COVID-19: (AUSTRALIA) QUEENSLAND REGULATIONS FOR COMMERCIAL LEASES

Date: 2 June 2020

**This information is accurate as of 5:00 P.M. on Tuesday 2 June 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 Queensland Government has now made regulations which give effect to the Code in Queensland.

The Code embodies 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 28 May 2020, the *Retail Shop Leases and Other Commercial Leases (COVID-19 Emergency Response) Regulation 2020* (Qld) (the Regulations) were made under the *COVID-19 Emergency Response Act 2020* (Qld) (the Act).

The main purposes of the Regulations are:

- to mitigate the effects of the COVID-19 emergency on lessors and lessees under affected leases by giving effect to the good faith leasing principles set out in the Code
- to establish a process for resolving:
  - small business tenancy disputes
  - affected lease disputes.

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 commenced on 28 May 2020 and expire on 31 December 2020.

However, many of the provisions of the Regulations relate to a period known as the response period, being the period commencing on 29 March 2020 and ending on 30 September 2020 (Response Period).

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WHO IS COVERED UNDER THE REGULATIONS?

Affected Leases

For the Regulations to apply, the lease must meet the following criteria:

- the lease must be a retail shop lease under the *Retail Shop Leases Act 1994* (Qld) (the RSLA) or a lease under which the leased premises are to be wholly or predominantly used for carrying on a business;
- on the commencement of the Regulations, the lease, or an agreement to enter into the lease, is binding on the lessee, whether or not the lease has commenced;
- the lessee is an SME entity, being an entity:
  - which 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; and
  - the lessee under the lease, or an entity that is connected with, or an affiliate of, the lessee responsible for, or involved in, employing staff for the business carried on at the leased premises, is eligible for the Commonwealth Government JobKeeper scheme.

In this article, such leases are referred to as "Affected Leases" and lessees under Affected Leases are referred to as "Affected Lessees".

A lease under the Regulations includes a lease, sub-lease, licence or other agreement under which a person grants a right to another person to occupy premises, other than as a residence.

Excluded Leases

The Regulations do not apply to the following leases:

- a lease under which the premises are to be used wholly or predominantly for a farming business under the *Farm Business Debt Mediation Act 2017* (Qld) sch 1; or
- a lease, permit, licence or sublease under the *Land Act 1994 (Qld)*, unless:
  - it is a sublease of premises under a lease that has a rental category of 13 or 16 under that Act; and
  - the sublessor under the sublease is not a government leasing entity.

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

General obligation to cooperate and act in good faith

Lessors and lessees under Affected Leases must cooperate and act reasonably and in good faith in all discussions and actions associated with:

- mitigating the effect of the COVID-19 emergency on the parties to the lease; and

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- other matters to which the Regulations apply.

Prohibition on Prescribed Action by Lessors

A lessor under an Affected Lease must not take a Prescribed Action on any of the following grounds:

- failure to pay rent for a period wholly or partly within the Response Period;
- failure to pay outgoings for a period wholly or partly during the Response Period; and
- the business not being open for business during the hours required by the lease during the Response Period.

There are, however, exceptions to the above, where a lessor may take a Prescribed Action, including:

- in accordance with:
  - a variation of the lease made under the Regulations;
  - a settlement agreement or other agreement between the lessor and lessee entered into about a failure to pay rent or outgoings or the business not being open; or
  - an order of a court or tribunal,
- if, despite a genuine attempt by the lessor to negotiate rent payable and other conditions of the lease under the Regulations, the lessee has substantially failed to comply with the lessee's obligations under the regulations in relation to the negotiations; or
- on a ground that is not related to the effects of the COVID-19 emergency.

A Prescribed Action includes:

- recovery of possession
- termination of the lease
- eviction of the lessee
- exercising a right of re-entry to premises
- seizure of any property, including for the purpose of securing payment of rent
- forfeiture
- damages
- the payment of interest on, or a fee or charge relating to, unpaid rent or outgoings
- a claim on a bank guarantee, indemnity or security deposit for unpaid rent or outgoings
- the performance of an obligation by the lessee or another person under a guarantee under the lease
- exercising or enforcing another right by the lessor under the lease or other agreement relating to the leased premises.

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Lessor must not increase Rent

A lessor under an Affected Lease must not increase the rent payable by the lessee during the Response Period.

If the lease provides for a review of rent during the Response Period, the lessor may review the rent under the lease but must not give effect to, and rent will not start to accrue under, an increase in rent until after the Response Period.

This provision does not apply to the payment of turnover rent.

Process to negotiate under the Regulations

The Regulations provide the following framework for negotiating a variation to a lease:

Step 1: A party to an Affected Lease asks another party, in writing, to the lease to negotiate the rent and other conditions of the lease.

Step 2: The parties must as soon as practicable give information relating to the request that is:

- true, accurate, correct and not misleading; and
- sufficient to enable the parties to negotiate in a fair and transparent way (Sufficient Information).

Step 3: Within 30 days after a party receives Sufficient Information about a request in Step 1, the lessor must offer the lessee a reduction in the amount of rent payable under the lease and any proposed changes to other stated conditions.

The lessor's offer must:

- relate to any or all of the rent payable under the Affected Lease during the Response Period;
- provide for no less than 50% of the rent reduction offered to be in the form of a waiver of rent; and
- have regard to:
    - all the circumstances of the lessee and the Affected Lease, including the reduction in turnover of the business carried on at the leased premises during the Response Period;
    - the extent to which a failure to reduce the rent payable under the lease would compromise the lessee's ability to comply with the lessee's obligations under the lease, including the payment of rent;
    - the lessor's financial position, including any financial relief provided to the lessor as a COVID-19 response measure; and
    - if a portion of rent or another amount payable under the lease represents an amount for land tax, local government rates, statutory charges, insurance premiums or other outgoings—any reduction in, or waiver of, the amount payable.

Step 4: Once the lessor's offer has been received, the lessee and lessor must cooperate and act reasonably and in good faith in negotiating a reduction in the amount of rent payable under the lease for the Response Period, including any conditions relating to the reduction in rent.

Step 5: Following an agreement between the parties, any reduction in rent and any conditions relating to the reduction in rent may be given effect by:

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- a variation to the lease; or
- another agreement between the parties that gives effect to the matters agreed to.

Step 6: If, after a reduction in the amount of rent is agreed between the parties to an Affected Lease a ground on which the agreement is based changes in a material way, a party may ask another party to the lease to negotiate a further reduction in rent during the Response Period.

Steps 1 to 5 apply to the negotiations (except the lessor is not required to offer 50% of the further rent reduction as a rent waiver).

Examples of Sufficient Information include:

- a clear statement about the terms of the lease the initiator is seeking to negotiate;
- a statement by the lessee that demonstrates why the lease is an Affected Lease, accompanied by supporting information and evidence, including:
  - accurate financial information or statements about the turnover of the lessee's business;
  - information demonstrating that the lessee is an SME entity, having regard to any entities that the lessee is connected with, or an affiliate of;
  - evidence of the lessee's eligibility for, or participation in, the JobKeeper scheme;
  - information about any steps the lessee has taken to mitigate the effects of the COVID-19 emergency on the lessee's business, including the details of any assistance being received by the lessee from the Commonwealth, State or a local government; and
- in relation to a franchisor—information about any concession or benefit provided to or by the franchisor in relation to rent or outgoings for the premises occupied by the franchisee, and any undertakings to pass those concessions or benefits on to the franchisee.

Parties should be aware that the Regulations require that personal information and information relating to business processes or financial information should be kept confidential and should not be disclosed other than in circumstances permitted by the Regulations.

Rent Waiver and Rent Deferral

Deferred Rent

If the parties agree to defer the payment of rent during their negotiations the variation of the lease or the agreement between the parties must:

- not require payment of the deferred rent to commence until the day after the end of the Response Period;
- require payment of the deferred rent to be amortised, using a method agreed between the parties, over a period of at least 2 years but no more than 3 years; and
- provide that the lessor must not, under the lease, require the lessee to pay interest or any other fee or charge in relation to an amount of deferred rent, unless the lessee fails to comply with the conditions on which the rent is deferred.

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Additionally, the lessor may continue to hold any security deposit given to the lessor until the deferred rent has been paid. If the lessor continues to hold the security deposit for a period after the lease ends, the lessor may draw down on the security under the same conditions provided for in the lease, even though the lease may have ended.

Extension of lease period

If the parties agree to waive rent or defer the rent for a period, the lessor must offer the lessee an extension to the term of the lease for the equivalent period for which rent is waived or deferred. The extension must be on the same conditions, except that the rent payable during the extension must be adjusted for the waiver or deferral.

The lessor is not required to offer an extension if the lessor:

- is subject to an existing legal obligation that is inconsistent with the obligation to extend the lease; or
- demonstrates that the lease cannot be extended because the lessor intends to use the leased premises for a commercial purpose of the lessor.

Reduction of services

If a lessee under an Affected Lease is unable to operate a business at the premises for any part of the Response Period because of the COVID-19 emergency, the lessor may cease or reduce any service at the premises:

- to the extent it is reasonable in the circumstances; and
- subject to any reasonable request by the lessee.

Negotiating a different agreement

Nothing in the Regulations:

- prevents the parties to an Affected Lease entering into an agreement that is inconsistent with; or
- affects the validity of an agreement that is inconsistent with the restrictions on taking Prescribed Actions or the process for negotiating rent reductions discussed above, regardless of whether the agreement is entered into before or after the commencement of the Regulations. Whilst this means lessors and lessees have the freedom to negotiate outside the suggested scope of the Regulations, the lessee retains its rights to request a rent renegotiation under the Regulations, despite any terms in the agreement seeking to curtail those rights.

General exemption for lessee complying with COVID-19 response measures

If a lessee under a retail shop lease, prescribed lease or other small business lease, does or omits to do something required under the lease:

- on or after 23 April 2020; and
- that is required under a COVID-19 response measure or a law of the Commonwealth or another State in response to the COVID-19 emergency,

the act or omission:

- is taken not to amount to a breach of the lease; and

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- does not constitute grounds for termination of the lease or the taking of any Prescribed Action by the lessor against the lessee.

However, this provision does not affect a termination of the lease or a Prescribed Action that was finalised or completed before 28 May 2020.

Actions taken between 29 March 2020 and 28 May 2020

If

- during the period from 29 March 2020 to 28 May 2020:
  - a proceeding for a dispute involving a Prescribed Action was started in relation to an Affected Lease; or
  - the lessor under the lease had started or taken an action that, if it had been started or taken after the commencement, would constitute taking a Prescribed Action in contravention the Regulations; and
- on the commencement of the Regulations:
  - the dispute has not been resolved; or
  - the action has not been completed or finalised,

the proceeding or action is taken to be stayed or suspended until the Response Period ends.

What happens if the parties can't agree?

The Regulations require parties to the lease to attempt to resolve any dispute prior to any mediation. In attempting to resolve a dispute each party must cooperate and act reasonably and in good faith.

If the parties fail to resolve the dispute, the small business commissioner (the Commissioner) can accept a dispute notice. A dispute notice may be dismissed if the Commissioner considers that the dispute notice:

- does not relate to an eligible lease dispute;
- is frivolous or vexatious; or
- has not be given in good faith.

The Commissioner must arrange a mediation conference.

If the parties are unable to resolve the dispute within 30 days of giving a dispute notice then there is scope to refer the matter to QCAT for a hearing.

HAVE THE REGULATIONS CLARIFIED THE UNCERTAINTIES OF THE CODE?

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

What if a Lessee is not an Affected Lessee?

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If the lease is not an Affected Lease, lessors and lessees may still use the principles of the Code as a framework for negotiating rent relief arrangements, but this is not mandatory in Queensland.

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

The Regulations apply to Affected Leases. As noted above, a lease of premises is an Affected Lease if amongst other things, on the commencement of the Regulations (being 28 May 2020), the lease, or an agreement to enter into the lease, is binding on the lessee, whether or not the lease has commenced. Thus, new leases entered into after 28 May 2020 are not subject to the Regulations.

What evidence does a Lessee 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 provide further guidance on what level of information is required to demonstrate the economic impact of the COVID-19 pandemic on the Affected Lessee. However, the examples of the Sufficient Information which is required to be provided by the parties are guidance notes only and are not prescriptive.

How is turnover determined?

Under the Regulations, the turnover of a business is defined to include income earned from internet sales but does not include a grant or assistance given by the Commonwealth, State or a local government to mitigate the effects of the COVID-19 emergency. The Regulations do not otherwise provide specific examples of what may or may not be considered in determining a lessee's turnover.

However, the meaning of an SME entity (which is relevant in the context of determining whether a lease is an Affected Lease) may provide some guidance. Section 5 of the *Guarantee of Lending to Small and Medium Enterprises (Coronavirus Economic Response Package) Rules 2020 (Cwlth)* provides that the annual turnover of an entity for a financial year is the total of the following that is earned in the 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.

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

The Regulations provide that for the purposes of working out whether a lessee is an SME entity (which again is relevant in the context of determining whether a lease is an Affected Lease), the lessee's annual turnover is:

- if the lessee is an entity connected with, or an affiliate of, another entity - the aggregate annual turnover of the entities; or

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- otherwise - the annual turnover of the business carried on by the lessee at the premises.

The Regulations also note that an entity that is a franchisee is not connected with, or an affiliate of, the franchisor merely because the entity is a franchisee.

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

The Regulations clarify that rent relief is available for Affected Lessees during the Response Period, being the period starting on 29 March 2020 until 30 September 2020.

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

The Regulations note the lessor's offer of rent relief must take into account a lessor's financial ability to offer rent relief, including any financial relief provided to a lessor as a COVID-19 response measure.

What about shopping centres? Do Lessors need to offer the same deal for all Lessees 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 Response Period. The rent relief offered by the lessor must "be based on all the circumstances of the Affected Lease".

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

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

The Regulations have not clarified this issue. Unless the Government issues a direction requiring closure, then the likely answer is that the lessor could potentially be exposed to claims in the event of closure. However, the Regulations do provide for the provision of services to be reduced to the premises if the lessee is unable to operate a business at the premises (see our comments above). The RSLA also provides that a lessor is not liable to pay compensation under section 43(1) of that Act for loss or damage suffered because the lessor takes action as a reasonable response to an emergency.

Is there a right for Lessees 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 Affected Lease, including the parties agreeing to terminate the Affected Lease.

Can a Lessor call on security during COVID-19?

The Regulations prohibit lessors under Affected Leases from calling on any security provided by an Affected Lessee or any other person securing the performance of the Affected Lessee's obligations under the Affected Lease during the Response Period due to the Affected Lessee's failure to, during the Response Period:

- pay rent;
- pay outgoings; or

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- operate and open for business during the hours specified in the Affected Lease.

This includes bonds, security deposits, indemnities or guarantees.

However, the Regulations do not prevent the lessor from calling upon security where a settlement agreement has been reached under the Regulations and the Affected Lessee does not comply with that agreement. Further, the Regulations do not prohibit the lessor from calling on any security for other reasons, where permitted under the Affected Lease.

The Regulations do not include clear provisions directing guarantors to be bound by (if not participating in negotiations) an agreement between the lessee and the lessor.

Can a Lessor terminate a lease during COVID-19?

If the lessee is an Affected Lessee, the lessor cannot terminate the lease if the grounds of termination are the Affected Lessee's failure to, during the Response Period:

- pay rent;
- pay outgoings; or
- operate and open for business during the hours specified in the Affected Lease.

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

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