

# IN FOCUS

OCTOBER 2020

## MANDATORY CODE OF CONDUCT - Retail and Commercial Tenancies

210.95

149.16

16

141%

# MANDATORY CODE OF CONDUCT

A recent decision of the NSW Supreme Court in **Sneakerboy v Georges Properties Pty Ltd (No.5) [2020] NSWSC 1141** has provided some clarity to the application of the regulations of the Mandatory Code of Conduct for retail and commercial tenancies.

The code was announced on 7 April 2020.

The objective of the code was to share in a proportionate measured manner, the financial risk and cash flow impact during the Covid-19 period whilst seeking to appropriately balance the interests of tenants and landlords.

It was intended that parties were to negotiate and agree to bespoke arrangements for each tenancy taking the tenants particular circumstances into account.

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Parties were expected to negotiate in good faith and provide each other with sufficient information in order to negotiate outcomes consistent with the code.

Each jurisdiction introduced draft regulations to implement the code, which are generally consistent.

In NSW, the **Retail and other Commercial Leases Covid-19 Regulation 2020 NSW** commenced on 24 April 2020.

## Coverage

The regulation applies to the enforcement or exercise of rights under a lease in relation to circumstances during the period from its introduction 24 April 2020 to 31 December 2020 (i.e. this has been extended from 24 October 2020)<sup>1</sup>.

## Application

The regulation applies to leases that existed before the commencement of the prescribed period i.e. 24 April 2020 and any subsequent renewal or extension of an existing lease.

- A 'retail shop lease' under the Retail Leases Act (1994) NSW which extends to licence agreements and other informal retail tenancy agreements covered by the Act; and
- A 'commercial lease' which relates to leasing of premises or land for a commercial purpose – it does not include agricultural leases.

## The regulations do not apply to new leases entered

**into after 24 April 2020 unless it is a renewal or extension of an existing lease.**

Parties to these leases are free to negotiate terms outside the scope of the code.

## Criteria

The Regulation applies to small to medium enterprise (SME) tenants who meet both of the following criteria:

- Qualify for the Commonwealth Jobkeeper program which generally requires:
  - the lessee operated a business since 1 March 2020;
  - the business has suffered (or likely to suffer) a decline in turnover by 30% or more;
  - the lessee is not in liquidation or under bankruptcy; and
  - the lessee is not an excluded entity (being major banks, government or local government entities or sovereign entities).
- Annual turnover in the 2018/2019 financial year was less than \$50 million:

*(NB the criteria for JobKeeper have been tightened from the September quarter).*

The National Cabinet did suggest that the principles underlying the code should apply "in spirit" to all leasing arrangements although the consequences of non compliance have never been made clear where the eligibility criteria are not met

## How is Turnover calculated

- for franchisees – the turnover of the business conducted at the premises or land concerned;
- for members of a corporate group – the turnover of the group (which includes a subsidiary tenant or related party tenant); and
- in any other case – the turnover of the business conducted by the lessee.

Turnover of a business includes any turnover derived from Internet sales;

<sup>1</sup>NB. In Western Australia, this period expires on 23 March 2021. In Tasmania - 1 December 2020.

## Impacted lessees can choose to contract out of the protections.

### Restrictions on Enforcement

Landlords are prohibited from taking prescribed action against an impacted lessee during the prescribed period under the terms of the lease, or seeking orders from a court or tribunal for breaches because of:

- A failure to pay rent;
- A failure to pay outgoings;
- A failure to open for business during the hours specified in the lease; or
- Breaches of the lease in order to comply with Commonwealth or NSW State Government COVID-19 legislation (public health orders etc).

Prescribed action generally includes:

- Termination of the lease, evicting the tenant, and exercising a right of re-entry to the premises;
- Call on a bank guarantee or rental bond or pursuing a guarantor;
- Charging interest or fees on unpaid rent;
- Recovering damages; and
- Any other remedies available.

## Tenants must comply with all their other (non COVID-19 related) obligations under the lease.

### Leasing principles

Either party can request to renegotiate the rent payable and any other terms of the lease.

During the COVID-19 period, a landlord cannot take any prescribed action unless they have complied with a request and participated in good faith negotiations.

The following principles apply when negotiating temporary lease arrangements:

1. landlords won't have the right to terminate leases for non-payment of rent during the COVID-19 pandemic period (or a reasonable subsequent recovery period);
2. tenants will need to continue to comply with the terms of their lease, subject to any negotiated amendments with their landlord;
3. rent reductions should be proportionate, payable in the form of waivers and deferrals of up to 100% of the amount of rent that would normally be paid. The amount of reduction should be assessed on a case-by-case basis, based on the reduction in the tenant's trade;
4. at least 50% of the total rent reduction should be in the form of a rent waiver (unless the tenant waives such a requirement);
5. tenants must be allowed to amortise the deferred rent over the greater of either the balance of the lease term or over no less than 24 months, unless the tenant and landlord agree otherwise;
6. if the landlord receives any reduction in statutory charges, such as land tax or council rates, or insurance, this reduction is to be passed on to the tenant in the appropriate proportion applicable under the lease;
7. any benefits received by landlords due to deferral of loan payments should be shared with the tenant in a proportionate manner;
8. landlords should seek to waive the recovery of any other expense (or outgoing payable) by a tenant, under lease terms, during the period the tenant is not able to trade;
9. all repayments should occur over an extended period and no repayment should commence until the earlier of the COVID-19 pandemic ending (as defined by the Australian Government) or the existing lease expiring, taking into account a reasonable subsequent recovery period;
10. no fees, interest or other charges should be applied to rent waived and no fees, charges or interest may be charged on rent deferrals;
11. landlords won't have the right to draw on a tenant's security (such as bond, bank guarantee or personal guarantee) for the non-payment of rent during the period of the COVID-19 pandemic and/or a reasonable subsequent recovery period;
12. the tenant should be provided with an opportunity to extend the lease for an equivalent period of the rent waiver and/or rent deferral

period. This is intended to provide the tenant additional time to trade, on existing lease terms, during the recovery period after the COVID-19 pandemic concludes;

13. landlords agree to freeze rent increases during the COVID-19 pandemic period and a reasonable subsequent recovery period, except for retail leases based on turnover rent; and

14. landlords won't have the right to apply any prohibition or levy any penalties if tenants reduce opening hours or cease to trade due to the COVID-19 pandemic.

## Mediation

Where attempts to renegotiate in good faith with an impacted lessee have failed, the Regulation provides for mandatory mediation before action can be taken in a tribunal/court.

This will be by way of reference to applicable state or territory retail or commercial leasing dispute resolution processes for binding mediation.

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In NSW, both retail and commercial leases must refer to the NSW Small Business Commissioner (with some exceptions) and the Commissioner needs to certify the mediation failed before proceedings can be initiated in a court or tribunal.

The Regulation requires a court or tribunal to have regard to the Leasing Principles of the Code when considering a decision or order enforcement action.

**The Regulation does not prevent enforcement action on grounds not related to the economic impacts of the COVID-19 Pandemic.**

**The existing rules of equity and common law continue. For example, tenant's seeking relief against forfeiture (which gives the tribunal/court broad discretion to prevent a landlord from terminating a lease on grounds of equity and fairness) is unaffected.**

## Sneakerboy

The Sneakerboy case provides some useful guidance as to the application of the Covid-19 leasing regime.

## Facts

Sneakerboy operated a sneaker business out of five premises in three states as well as an online presence.

The company experienced a sudden decline in revenue in February 2020 which it attributed to the Covid-19 pandemic and ceased paying rent i.e. they had a history of paying late.

On 20 March 2020, the Government placed mandatory restrictions upon non-essential indoor gatherings which included the lessee's store and on or about 23 March 2020 the lessee ceased trading from the premises and redirected stock to focus an online sales.

On 25 March 2020 the lessor re-entered possession of the relevant Sydney CBD premises on the basis the rent was late and the lessee had abandoned the premises.

NB – this took place before the introduction of the Mandatory Code of Conduct.

## Issue

The landlord called upon the bank guarantee in the amount of \$253,668.90 which was paid by the bank on 15 June 2020.

This had the effect of paying the outstanding rent.

In **Sneakerboy v Georges Properties Pty Ltd [020] NSWSC 996 "(Sneakerboy No.1)"** the tenant sought relief against forfeiture.

i.e. this is an order that it be permitted to re-enter the premises and continue to occupy the premises under the lease.

## Decision

Ultimately the relief was granted as the landlord had secured repayment of the unpaid rent by calling in the bank guarantee.

The restoration of the lease had the effect of bringing it under the umbrella of the leasing regulation.

**Sneakerboy Retail Pty Ltd trading as Sneakerboy v Georges Properties Pty Ltd (No.2) [2020] NSWSC 1141 (Sneakerboy No.2)** clarified a number of issues with respect to the Leasing Regulation.

## Application of Covid-19 Regime

The court held that the Covid-19 Leasing Regime had retrospective effect from 1 April 2020 (i.e. in line with the period the Jobkeeper program is operational,

notwithstanding the regulation was not passed until 24 April 2020).

## Tenants Trade

Leasing principle 3 of the Code of Conduct provides:

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*“rent reductions should be proportionate..... the amount of reduction should be assessed on a case by case basis based on the reduction in the tenants trade”.*

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The court held:

- That consideration should be given to a particular tenants turnover from all locations where the tenant conducts retail business including online sales.
- If tenants costs are down e.g. due to the effect of government subsidies, then that should be reflected in the calculation of an appropriate reduction.
- Businesses with regular trade should compare revenue with an equivalent period in the previous year. Whereas seasonal businesses would need to compare Covid-19 effected turnover with a longer pre-Covid-19 period.

## Recovery Period

The Code of Conduct provides its protections to a subsequent 'reasonable recovery' period after the Covid-19 pandemic period.

In Sneakerboy the court accepted a reasonable recovery period would be six months from the end of the leasing regime providing Sneakerboy at least until 30 April 2021 before the landlord could raise the rent and recover possession.

However the court foreshadowed that in relevant circumstances the court might be open to longer periods of recovery. As the code is intended to apply on a case by case basis, it is a possibility that the recovery period could be less in relevant circumstances being where normal trading conditions are restored quicker.

## Implications

- Eligible tenants need to negotiate rent relief during the period the regulation is in place. This is to take advantage of the codes protection including the entitlement to a reasonable recovery period. This is currently due to expire on 31 December 2020. If negotiations are not concluded before that time, the protections will not be available. (subject of course to further extensions).

- The courts appear to be reasonably lenient to 'Covid-19' effected tenants. Accordingly, landlords should exercise some caution with respect to lease termination.

- Landlords will have to factor the availability of subsequent reasonable recovery period into their negotiations. The effect of the protections offered by the code in respect of reduced rent and prohibition of terminations, could last at least six months and potentially beyond that after the codes expiry, before the standard lease terms resume.

The anecdotal evidence suggests the code enabling regulations have had some difficulties in their practical application:

- There have been some reports of both tenants and landlords not engaging with the process, this is particularly the case with respect to overseas based landlords.
- Landlords have requested an unreasonable level of financial information in the rent review process.
- Both landlords and tenants have behaved opportunistically with respect to the process. There have been instances of landlords seeking new leases at the existing rental as a condition of providing Covid-19 relief.
- There have been indications that landlords are attempting to avoid rent deferrals by offering larger 'discounts or waivers' to tenants than would otherwise be required by the Code;
- Tenants not eligible for protection under the code have been taking advantage of uncertainty in the commercial rental market negotiating new leases at a lower rental than their existing leases.
- The respective state leasing dispute resolution processes were under resourced for the level of mediation services required, when the regulations were introduced. In NSW an additional \$10 million was allocated to the NSW Small Business Commission in September.

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