lease

1. Landlords must not terminate a lease based on a Tenant’s failure to pay rent for the duration of the Covid-19 pandemic (including a reasonable recovery period).
2. Tenant’s must remain committed to the terms of their lease subject to any temporary rental agreements entered into under the Code.

Amendments to Rental Payments

3. Landlords must offer Tenant’s reductions in rent payable in the form both ‘waivers and deferrals. The reduction may be up to 100% of the rent ordinarily payable and is to be assessed on a case by case basis based on the Tenant’s reduced trade during the Covid-19 pandemic (including a reasonable recovery period).
 - a. A waiver means that the amount otherwise payable cannot be recouped by the landlord at any time, including after the pandemic. Therefore, a Tenant is not required to pay any waived amount.

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- b. A deferral means that the amount otherwise payable is to be paid at a later agreed upon date. A Tenant is obliged to pay a deferred amount before the date specified.
 - c. The Code defines deferral and waiver to also refer to any other agreed variation of the lease including such as pausing or hibernating the lease.
4. Principle 3 above means that landlords must reduce the Tenant's ordinarily payable rental amount, by offering a combination of 'waiver and deferral' – meaning that Tenant's won't have to pay a portion of an agreed reduction at all, but will have to pay a proportion of that reduction at a later date. In this respect the amount 'waived' (that does not need to be paid) is to be at least 50% of the rental reduction agreed, and can be more than 50% in circumstances where the Tenant would otherwise be financially unable to comply with the lease. If a waiver of more than 50% of the reduction is required regard must be given to the landlord's financial capacity to provide that additional waiver. Finally, a Tenant may voluntarily dispose of the 50% minimum waiver requirement by agreement.

Rental Deferral

5. In respect of the amount of rent ordinarily payable which is deferred, the amount deferred must be completely paid back over a 24-month period starting from the earlier of the lease expiry date or the end of the Covid-19 pandemic.
6. Any reduction in the landlord's statutory charges or insurance costs is to be passed on to the Tenant in a proportion applicable under the terms of the lease.
7. If landlords obtain benefit through deferral of their loan repayments provided by their financial institution, they should seek to share this benefit proportionately with their Tenant.
8. If a Tenant is unable to trade, then landlords should seek to waive recovery of any other expenses or outgoings payable by a tenant. If this is necessary, then landlords may reduce services provided to the Tenant as required.
9. In respect of deferred amounts to be repaid by Tenants, repayments must occur over an extended period of time so as not to burden the Tenant financially. Refer to principle 5.
10. Landlords must not charge fees, interest, punitive charges or other charges in respect of rent waived or deferred.
11. Landlords must not draw on a tenant's security for the non-payment of rent during the pandemic.
12. The Tenant should be provided with an option to extend its lease for a period equivalent to the period of the rent reduction period so as to allow the Tenant to trade on existing lease terms after the pandemic (during the recovery period).
13. Landlords agree to a freeze applicable rent increases for the duration of the pandemic.
14. Tenants will not be in breach of their lease if they cease to trade or reduce their opening hours during the pandemic.

Failure to Agree on Temporary Leasing Terms

If landlords and Tenants are unable to reach an agreement on temporary leasing arrangements, either party may refer the matter for a binding mediation. At the date of publication, it is not completely clear what, if any, mechanism will be available should parties fail to reach an agreement at mediation. It may be that legislation will allow escalation of the matter to tribunals and courts, or alternatively that the matter may be referred to arbitration with no ability to appeal the arbitrator's decision.

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Practical Conclusions

The intention of the Code and the likely effect of legislation that will be enacted to enforce the Code is that landlords and Tenants will enter into good faith negotiations to reach agreements in respect of their leases that allow both the landlord and Tenant alike to withstand the hardship caused by the effects of Covid-19.

In preparation for the enforcement of the Code, both landlords and Tenants ought to consider taking the following steps:

- Assess whether they are a business (or are a landlord to a business) that will be affected by the Code as outlined above;
- Gather relevant information on your historical and current financial data set, including information to assess and support a claim for rental relief due to the impact of Covid-19 on your profit and loss statements;
- If the above is applicable, make contact with your landlord or Tenant, establish a good relationship, create an open channel of communication, and draw attention to any expectation of the Code applying to your agreement;
- Reach out to a team of lawyers experienced in commercial lease agreements to ensure that any agreement you enter is enforceable according to the Code, and that the terms of your agreement are appropriate having regard to your commercial interests.

Please [contact our office](#) for further information on our [property law services](#) or for advice on how Covid-19 impacts your property transaction and leases.

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