
COVID-19: Victoria releases new regulations for commercial tenancies

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In April 2020 the Commonwealth Government introduced a new Code of Conduct for commercial tenancies (**Code**) intended to aid the management of cash flow for SME tenants and landlords that are suffering financial stress or hardship as a result of the COVID-19 pandemic. The Code includes a set of good faith leasing principles for application to commercial tenancies where the tenant is an eligible business for the purpose of the Commonwealth Government's JobKeeper program. You can find our full analysis of the key changes the Code introduced [here](#).

In response, Victoria enacted the ***COVID-19 Omnibus (Emergency Measures) Act 2020 (Vic Act)*** on 24 April 2020 and the ***COVID-19 Omnibus (Emergency Measures) (Commercial Leases and Licences) Regulations 2020 (Vic Regulations)*** on 1 May 2020.

In this special report, we provide our analysis of the Vic Act and Vic Regulations and outline a number of important differences that distinguish Victoria's approach with that of the Commonwealth.





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Enactment and interaction with the Code

Like Queensland, but unlike New South Wales, the Vic Regulations do not expressly refer to the Code, but instead (together with the Vic Act) operate to generally reflect the Leasing Principles of the Code but with numerous important differences.

The Vic Regulations commenced on 1 May 2020 but operate retrospectively from 29 March 2020 to 29 September 2020 (both dates inclusive) (**the relevant period**).



Eligibility

Eligible lease

The Vic Regulations apply to eligible leases. Subject to the carve outs noted below, an eligible lease is:

- a retail lease as defined in the *Retail Leases Act 2003* (Vic) (**Retail Leases Act**); or
- a non-retail commercial lease or licence, being:
 - a non-retail lease of premises under which the premises are let for the sole or predominant purpose of carrying on a business at the premises; or
 - a commercial licence, sub-licence or agreement for a licence or sub-licence, under which a person has the right to non-exclusively occupy a part of the premises for the sole or predominant purpose of carrying on a business at the occupied premises. The licence need not be in writing or partly in writing and may be express or implied,

and:

- which is in effect on 29 March 2020; and
- the tenant under which is, on or after 29 March 2020:
 - an SME entity, being an entity with an anticipated turnover for the current financial year of less than \$50 million, or an actual turnover for the previous financial year of less than \$50 million; and
 - an employer who qualifies and participates in the JobKeeper Program.

The eligibility criteria in Victoria generally reflect the relevant provisions of the Code. Interestingly, under the Vic Act, the tenant must not only be an SME entity that qualifies for the JobKeeper Program, but it must also participate in the JobKeeper Program for the lease to be an eligible lease.

The Vic Act and Vic Regulations contain two main carve outs to eligible leases. These are detailed below.

Leases of a prescribed class

A lease or licence of premises which may be used wholly or predominantly for a specified list of farming and agricultural purposes will not be an eligible lease.

Corporate tenants with an aggregated turnover in excess of \$50 million

If the tenant meets one or more of the following criteria, the lease will not be an eligible lease:

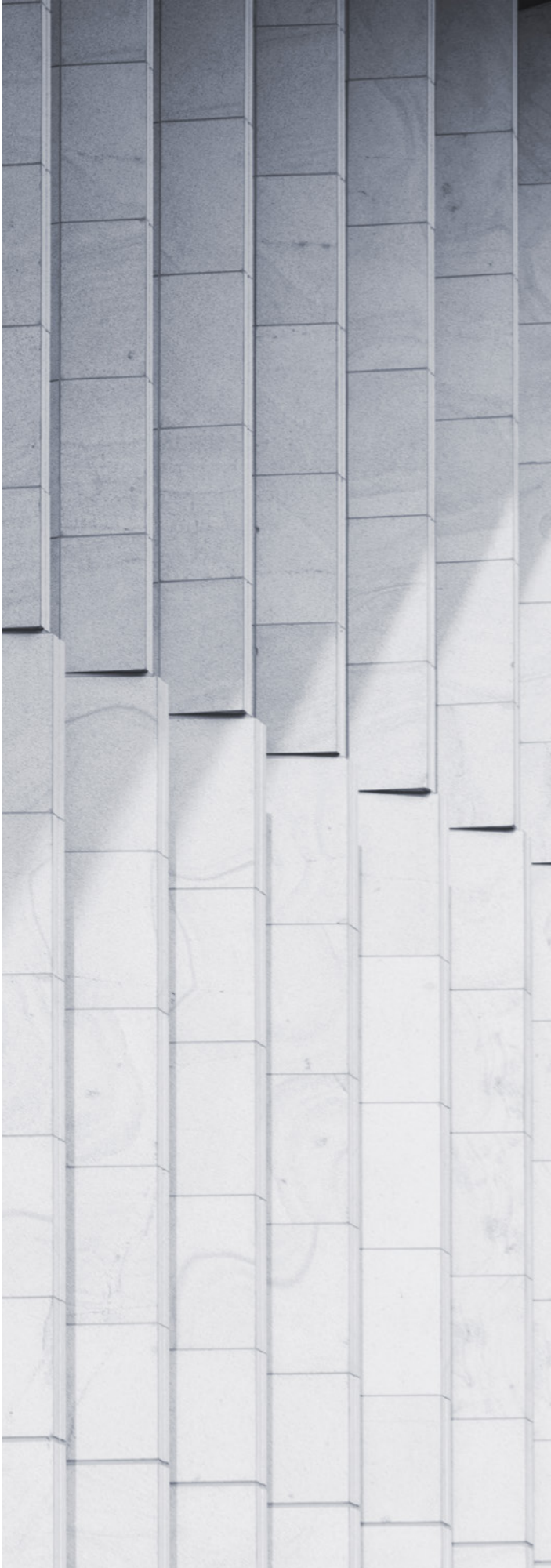
- the tenant is a member of a group of entities, by way of being connected with another entity or entities within the meaning of s 328-125 of the *Income Tax Assessment Act 1997* (Cth) (**Income Tax Act**) and the aggregate turnover of the group of entities exceeds \$50 million in the most recent financial year; or
- there is a relationship or connection between the tenant and another entity, in that they are affiliates or the tenant is an affiliate of the other entity or entities, within the meaning of s 328-330 of the *Income Tax Act* and the aggregate turnover of the tenant and the other entity or entities exceeds \$50 million in the most recent financial year.

This provides useful clarification of the position under the Code and would also appear to narrow the group of leases that will constitute an eligible lease for the purposes of the Vic Regulations.

The assessment that needs to be made to determine whether a corporate tenant is a member of a 'prescribed group' or is an 'affiliate' of another entity and whether that group or those affiliated entities have an annual turnover exceeding \$50 million is substantially the same assessment that needs to be made when assessing the annual group turnover of an entity for the purpose of the JobKeeper Program.

The Vic Regulations define prescribed groups and prescribed relationships by reference to the *Income Tax Act*, the turnover of foreign entities (to the extent that they are part of the relevant group or affiliated with the tenant) will be included in the assessment of the \$50 million threshold.

Given the grouping provisions, the ability of a landlord to verify the aggregate turnover of the tenant's group and affiliates will be limited without full co-operation from the tenant (ie providing a structure chart and relevant financial information) or an assessment by the ATO of eligibility. The inability for a landlord to verify this information is addressed to some extent by the requirement under the Vic Regulations for tenants requesting rent relief to provide the landlord with not only a statement confirming that the lease is not excluded from the operation of the Vic Regulations



but the requirement that a tenant must provide evidence that it qualifies for and is a participant in the JobKeeper Program.

Turnover is defined broadly and is specified to mean:

- 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; and
- other operating income.

earned or received by an entity in the most recent financial year.

Our reading of the Vic Regulations is that they require the assessment of turnover to be made by reference to FY 2019.

Other means of 'control or influence'

The Vic Act also allows regulations to prescribe that a lease will not be an eligible lease where an entity has a prescribed method of control or influence, through the holding of a prescribed interest, right or power, in relation to acts or decisions relating to the ownership, management or affairs of a tenant under the retail lease or a non-retail commercial lease or licence that is a body corporate. This test is not linked to the turnover of the tenant or controlling entity and could potentially extend to a franchisor that has a level of control or influence over the franchisee. Despite the Vic Act allowing regulations to include a carve out to eligible leases on this basis, the Vic Regulations have not done so at this stage.

Adoption of leasing principles under the National Code

The Vic Regulations generally reflect the Leasing Principles in the Code. We have provided further details on the main provisions of the Vic Regulations, and how they reflect, clarify or depart from the Code, below.

Breach of an eligible lease

Regulation 9(1) is narrower than Leasing Principle 1 of the Code, which prevents termination of leases for non-payment of rent during 'the COVID-19 pandemic period (or a reasonable subsequent recovery period)'. Under Regulation 9(1), a tenant is not in breach of an eligible lease for failing to pay rent only if:

- the tenant has properly requested rent relief from the landlord and complied with the tenant's obligations to negotiate the landlord's offer of rent relief in good faith but the rent relief has not yet been agreed between the landlord and tenant; or
- the landlord and tenant have agreed to rent relief and the tenant has paid rent in accordance with that agreement.

Any request for rent relief by a tenant must be in writing and be accompanied by a statement that the lease is an eligible lease, and information evidencing that the tenant is an SME entity and qualifies for and is a participant in the JobKeeper Program (**compliant request**).

If either of those scenarios apply, Regulations 9 (2) to (4) prohibit a landlord under an eligible lease from:

- evicting or attempting to evict a tenant;
- re-entering or attempting to re-enter the premises; or
- consistent with Leasing Principle 11 of the Code, having recourse against security provided.

A tenant will be in breach for failing to pay rent (and the landlord can take action, including by having recourse against any security provided under the eligible lease) if:

- the tenant has not made a compliant request for rent relief and has not negotiated the landlord's offer in good faith; or
- if the landlord and tenant have agreed to rent relief but the tenant is not paying rent in accordance with that agreement.

Consistent with the Code, there is no restriction on a landlord from taking action, including terminating an eligible lease or drawing down on a security under an eligible lease, for breaches of the eligible lease other than non-payment of rent.

Leasing Principle 2 of the Code, which provides that a material failure by a tenant to abide by substantive terms of a lease will forfeit any protection provided to the tenant under the Code, is not reflected in the Vic Regulations. In our view, the effect of this omission is that a landlord retains all of its rights under the lease (including termination and having recourse to security) for any breach by a tenant of a lease whether or not it is a substantive term, other than non-payment of rent (**other material breach**). However, if the tenant has otherwise made a Complaint Request, the occurrence of an other material breach will not entitle the landlord to disregard Regulations 9 (2) to (4).

The Vic Regulations do not expressly deal with whether a landlord can have recourse against security in relation to a tenant's failure to pay rent prior to commencement of the relevant period. Our view is that, provided the tenant has made a compliant request and negotiated the landlord's offer in good faith in accordance with Regulations 10(1) to (5), the prohibition on recourse against security for non-payment of rent during the relevant period is broad enough to prohibit the recovery of arrears that are owing before the relevant period.

Prohibition on rent increases

Consistent with Leasing Principle 13 of the Code, the Vic Regulations prevent a landlord from increasing rent under an eligible lease during the relevant period. This does not apply to turnover rent. Unlike the Code, the landlord and tenant may agree that this regulation preventing rent increases does not apply.

Unlike the NSW Regulations, the Vic Regulations do not prohibit landlords from recovering rent increases from tenants after the relevant period that would have been imposed during the relevant period if it were not for the application of the Vic Regulations. It is therefore open to landlords to recover lost rent increases (on rent paid during the relevant period) after the relevant period ends.

In our view, a landlord may:

- still effect the rent increase, but will not be entitled to recover the increased rent during the relevant period; and
- implement the rent increase immediately when the relevant period ends.

To satisfy the obligation to act in good faith, it would be prudent that any such entitlement should be clearly specified in any written agreement between the landlord and the tenant, particularly if the parties agree that lost rent payments are to be repaid after the relevant period.

Payment of deferred rent

Consistent with Leasing Principle 9 of the Code, if rent is deferred, the landlord must not request the payment of the deferred rent to commence until the earlier of:

- the expiry of the relevant period (i.e., after 29 September 2020); and
- expiry of the term of the eligible lease (disregarding any extension of the term provided for in the Vic Regulations).

The Code states that no payment of the deferred rent should occur until the earlier of these dates, but the Vic Regulations state that the landlord may not request payment. It is therefore open for tenants to commence paying earlier if they choose to do so.

Importantly, unlike the Code, the Vic Regulations provide that this regulation does not apply if the landlord and tenant agree otherwise.

Consistent with the Code unless otherwise agreed by the parties the deferred rent is amortised over the greater of:

- the balance of the term of the eligible lease (as extended under the Vic Regulations); and
- a period of no less than 24 months.

Unlike the Code, the Vic Regulations also state that the method of amortisation is to be agreed between the parties. The Code states that no punitive interest, fee or charge may be charged for the repayment of a deferral of rent. However, Regulation 17 states that the landlord may not require a tenant to pay any interest fee or charge for a deferral.

Extension of term of eligible lease

The Vic Regulations differ to Leasing Principle 12 of the Code in the following two important respects:

- the Code contemplates a tenant being provided an opportunity to extend its lease for an equivalent period to the rent waiver and/or deferral. However, Regulation 13 is limited an obligation on the landlord to offer the tenant an extension for the period of any agreed rent deferral; and
- the offer to extend for the period of the deferral applies unless a landlord and tenant agree that this regulation does not apply to them.

The Vic Regulations clarify that the terms and conditions of the extended lease must be the same as the lease before the commencement of the Vic Regulations.

Outgoings and expenses

Regulation 15 is broader than Leasing Principle 6 of the Code, which applies to statutory charges and insurances only. Specifically, under Regulation 15, if any outgoing charged or imposed on the landlord in relation to a premises is reduced, the landlord must pass on that reduction in the outgoing (on a proportionate basis) to the tenant. If the tenant has already paid the relevant outgoing (or the tenant's proportion of it) on the basis of the unreduced amount, the landlord must reimburse the tenant the excess amount paid by the tenant as soon as possible.

Consistent with Leasing Principle 8 of the Code, Regulation 14 provides that regardless of whether or not any outgoings charged or imposed on the landlord in relation to a premises is reduced, if a tenant under an eligible lease is not able to operate their business at the premises for any part of the relevant period, the landlord must consider waiving recovery of outgoings and other expenses for the period during which the tenant is not able to operate.

Unlike the Code which gives a landlord the right to reduce services as required, Regulation 14(3) entitles the landlord to cease or reduce the provision of services as is reasonable in the circumstances and in accordance with any reasonable request of the tenant.

Change in trading hours

Regulation 18 provides that a tenant under an eligible lease is not in breach if during the relevant period it reduces the opening hours of the business or closes the premises and ceases to carry on business at the premises. If this occurs a landlord is prohibited from taking the usual courses of action i.e. evicting the tenant, re-entering and having recourse to the security.

Regulation 18 limits the operation of Leasing Principle 14 in that it only applies to reducing the hours of business or ceasing to trade during the relevant period. In our view, a landlord will have recourse if this practice continues on expiry of the relevant period.

Confidentiality

Unlike the Code, the Vic Regulations include specific provisions relating to confidentiality. A landlord and tenant are prohibited under an eligible lease from disclosing communications or information obtained in connection with the operation of the Vic Regulations except with consent, or to a professional adviser or financier, or as authorised by the Small Business Commission or at law, or for the purpose of any proceeding in court or tribunal.

Regulation 24, however, allows a landlord under an eligible lease may give the statement required to be provided by a tenant as part of a compliant request, to the Commissioner for State Revenue for the purpose of applying for tax relief.

Other leasing arrangements

Unlike the Code the Vic Regulations do not include any motherhood statements requiring the spirit of the Vic Regulations to apply to all leasing arrangements for affected businesses. The Vic Regulations are specific as to what requirements must be met for each provision of the Vic Regulations to be operational.

Deemed inclusion of Vic Regulations in leases

A number of the Vic Regulations state that they are taken to form part of an eligible lease. This means that non-compliance will not only result in a breach of the statute but a breach of the lease giving the other party a contractual right for non-compliance.

The relevant Vic Regulations are as follows:

- Regulation 8 – landlords and tenants must work cooperatively;
- Regulation 12 – prohibition on rent increases;
- Regulation 13 – extension of term;
- Regulations 14 and 15 – recovery of outgoings or expenses and reduction in outgoings;
- Regulation 16 – payment of deferred rent;
- Regulation 17 – no fees, interest or charges; and
- Regulation 19 – confidentiality.



Obligation to negotiate

Good faith negotiations – not directly proportionate to turnover reduction

The Vic Regulations provide that a tenant under an eligible lease may request rent relief from the landlord provided it makes a compliant request. The requirement that tenants provide this information at the time rent relief is requested will reduce the administrative burden on landlords that are currently having to make a number of complicated assessments regarding a tenant's eligibility for relief.

If a tenant under an eligible lease makes a compliant request, the landlord must offer rent relief within 14 days after receiving the tenant's request. Unlike the Code, which requires rent relief offered to tenants to be directly proportionate to the reduction in the tenant's turnover, the Vic Regulations require a landlord's rent relief offer to be based on a much broader range of circumstances.

In particular, Regulation 10(4) requires the landlord's offer to be based on all the circumstances of the eligible lease and:

- relate to up to 100% of the rent payable during the relevant period;
- provide that no less than 50% of the rent relief is in the form of a waiver, unless the parties otherwise agree in writing;
- apply to the relevant period; and
- take into account:
 - the reduction in the tenant's turnover from the premises during the relevant period;
 - any waiver given by the landlord;
 - whether a failure to offer sufficient rent relief would compromise a tenant's capacity to fulfil the tenant's ongoing obligations under the lease;
 - a landlord's financial ability to offer rent relief, including any relief provided to a landlord by its lenders as a response to the COVID-19 pandemic; and
 - any reduction in outgoings charged or imposed on the premises.

This assessment represents an important difference to the Code including the relevance of the reduction in turnover and the recognition of the financial impact that rent relief has on the landlord.

Requirement to attempt negotiations

The landlord and tenant are expressly required under the Vic Regulations to negotiate in good faith the rent relief to apply during the relevant period.

Regulation 8(2) sets out the specific 'good faith obligation':

A landlord and tenant under an eligible lease must cooperate and act reasonably and in good faith in all discussions and actions associated with matters to which these Regulations apply.

The term good faith is not defined in the Code or the Vic Regulations, and has been the subject of much debate in the courts. In recent decisions the courts and academic commentators have held or opined that a duty of good faith encompasses the following obligations: to act honestly and with fidelity to the bargain, to communicate decisions, to cooperate, not to undermine the bargain or substance of the contractual benefit bargained for, to act reasonably and with fair dealing, not act arbitrarily or capriciously and to take into consideration the interest of the other party. Importantly, the duty does not limit the parties seeking to strike the best possible bargain in their own interest. Rather, the concept of good faith requires an honest and genuine attempt to resolve the differences by discussion and, if thought to be reasonable and appropriate, by compromise.

Whether the parties have acted in good faith will be dependent on the relevant circumstances of each matter under negotiation.

Re-negotiations if a tenant's financial circumstances materially change

The Vic Regulations allow a tenant (but not a landlord) to re-open negotiations if the tenant's financial circumstances materially change after an agreement or variation as to rent relief has been reached. The parties must then comply with the offer and negotiation process described above in relation to that subsequent request.

Importantly, while the Vic Regulations allow a tenant to re-open negotiations (presumably if the tenant's financial circumstances deteriorate), they do not expressly contemplate a landlord re-opening negotiations if a tenant's financial circumstances improve. Whether or not a landlord can initiate negotiations regarding changes to rent relief being offered is therefore unclear. However, it is worth noting that Regulation 11 (2) provides that a landlord's subsequent offer of rent relief (i.e. an offer made in response to a change in the tenant's financial circumstances) does not need to comply with the requirement for at least 50% of the rent relief to be provided in the form of a rent waiver.



Dispute resolution

The Vic Regulations provide that:

- a landlord or tenant may refer an eligible lease dispute to the Small Business Commission for mediation; and
- a party cannot commence proceedings in VCAT or a court in relation to an eligible lease dispute until the Small Business Commission has certified in writing that the mediation has failed or unlikely to resolve the dispute.

An *eligible lease* dispute will be a dispute about the terms of an eligible lease that arises in relation to a matter to which the Vic Regulations apply. For an in-depth discussion on the definition of an eligible lease under the Vic Act and Vic Regulations please see above under the heading 'Eligibility'.

Mediation process

The mediation process under the Vic Regulations is similar in operation to the existing mediation and dispute resolution processes for retail tenancy disputes under the Retail Leases Act.

Mediation is not limited to formal mediation procedures and extends to preliminary assistance in dispute resolution, such as the giving of advice to ensure that the landlord and the tenant are fully aware of their rights and obligations and to ensure there is full and open communication between the landlord and the tenant concerning the matter.

The Vic Regulations prohibit parties from using mediation to prolong or frustrate reaching an agreement.

The steps for mediation can be found on the [Victorian Small Business Commission website](#). The process will require parties to lodge an application for mediation, participate in pre mediation resolution assistance and attend mediation. If settlement is not achieved, mediation ends and either party may apply to VCAT or the courts for a decision on their dispute.

Proceedings

The Small Business Commission must certify in writing that mediation has failed, or is unlikely to resolve the dispute, before a party can commence proceedings in VCAT or a court in relation to the dispute (unless leave is granted for proceedings in the Supreme Court).

The Vic Regulations provide that VCAT must take into account in making an order:

- the reduction in a tenant's turnover associated with the premises during the relevant period;
- any waiver of recovery of outgoings and other expenses payable by the tenant;
- whether a failure to offer sufficient rent relief would compromise a tenant's capacity to fulfil the tenant's ongoing obligations under the eligible lease, including the payment of rent;
- 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;
- any reduction to any outgoings charged, imposed or levied in relation to the premises; and
- the certificate issued by the Small Business Commission that mediation has failed or is unlikely to resolve the dispute.

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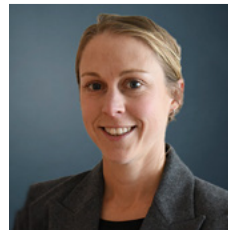
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