COVID-19: (AUSTRALIA) VICTORIAN REGULATIONS FOR COMMERCIAL LEASES AND LICENCES

Date: 5 May 2020

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**This information is accurate as of 5:00 P.M. on Monday, 4 May 2020 and is subject to change as this situation evolves.*

Following the release of the National Cabinet's *Mandatory Code of Conduct: SME Commercial Leasing Principles During COVID-19* (the Code) on 7 April 2020, the Victorian Government has now enacted regulations which give effect to the Code in Victoria.

The Code embodied a set of good faith leasing principles to apply to certain commercial tenancies experiencing financial stress or hardship because of the COVID-19 pandemic. You can read more about the Code and the emergency powers provisions in other states in our previous alert which can be found here.

On 1 May 2020, the *COVID-19 Omnibus (Emergency Measures) (Commercial Leases and Licences) Regulations 2020* (Vic) (the Regulations) were made under the *COVID-19 Omnibus (Emergency Measures) Act 2020* (Vic) (the Act). The Regulations give effect to the Code and introduce conditions during the COVID-19 pandemic period which:

- prohibit and regulate the exercise of certain landlord rights to enforce terms under commercial leases and licences, and
- require landlords and tenants to renegotiate rent and other terms of their commercial leases and licences in good faith, having regard to the Code and prior to the enforcement of any legal action under their commercial leases and licences.

In this article, we will discuss:

- When do the Regulations apply?
- Who is covered under the Regulations?
- What are the key provisions of the Regulations?
- Have the Regulations clarified the uncertainties from the Code?

WHEN DO THE REGULATIONS APPLY?

The Regulations apply retrospectively and are taken to have come into effect on and from 29 March 2020. The Regulations apply to rent and other amounts payable during the six month period starting on 29 March 2020 and ending on 29 September 2020 (the Relevant Period).

WHO IS COVERED UNDER THE REGULATIONS?

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Eligible commercial leases and licences

For the Act and the Regulations to apply, the lease or licence must meet the following criteria:

- the lease must be a retail lease under the *Retail Leases Act 2003* (Vic) or a commercial lease or licence under which the premises are occupied for the sole or predominant purpose of carrying on a business, and
- the tenant or licensee must, on or after 29 March 2020 be a "SME entity" who:
  - is an employer who qualifies for and is a participant in the JobKeeper scheme, and
  - who carries on a business (or is a non-profit body) during the current financial year, and
  - for which one or both of the following applies:
    - the entity's annual turnover for the current financial year is likely to be less than AUD50 million, or
    - the entity's annual turnover for the previous financial year was less than AUD50 million.

In this article, such leases or licences are referred to as "Eligible Leases" and tenants or licensees under Eligible Leases are referred to as "Eligible Tenants".

The Regulations also apply to sub-leases, sub-licences and agreements for lease or licence which meet the criteria outlined above.

Eligible Leases are covered even if they are not in writing or are only partly in writing, or are express or implied.

Importantly, if a lease or licence was not in place on 29 March 2020, it will not be covered by the Regulations. This means that new leasing arrangements negotiated or entered into after 29 March 2020 cannot be Eligible Leases.

Agricultural leases or licences excluded

The Regulations do not apply to agricultural leases, including commercial leases or licences under which the premises may be used wholly or predominantly for:

- agricultural, pastoral, horticultural or apicultural activities
- poultry farming, dairy farming, aquaculture, tree-farming or any business that consists of the cultivation of soils, the gathering of crops or rearing of livestock, or
- grazing, including agistment.

Excluded corporate groups or relationships

The Regulations do not apply where the tenant or licensee is a member of a corporate group for income taxation purposes (ie. the tenant controls or is controlled by another entity, or both entities are controlled by the same third entity) and the aggregate turnover of the group is more than AUD50 million.

The Regulations also do not apply if the tenant or licensee is an affiliate of another entity for income taxation purposes (ie. that entity acts in accordance with the tenant's directions or wishes in relation to the affairs of the entity's business) and the aggregate turnover of the tenant or licensee and the other entity exceeds AUD50 million.

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WHAT ARE THE KEY PROVISIONS OF THE REGULATIONS RELATING TO ELIGIBLE LEASES?

General obligation to cooperate and act in good faith

Landlords and tenants under Eligible Leases are under a general obligation to cooperate and act reasonably and in good faith in all discussions and actions associated with matters to which the Regulations apply.

This obligation is taken to be included in every Eligible Lease by the Regulations.

Prescribed actions not breaches of Eligible Leases

Subject to the Eligible Tenant complying with certain notification pre-conditions (outlined below under "Request for rent relief"), the following actions by Eligible Tenants are deemed not to be breaches of an Eligible Lease during the Relevant Period:

- not paying the amount of rent required to be paid under the Eligible Lease
- reducing the opening hours of the business carried out at the premises, or
- closing the business and ceasing to carry out any business at the premises.

Prohibition on eviction and other action by landlords

Subject to the Eligible Tenant complying with certain notification pre-conditions (outlined below under "Request for rent relief"), during the Relevant Period landlords cannot:

- evict or attempt to evict Eligible Tenants, or otherwise re-enter or attempt to re-enter or recover premises under an Eligible Lease, for:
  - non-payment of rent, or
  - reducing the Eligible Tenant's opening hours or ceasing to trade
- have, or attempt to have, recourse to any security relating to the non-payment of rent (including any bond, security deposit, indemnity or guarantee) due to the Eligible Tenant:
  - failing to pay rent, or
  - reducing the Eligible Tenant's opening hours or ceasing to trade
- increase the rent payable under the Eligible Lease at any time during the Relevant Period, unless the landlord and Eligible Tenant agree in writing. Note, however, that this does not apply to a retail lease to the extent that the lease provides for the rent to be determined by reference to the volume of trade of the tenant's business, or
- require an Eligible Tenant to pay interest or any other fee or charge in relation to any deferred rent under agreed rent relief arrangements.

Request for rent relief

Eligible Tenant must submit request in writing

The protection afforded to Eligible Tenants by the Regulations is dependent upon the Eligible Tenant making a request of the Landlord for rent relief. The request must be in writing and must include:

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- a statement by the Eligible Tenant that the lease is an Eligible Lease and the lease is not excluded from the operation of the Regulations under section 13(3) of the Act (in relation to excluded corporate groups), and
- information that shows that the Eligible Tenant is an eligible SME entity and qualifies for, and is a participant in, the JobKeeper scheme.

The requirement that the Tenant make such request is a limited "win" for landlords. It also has implications for the many tenants who have been unilaterally withholding rent from landlords (without agreement on rent relief being reached). Eligible Tenants who have withheld rent should act promptly to ensure that a formal request for rent relief is made of the relevant landlord, in compliance with the Regulations.

Landlord's response to request

Landlords must respond to requests for rent relief within 14 days after receiving the Eligible Tenant's request (or a different timeframe if agreed by the parties in writing).

A landlord's response must include an "offer" for rent relief which must "be based on all the circumstances of the Eligible Lease" and:

- relate to up to 100% of the rent payable under the Eligible Lease during the Relevant Period (six month period starting on 20 March 2020), and
- provide for at least 50% of the rent relief offered to be by way of waiver of rent (unless the parties agree otherwise in writing), and
- apply to the Relevant Period, and
- take into account:
  - the reduction in the Eligible Tenant's turnover associated with the premises during the Relevant Period, and
  - any waiver of outgoings given by the landlord under regulation 14(2), and
  - whether a failure to offer sufficient rent relief would compromise the Eligible Tenant's capacity to fulfil the Eligible Tenant's ongoing obligations under the Eligible Lease, including the payment of rent, and
  - the landlord's financial ability to offer rent relief, including any relief provided to the landlord by any of its lenders as a response to the COVID-19 pandemic, and
  - any reduction to any outgoings charged, imposed or levied in relation to the premises.

Rent relief means any form of relief provided to an Eligible Tenant in respect of the obligation under an Eligible Lease to pay rent, including a waiver, reduction, remission or deferral of rent.

In what some may consider to be a departure from the Code, it appears that the amount of rent relief offered by the landlord does not need to be directly in proportion to the reduction in the Eligible Tenant's turnover.

It is perplexing that the landlord's offer of rent relief is required take account of all of these matters in circumstances where they are not required to be addressed by the Eligible Tenant's request for rent relief. Without

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additional information, it will present practical challenges to landlords being able to formulate their offers with specificity. In these circumstances, Eligible Tenants should consider providing additional information (or submissions) addressing all relevant considerations at the time the request for rent relief is made. Otherwise, offers from landlords will likely be limited to in principle proposals.

Negotiation in good faith

Following receipt of the landlord's offer by the Eligible Tenant, the parties must negotiate in good faith to agree on the rent relief to apply during the Relevant Period.

Although a rent relief agreement could be documented simply (for example, by way of exchange of correspondence), we recommend that rent relief arrangements be documented by formal deed. The deed should address all relevant matters, including any adjustments to be made based upon the actual turnover (or profit) of the Eligible Tenant during the Relevant Period, rights to inspect or audit accounts and warranties as to the accuracy of information provided by the parties.

Deferred rent

If the agreed rent relief arrangements include deferral of rent, the landlord must not request payment of the deferred rent until the earlier of 29 September 2020 or the expiry of the term of the lease.

The deferred rent must be amortised over at least two years of the term of the Eligible Lease, or if the balance of the term of the Eligible Lease is longer than two years, over that balance period.

Extension of term

If the agreed rent relief arrangements include deferral of rent, the landlord must offer the Eligible Tenant an extension of the term of the Eligible Lease for a period equivalent to the period for which rent is deferred. In certain circumstances it is possible that FIRB issues may need to be taken into consideration for some 'foreign' tenants.

Reduction in outgoings

If any outgoings charged in relation to the premises are reduced, a landlord must not require an Eligible Tenant to pay any amount in respect of that outgoing that is greater than the Eligible Tenant's proportional share of the reduced outgoing.

If the Eligible Tenant has already paid more than their proportional share of the reduced outgoing, the landlord must reimburse the amount overpaid to the Eligible Tenant as soon as possible.

Recovery of outgoings

Landlords must consider waiving recovery of any outgoing or other expense payable by the Eligible Tenant under the Eligible Lease for any part of the Relevant Period that the Eligible Tenant is not able to operate their business at the premises.

If the Eligible Tenant is not able to operate their business at the premises for any part of the Relevant Period, the landlord may cease to provide, or reduce provision of, any service at the premises that is reasonable in the circumstances and in accordance with any reasonable request of the Eligible Tenant.

Further request for rent relief

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Significantly, if the Eligible Tenant's financial circumstances "materially change" after rent relief arrangements have been agreed, the Eligible Tenant can make a further request to the landlord for rent relief. This opens the doors for Eligible Tenants who may have already agreed some rent relief to approach their landlords for a further reduction.

If a further request for rent relief is made, the above process must be repeated by the parties again in respect of the further rent relief request, except that the landlord does not need to provide at least 50% of the further relief by way of a waiver of rent. There is no prescribed limit to the number of times that new requests can be made by tenants.

There is also no mechanism by which a landlord may seek to renegotiate a prior rent relief agreement, even if the position of the tenant has improved (or the financial position of the landlord has worsened), unless such an arrangement is agreed between the parties as part of the original rent relief agreement.

Civil penalties

The Regulations impose civil penalties of up to 20 penalty units (currently approximately AUD3,300) on landlords who terminate an Eligible Lease, recover possession of premises or have recourse to securities based on non-payment of rent or reductions in trading hours during the Relevant Period. The penalties apply retrospectively and also to "attempts" by landlords to take these actions.

What happens if the parties can't agree?

Mediation by Victorian Small Business Commission (VSBC)

Landlords or tenants under Eligible Leases may refer a dispute about the terms of the Eligible Lease arising in relation to a matter to which the Regulations apply to the VSBC for mediation. The mediation provisions in relation to retail tenancy disputes under the *Retail Leases Act 2003* (Vic) will apply to all Eligible Leases (to the extent applicable).

Landlords and tenants may be represented by lawyers at mediations by the VSBC, but mediators may also request a meeting without lawyers present.

The VSBC has indicated that mediation services will be free for disputes under Eligible Leases.

Despite the introduction of the Regulations, concerns regarding the sheer volume of matters that may be referred for mediation remains a concern. The Regulations do not impose a timeframe within which a dispute must be resolved. It is entirely possible that rent relief arrangements to apply during the crisis period will still be unresolved well after the end of the pandemic.

Determination by VCAT or court

The usual dispute resolution procedures under Division 4 of Part 10 of the *Retail Leases Act 2003* (Vic) will apply to all Eligible Leases. This requires the VSBC to certify that mediation has failed, or is unlikely to resolve the dispute, before the dispute may proceed to determination by VCAT or a Court.

HAVE THE REGULATIONS CLARIFIED THE UNCERTAINTIES OF THE CODE?

As mentioned in our previous alert, which can be found here, the Code contained several uncertainties regarding its application and implementation. We have revisited some of these uncertainties below in light of the introduction of the Regulations:

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What if a tenant is not an Eligible Tenant?

The restrictions and obligations under the Regulations only apply to Eligible Leases.

Landlords and tenants who are not subject to the Code may still use its principles as a framework for negotiating rent relief arrangements, but this is not mandatory in Victoria. The dispute resolution measures provided under the Regulations, including mediation with the VSBC, are only available for Eligible Leases.

Do the Regulations apply to new leases entered into during the COVID-19 pandemic?

As outlined above, the Regulations apply to commercial leases or licences (or agreements for lease or licence) which were in effect on 29 March 2020. Leasing arrangements entered into after this time are not covered by the Regulations.

What evidence does a tenant have to provide to support financial stress or hardship and how do they demonstrate it is a direct result of the COVID-19 pandemic?

The Regulations do not provide any further guidance on what level of information is required to demonstrate the economic impact of the COVID-19 pandemic on the Eligible Tenant. As noted above, an Eligible Tenant's request for rent relief need only address eligibility criteria however the landlord is required to take into account a broad range of relevant matters.

Under the Code, landlords and tenants are expected to provide "sufficient and accurate information" within negotiations, which is defined to include information generated from an accounting system and information provided to or received from a financial institution.

How is turnover determined?

The Regulations clarify that "turnover" is calculated by reference to the most recent financial year (except where it's being estimated for the current financial year) and is the total of the following that is earned in that financial year in the course of the business:

- the proceeds of sales of goods and/or services
- commission income
- repair and service income
- rent, leasing and hiring income
- government bounties and subsidies
- interest, royalties and dividends
- other operating income.

This would include any income derived from internet sales of goods and services.

How do turnover tests apply to tenants that are part of corporate group or a franchise structure?

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If the Eligible Tenant is a member of a corporate group, the relevant turnover is the aggregate turnover of the group. If the Eligible Tenant is an affiliate of another entity, the relevant turnover is the aggregate turnover of the Eligible Tenant and the other entity.

In any other case, the relevant turnover is the turnover of the business conducted by the Eligible Tenant.

Are tenants entitled to a reduction in rent due to COVID-19? For how long?

The Regulations clarify that rent relief is available for Eligible Tenants during the Relevant Period, being the six month period starting on 29 March 2020.

What happens to rent reviews during the crisis period?

Under Eligible Leases, the Regulations provide that the rent cannot increase at any time during the Relevant Period, unless the landlord and Eligible Tenant agree in writing. This does not apply to rent increases on account of turnover rent.

Presumably, once the Relevant Period elapses, rental increases could apply on a going forward basis. However, this remains somewhat unclear.

What about outgoings?

If any outgoings charged in relation to the premises are reduced, landlords must not require Eligible Tenants to pay more than the Eligible Tenant's proportional share of the reduced outgoing.

If an Eligible Tenant has already paid more than their proportional share of the reduced outgoing, the landlord must reimburse the amount overpaid.

Landlords must also consider waiving recovery of any outgoing or other expense payable by the Eligible Tenant under the Eligible Lease for any part of the Relevant Period that the Eligible Tenant is not able to operate their business at the premises.

It is not entirely clear what is meant by an Eligible Tenant being "not able to operate" and whether this would apply to an Eligible Tenant that is not subject to a direction that prevents its business from trading, but that elects to close for safety reasons or because it is not economically viable to continue to trade.

What about landlords who are facing financial hardship due to COVID-19?

Regulation 10(4)(d)(iv) requires the landlord's offer of rent relief to take into account a landlord's financial ability to offer rent relief, including any relief provided to a landlord by any of its lenders as a response to the COVID-19 pandemic.

If a landlord is facing financial hardship, this may be taken into account in the landlord's offer of rent relief to an Eligible Tenant.

What about shopping centres? Do landlords need to offer the same deal for all tenants within the same shopping centre or building?

No, the Regulations only provide that the parties must "negotiate in good faith with a view to agreeing the rent relief to apply" during the Relevant Period. The rent relief offered by the landlord must "be based on all the circumstances of the Eligible Lease".

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The economic impacts of the COVID-19 pandemic will be different for all shopping centre tenants. The Code requires landlords to agree to "tailored, bespoke and appropriate temporary arrangements" for each tenant on a case-by-case basis.

If only a few tenants are left trading in a shopping centre or building, can the landlord close the building or shopping centre to reduce costs without incurring compensation claims from the remaining tenants?

The Regulations have not clarified this issue. Unless the Victorian Chief Health Officer issues a direction requiring closure, then the likely answer is that the landlord could potentially be exposed to claims in the event of closure.

Is there a right for tenants to terminate the lease agreement due to COVID-19?

In the absence of a right of termination under a lease, no.

However, the Regulations do not prevent the parties from agreeing to take any action in relation to the Eligible Lease, including the parties agreeing to terminate the Eligible Lease.

Can a landlord call on security during COVID-19?

The Regulations prohibit landlords under Eligible Leases from calling on any security provided by an Eligible Tenant or any other person securing the performance of the Eligible Tenant's obligations under the Eligible Lease during the Relevant Period due to the Eligible Tenant's failure to, during the Relevant Period:

- pay rent, or
- operate and open for business during the hours specified in the Eligible Lease.

This includes bonds, security deposits, indemnities or guarantees.

However, the Regulations do not prevent the landlord from calling upon security where a rent relief agreement has been reached and the Eligible Tenant does not comply with that agreement. Further, the Regulations do not prohibit the landlord from calling on any security for other reasons, where permitted under the Eligible Lease.

The regulations do not include clear provisions to direct guarantors to be bound by (if not to also participate in negotiating) the outcomes as between the tenant and the landlord.

Can a landlord terminate a lease during COVID-19?

If the tenant is an Eligible Tenant, the landlord cannot terminate the lease if the grounds of termination are the Eligible Tenant's failure to, during the Relevant Period:

- pay rent, or
- operate and open for business during the hours specified in the Eligible Lease.

The Regulations would not prevent termination on grounds of arrears of rent relating to the period prior to the Relevant Period. Equally, there is no prohibition on terminating a lease based upon another breach (other than a failure to pay rent or a failure to trade in the Relevant Period). Any termination by a landlord would be subject to the right of the tenant to apply for relief against forfeiture, being a remedy which is readily granted where the tenant is able to demonstrate that the relevant breach will be rectified.

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