

COVID-19: (AUSTRALIA) UPDATE TO SOUTH AUSTRALIAN ACT AND REGULATIONS FOR COMMERCIAL LEASES

Date: 26 May 2020

Australia Real Estate Alert

By: Samuel Brown, Will Grinter, Karen Yuan, Elyse O'Hara

**This information is accurate as of 1:00 P.M. on Friday 21 May 2020 and is subject to change as this situation evolves.*

On 7 April 2020, the National Cabinet issued a Mandatory Code of Conduct (the Code), which imposes a set of good faith leasing principles that apply to certain commercial tenancies experiencing financial stress or hardship because of the COVID-19 pandemic.

On 11 May 2020 we released an [alert](#) detailing the following South Australian legislation which was introduced on 9 April 2020 and 16 April 2020 respectively, after the introduction of the Code:

- COVID-19 Emergency Response Act 2020 (the Act)
- COVID-19 Emergency Response (Commercial Leases) Regulations 2020 (the Previous Regulations).

On Friday, 15 May 2020, the South Australian Government introduced the following further legislation relating to commercial leases:

- COVID-19 Emergency Response (Further Measures) Amendment Act 2020 (the Amendment Act)
- COVID-19 Emergency Response (Commercial Leases No 2) Regulations 2020 (the Regulations).

The Amendment Act replaces the provision contained in the Act which dealt with commercial leases, as detailed in our previous alert, with a more general provision that allows the Governor to make regulations for the purpose of mitigating the adverse impacts on commercial leases resulting from the COVID-19 pandemic.

The Regulations revokes the Previous Regulations and the objectives of the Regulations are, having regard to the Code to:

- implement temporary measures to apply to parties to certain commercial leases related to the circumstances brought about by the COVID-19 pandemic
- provide for mechanisms to resolve disputes concerning those leases.

Under the Regulations, during the prescribed period, the provisions of applicable commercial leases are modified to:

- prohibit and regulate the exercise of certain landlord rights to enforce terms under commercial leases
- require landlords and tenants to negotiate rent and other terms of their commercial leases in good faith.

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 for the period commencing on 30 March 2020 and ending on 30 September 2020 (Prescribed Period).

WHO IS COVERED UNDER THE REGULATIONS?

Included commercial leases

The Regulations apply to "commercial leases" that are entered into before 30 March 2020, being:

- retail shop leases within the meaning of the Retail and Commercial Leases Act 1995
- leases under the Landlord and Tenant Act 1936, including a retail shop lease to which Part 4 of that Act applies, or
- other agreements under which a person grants or agrees to grant another person for value a right to occupy premises for carrying on a business (whether or not the right is of exclusive occupation and whether or not the agreement is expressed or implied, oral or in writing).

The Regulations will also apply to commercial leases entered into after 30 March 2020 if it is entered into by means of an option to extend or renew, or any other extension or renewal of an existing lease on the same or substantially similar terms as the existing lease.

The majority of the provisions of the Regulations only apply to commercial leases where the tenant is an "affected lessee". A tenant is an affected lessee if:

- the tenant is suffering financial hardship as a result of the COVID-19 pandemic (as identified in detail below)
- the following turnover for the 2018/2019 financial year (or a 12 month period or such lesser period as determined by the Court or the Minister) is less than AUD50 million:
 - if the tenant is a franchisee: the turnover of the business conducted at the premises the subject of the commercial lease
 - if the tenant is a corporation that is a member of a group (i.e. if the tenant is a related body corporate of another corporation within the meaning of the Corporations Act 2001): the turnover of the group
 - in any other case: the turnover of the business conducted by the tenant at the premises the subject of the commercial lease.

In each of the above cases, turnover includes any turnover derived from the internet sales of goods or services.

A tenant is taken to be suffering financial hardship as a result of the COVID-19 pandemic if the tenant is eligible for, or receiving, a JobKeeper payment in respect of the business of the tenant (whether in their capacity as an employer or on their own behalf). You can read more about eligibility for the JobKeeper payment in the K&L Gates tax team's Employer Guide to the JobKeeper Scheme which can be found [here](#).

Excluded leases

The Act does not apply to:

- a lease under the *Pastoral Land Management and Conservation Act 1989*, or
- a lease under the *Crown Land Management Act 2009*.

WHAT ARE THE KEY PROVISIONS OF THE REGULATIONS?

Prescribed Actions

If a tenant is an affected lessee, a landlord cannot take any prescribed action against the tenant for a breach of the lease during the Prescribed Period due to:

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

A "prescribed action" includes taking action under the provisions of a commercial lease or seeking orders or issuing proceedings in a court for:

- eviction of the tenant from the premises
- the exercise of a right of re-entry to the premises
- recovery of land
- distraint of goods, being the seizure of property in order to obtain payment of rent or other money
- forfeiture
- damages
- requiring a payment of interest on unpaid rent otherwise payable by the tenant
- recovery of a security bond (whole or part)
- performance of obligations by the tenant or any other person pursuant to a guarantee
- possession
- termination, or

- any other remedy otherwise available to the landlord against the tenant at common law or under the law of South Australia.

The restriction on prescribed actions does not apply to or in respect of a failure to pay rent where:

- the amount payable during the Prescribed Period has been agreed by the parties under a mediation or as determined by the Court
- the failure to pay rent constitutes a breach of the agreement or a Court order.

Additional Restrictions

In addition to the prohibition on prescribed actions, if a tenant is an affected lessee, a landlord:

- must not, unless otherwise agreed between the landlord and tenant, increase the rent payable under a commercial lease (other than rent or a component of rent determined by reference to turnover)
- must not, during the Prescribed Period, require a tenant to pay land tax or reimburse the landlord for the payment of land tax in respect of a commercial lease
- must pass the benefit of any waiver of land tax or a relief payment under a scheme administered by the Treasurer for the purposes of providing land tax relief to persons suffering financial hardship to the tenant in the form of a waiver of rent payable under the commercial lease in accordance with the provisions of that scheme.

Renegotiation

The parties to a commercial lease and any guarantor or other person with an interest in the lease must make a genuine attempt to negotiate in good faith the rent payable and other terms of the commercial lease during the Prescribed Period, having regard to:

- the economic impacts of the COVID-19 pandemic on the parties to the lease
- the provisions of the Act and the Regulations
- the provisions of the Code.

The provision requiring the parties to negotiate in good faith the rent payable and other terms of the commercial lease is not limited to circumstances where the tenant is an affected lessee. That said, to the extent the tenant (or the landlord for that matter) is impacted by the economic impacts of the COVID-19 pandemic is to be taken into account (as well as other guidance in the Code).

The dispute resolution mechanisms under the Regulations are only available where the tenant is, or is purporting to be, an affected lessee.

The Regulations provide that a tenant may only apply for mediation if the tenant is, or is claiming to be an affected lessee and the parties may only apply to the Court if the Commissioner has issued a certificate stating that the mediation has been terminated without resolution, that mediation would not be reasonable in the circumstances or that a party refused to participate or did not participate in good faith.

Future Law Protections

The Regulations provide that an act or omission of a tenant, pursuant to a requirement under the laws of South Australia in response to the COVID-19 pandemic, will not:

- be taken to be a breach of the commercial lease
- constitute grounds for termination or the taking of any prescribed action by the landlord against the tenant.

This additional protection of tenants could have broad implications depending on what future laws relating to the COVID-19 pandemic are brought into place by the state of South Australia. Practically speaking, it is most likely to apply in any circumstances where premises are ordered to close and, as a result, tenants cannot trade or meet other obligations under their relevant commercial leases where physical access to premises is required.

Actions taken prior to 9 April 2020

The Regulations contain a provision that applies in circumstances where a landlord has sought to enforce its rights under a commercial lease during the period between 30 March 2020 and 9 April 2020 (Relevant Period), being the period of time between the commencement of the Prescribed Period and the day on which the Act was assented to.

If a tenant is suffering financial hardship as a result of the COVID-19 pandemic and during the Relevant Period:

- a landlord has taken or commenced, but not yet completed or finalised, a prescribed action
- a landlord has taken or commenced, but not yet completed or finalised, the performance of any other measure that the landlord would not have been permitted to undertake or commence during the Prescribed Period, or
- the operation of the terms of a commercial lease has had effect, or has a periodic or ongoing effect, contrary to the operation of the Act as in force immediately before the Regulations came into operation (i.e. before 15 May 2020),

the action, operation or effect will, insofar as it remains incomplete or ongoing, or has a periodic or ongoing effect, be stayed or suspended until the end of the Prescribed Period.

Agreements reached between prior to 15 May 2020

The Regulations contain a provision that applies to agreements reached during the period between 30 March 2020 and 15 May 2020 (Designated Period), being the period of time between the commencement of the Prescribed Period and the day on which the Regulations came into operation.

If the parties have agreed to vary the terms or modify the operation of a lease during the Designated Period, an order of the Court made under the Regulations may not modify or affect the operation of that agreement insofar as that agreement operated during the Designated Period. An order of the Court may, if the Court so determines, operate to modify or affect that agreement to the extent it operates after the Designated Period.

HAS THE ACT CLARIFIED THE UNCERTAINTIES OF THE CODE?

In a previous alert relating to the introduction of the Code, which can be found [here](#), we mentioned that the Code contained several uncertainties regarding its application and implementation. In this section, we revisit the uncertainties of the Code in light of the introduction of the Regulations.

What if a tenant is not an affected lessee?

As mentioned above, the provision contained within the Regulations that requires parties to negotiate the rent payable and other terms of a commercial lease is not limited to affected lessees.

Whilst a landlord is required to make a genuine attempt to negotiate in good faith the rent and other terms of any commercial lease, the dispute resolution mechanisms within the Regulations are only available where the tenant is an affected lessee.

So, where the tenant is not an affected lessee, the parties obligations are limited to negotiating the terms (including rent) of the commercial lease in good faith. If any disputes arise during the negotiation process, then neither party will have access to the dispute resolution provisions contained in the Regulations.

The future law protections discussed above also broadly apply to all commercial leases regardless of whether the tenant is an affected lessee.

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

The Regulations apply to commercial leases entered into before 30 March 2020 and will only apply to leases entered into after 30 March 2020 in circumstances where that lease is entered into by means of an option to extend or renew, or any other extension or renewal of an existing lease, on the same or substantially similar terms as the existing lease.

The Regulations do not specify when a lease is "entered into". In the case of a retail shop lease, the provisions of the *Retail and Commercial Leases Act 1995* will apply and the lease will be entered into on the earlier of the date both parties have executed the lease, the date the tenant takes possession of the retail shop or the date the tenant commences paying rent. The position with respect to other commercial leases is not clear, particularly where the parties have entered into an agreement for lease with a lease commencement date after 30 March 2020. However, given that the terms of the lease were negotiated prior to the COVID-19 pandemic and the general tenant friendly provisions in the Regulations, we expect that any dispute as to whether the Regulations apply would determine that a lease pursuant to an existing agreement for lease would be governed by the Regulations.

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

Under the Regulations, a tenant is taken to be suffering financial hardship as a result of the COVID-19 pandemic if the tenant is eligible for, or receiving, a JobKeeper payment in respect of the business of the tenant.

Further, the Regulations provide some clarity regarding the scope of information that the Court may have regard to in determining whether a tenant is an affected lessee:

- whether or not the tenant is eligible for, or is receiving, a JobKeeper payment in respect of the business of the tenant (whether in their capacity as an employer or on their own behalf)
- any reduction in turnover of the business of the tenant (as verified by financial records or statements provided by the tenant) during a specified period as compared with another specified period determined by the Court as being relevant to the circumstances of whether or not the tenant is suffering financial hardship as a result of COVID-19.

This ultimately allows the Court to determine the scope of the financial records or statements to be provided by the tenant and what "specified periods" are appropriate for conducting a comparison of the business' turnover.

How is turnover determined?

The Regulations have clarified that "turnover" is calculated by reference to:

- the 2018/2019 financial year, or
- a 12 month period or such lesser period as determined by the Court or the Minister by notice in the Gazette.

The Regulations have also clarified that "turnover" includes turnover derived from Internet sales of goods or services.

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

If the tenant is a franchisee, the relevant turnover is the turnover of the business conducted at the premises the subject of the commercial lease.

If the tenant is a corporation that is a member of a group (i.e. if the tenant is a related body corporate of another corporation within the meaning of the Corporations Act 2001), the relevant turnover is the turnover of the group.

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

The Regulations require the parties to make a genuine attempt to negotiate in good faith the rent payable under commercial leases during the Prescribed Period having regard to:

- the economic impacts of the COVID-19 pandemic on the parties to the lease
- the provisions of the Act and the Regulations
- the provisions of the Code.

In particular, Principle 3 of the Code states that landlords must offer tenants proportionate reductions in the rent in the form of waivers and deferrals.

However, the Regulations do not shed any further light on our previously raised questions regarding payment of any deferred rent amount where a lease expires before the pandemic ends and how the landlord retains the contractual right to recover any rent.

Landlords who agree to any deferral arrangements should document the obligation to pay deferred rent and the ability to have recourse to security where deferred rent obligations are not met.

What happens to rent reviews during the Prescribed Period?

If, during the Prescribed Period, a tenant is an affected lessee, the rent payable must not be increased, other than rent or a component of rent that is determined by reference to turnover, unless otherwise agreed between the landlord and the tenant.

The wording of this provision is unclear as to whether rent reviews can be applied for the balance of the lease year, once the Prescribed Period has elapsed.

The lack of clarity arises because the provision does not expressly state that rent reviews must not occur during the Prescribed Period. The provision states that rent must not be increased if during the Prescribed Period the tenant is an affected lessee. The restriction on rent reviews is not a broad ban on rent reviews during the Prescribed Period, it only applies where the tenant is an affected lessee.

However, once the Prescribed Period elapses, the Regulations will no longer apply. On this basis, there is a strong argument that rent reviews can take place after the expiry of the Prescribed Period.

What about outgoings?

The Regulations:

- prevent a landlord from requiring an affected lessee to pay land tax or reimburse the landlord for the payment of land tax during the Prescribed Period
- require a landlord to pass on the benefit of any waiver or relief payment under a scheme administered by the Treasurer for the purposes of providing land tax relief to the tenant in the form of a waiver of rent payable under the commercial lease in accordance with the provisions of that scheme.

While the Code requires landlords to pass on any reductions in statutory charges, as well as the benefit of any deferral of loan repayments on a proportionate basis, the Act does not prescribe this.

Similarly, while the Code requires landlords to waive the recovery of outgoings or other expenses under a lease during the period that the tenant is unable to trade from the premises, the Act does not impose such an obligation.

However, the parties should be aware that in making an order granting relief to an affected lessee in relation to payment of rent, the Court must have regard to:

- whether the landlord has agreed to waive recovery of any outgoings or other expense payable by the tenant under the lease
- any reduction by a third party to outgoings in relation to the premises.

This suggests that a landlord failure to waive outgoings or pass on any reduction in outgoings may impact the sum of relief that a Court will grant to an affected lessee.

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

When negotiating the rent and other terms under its commercial lease, both parties are to have regard to the economic impacts of the COVID-19 pandemic and the leasing principles set out in the Code. This includes Principle 4 of the Code which states that regard must be had to the landlord's financial ability to provide rent waivers.

Further, in making an order granting relief to an affected lessee in relation to payment of rent, the Court must have regard to the ability of the landlord to provide rent relief, including any relief provided to the landlord by a third party in response to the COVID-19 pandemic.

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 are to negotiate in good faith the rent payable under, and other terms of, the commercial lease having regard to the economic impacts of the COVID-19 pandemic and the provisions of the Act, the Regulations and the Code.

The economic impacts of the COVID-19 pandemic will be different for each tenant of a shopping centre. In accordance with the Code, rent relief may be a "tailored, bespoke and appropriate temporary arrangement" 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 Government issues a direction requiring closure, then it is likely that the landlord may 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 parties may separately negotiate and agree to a surrender of the lease.

Can a landlord call on security during COVID-19?

If a tenant is an affected lessee, a landlord cannot take action for recovery of a security bond or performance of obligations pursuant to a guarantee, on grounds of a breach of the lease during the Prescribed Period due to:

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

However, the Act does not prevent the landlord from calling on security for other reasons, where permitted under the lease.

Can a landlord terminate a lease during COVID-19?

If a tenant is an affected lessee, a landlord cannot take action to terminate the lease, on grounds of a breach of the lease during the Prescribed Period that consists of:

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

The Regulations do not prevent the termination of a lease in circumstances where a tenant has breached the lease and the breach consists of matters unrelated to the COVID-19 pandemic (i.e. a breach that does not consist of a failure to pay rent, outgoings or operating the business during the hours specified under the lease).

What happens if the parties can't agree?

Mediation

A party to a commercial lease may apply to the Small Business Commissioner for resolution of a "relevant dispute", being a dispute in relation to:

- whether or not a tenant is suffering financial hardship as a result of the COVID-19 pandemic
- the provision of rent relief during the Prescribed Period (including a failure of a party to take part in a negotiation in respect of the provision of rent relief), or
- a dispute in relation to issues that have occurred in relation to the COVID-19 pandemic. The issue may arise from, or relate to, the operation of the Regulations, a commercial lease or any other matter relevant to the occupation of the premises or to a business conducted at the premises.

Importantly, a tenant may only apply to the Commissioner for mediation if the tenant is, or is claiming to be, an affected lessee.

Court Proceedings

A party may only apply to the Court for resolution of a relevant dispute, if the Commissioner has issued a certificate stating that the mediation has been terminated without resolution, that mediation would not be reasonable in the circumstances or that a party refused to participate or did not participate in good faith.

The Court may make a determination as to whether or not a tenant is an affected lessee and in making such an order may have regard to:

- whether the tenant is eligible for, or is receiving, a JobKeeper payment in respect of the business of the tenant (whether in their capacity as an employer or on their own behalf)
- any reduction in turnover of the business of the tenant (as verified by financial records or statements provided by the tenant) during a specified period as compared with another specified period determined by the Court as being relevant to the circumstances of whether or not the tenant is suffering financial hardship as a result of COVID-19.

The Court may also make one or more of the following orders:

- an order granting rent relief to an affected lessee and at least 50% of the rent relief must be in the form of a waiver
- an order requiring the payment of some or all of the rent under a commercial lease into the Court until the lease has been performed
- an order requiring that rent paid into the Court be paid out and applied as directed by the Court
- an order modifying the terms and conditions of a lease in the manner specified in the order
- an order to defer the payment of rent under an affected lease for a specified period not exceeding 24 months from the day on which the order is made and if the Court makes this order it may also make an order extending the term of the lease for the period for which rent is deferred
- any other orders the Court thinks necessary or desirable to resolve a dispute between the parties to a commercial lease.

The Regulations do not impose a timeframe within which a dispute must be resolved. It is possible that rent relief arrangements to apply during the crisis period will still be unresolved well after the end of the pandemic.

KEY CONTACTS



SAMUEL BROWN
PARTNER

SYDNEY
+61.2.9513.2466
SAMUEL.BROWN@KLGATES.COM



WILL GRINTER
PARTNER

MELBOURNE
+61.3.9640.4411
WILL.GRINTER@KLGATES.COM



KAREN YUAN
SENIOR ASSOCIATE

SYDNEY
+61.2.9513.2467
KAREN.YUAN@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.