



HILLHOUSE

legal partners

COVID-19 AND COMMERCIAL LEASE AGREEMENTS

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The government has announced, as part of its emergency response to COVID-19, the closure of “non-essential” services including, but not limited to, pubs and clubs, cinemas and entertainment venues, restaurants and cafes, gyms and indoor sporting venues.

The decision has forced thousands of businesses to close their doors for the foreseeable future. It is likely the impact will continue across various other industries and business types generally and indeed announcement of additional closures was made on 24 March, 2020 with further announcements expected.

This raises serious questions for both landlords and tenants alike about how commercial leases continue to operate in these uncertain times.

When we refer to commercial leases, we are referring to industrial, office, commercial, retail and other leases with a business foundation. We are not referring to residential tenancy leases.

What does the lease say?

Each lease needs to be considered on the face of what the document says. That being said, many leases contain clauses which, for example, provide that the tenant:

- ◆ Conducts the business from the premises during certain hours.
- ◆ Complies with all laws and the requirements of authorities.
- ◆ Evacuates the premises when informed of an actual or suspected emergency.
- ◆ Keeps the premises clear of all infectious diseases and provide any notifications required by law to the landlord and any relevant authority.
- ◆ Disinfects the premises in accordance with any requirements of any authority and any directions of the landlord.
- ◆ Abatement of rent provisions to reduce rent payable in certain circumstances which can include instances where the tenant is unable to use or access the premises.

Recent, and potentially future, announcements by government may cause a conflict between various provisions within a lease.

For example, if government orders the closure of certain businesses, the tenant is required to comply with that direction under the clause which requires them to comply with laws, but that then may cause the tenant to be in breach of the obligation to operate the business from the premises during certain hours.

While this question is open for debate, our view is that the obligation to comply with the law and requirements of authorities is paramount and over-rides the requirement to keep the premises open for business. In the event of a government-ordered “lockdown”, a tenant must comply with that requirement in preference to other provisions.

If tenants are forced to close their businesses as a result of a direction from the government, consideration should first be given to any rent abatement provision contained in the lease.

Usually these clauses relate to circumstances in which premises are damaged or destroyed through no fault of the tenant, but in some cases the rent abatement clause relates specifically to “access” to the premises being restricted or the tenant’s ability to use the premises for the permitted use, in which case the abatement provisions may become operational.

Ultimately, the parties’ rights are governed by what the lease says, and commercial leases have a very broad range of different wordings, especially in some of the lesser used clauses like the ones that are likely to arise/be relied upon in the current environment.

With that being the case, it would be opportune and indeed prudent management to review your lease and ensure that you comply with the requirements of the lease to the extent that they do not conflict with any over-riding law or the requirements of relevant authorities and to also ascertain what options may be available to you if you are under financial hardship in the current unprecedented economic environment.

Force Majeure and Frustration

Over the coming weeks and months, you will hear a lot about Force Majeure and Frustration. Our comments are restricted, insofar as they solely relate to leases.

In very simple terms:

- ◆ Force Majeure allows for the suspension of a party’s rights and obligations under a contract if certain specified events occur, beyond the control of the party claiming Force Majeure; and
- ◆ The doctrine of Frustration allows a party to terminate a contract when a frustrating event that is unavoidable and unforeseen occurs, so that the parties are no longer bound to perform their obligations under the contract while that event continues to occur.

Generally, to establish Frustration, an event must occur which:

- ◆ Is entirely beyond what was contemplated by the parties when they entered into the lease.
- ◆ Should not be an event which could have been foreseen by the parties.
- ◆ Must render further performance impossible, illegal or makes it radically different from that contemplated by the parties at the time the lease was entered into.

It needs to be noted that, historically, there has been little consideration by courts of claims for Frustration relating to leases. Long-term leases, by their very nature, will rarely be frustrated, as the pandemic will have an “end” date at some point in time, after which time the party’s obligation can continue as contemplated by the lease.

Lessees under shorter term leases or leases with only a short period until the term is completed, may well be able to claim that the lease has been frustrated.

Government has indicated that closures, lockdowns etc may last for a number of months. If a lease only has a couple of months left until its expiry and the premises are forced to close as a result of government direction, that may give rise to a claim that the lease has been frustrated and may be able to be terminated in those circumstances.

Force Majeure, on the other hand, is a creature of contract. What qualifies as an event of Force Majeure will depend on the wording of the particular clause.

Unfortunately, the majority of leases do not contain a Force Majeure clause.

Again, it is prudent management to have your lease reviewed to ascertain what options may be available to you if you are under financial hardship in the current unprecedented economic environment.

Refusal to pay rent

In general terms, the withholding of rent will constitute a breach of a material term of a lease, allowing a landlord to terminate the lease after complying with statutory obligations and any obligations under the lease to make demand for payment.

If a breach occurs and the landlord is entitled to re-enter and take possession of the premises, it may allow the landlord to make a claim for damages from the tenant associated with any loss suffered by the landlord arising from the tenant’s breach of the lease.

Landlords taking a strict approach to payment of rent in circumstances where businesses are forced to close as a result of a government directives need to be mindful of the following:

- ◆ Increasing speculation that government will place restrictions on landlords evicting tenants during the period of any forced closure.
- ◆ The government has just taken steps to protect businesses and directors facing insolvency issues. It is highly likely the government will also take steps to protect tenants.
- ◆ The likelihood that courts may close or be suspended, making it difficult to enforce eviction rights.
- ◆ Any such action taken will be received by a sympathetic court far more likely than normal to provide relief against forfeiture.
- ◆ If eviction is possible, the ability to find replacement tenants in the foreseeable future will be incredibly challenging.

Retail Shop Leases Act 1994 (RSLA)

Retail leases are covered by the provisions of the RSLA, particularly Section 43(1) which provides that a landlord must pay compensation to tenants in certain circumstances, including where a lessor substantially restricts a tenant's and the tenant's customers access to the premises.

That being said, Section 43AB of the RSLA specifically provides that a landlord is not liable to pay compensation under section 43(1) for loss or damage suffered because the lessor takes action:

- ◆ As a reasonable response to an emergency; or
- ◆ In compliance with any duty imposed under an Act or resulting from a requirement imposed by an entity acting under the Authority of an Act.

As such, it would be unlikely that retail tenants will be entitled to claims for compensation resulting from government-ordered closure arising from the pandemic.

Again, it is prudent management to have your lease reviewed to ascertain what options may be available to you if you are under financial hardship in the current unprecedented economic environment.

How can Hillhouse Legal Partners help?

In these very trying and uncertain times we recommend candid dialogue between tenants and landlords.

The full economic impact of the epidemic is yet to be felt and we expect that it will affect both landlords and tenants. With mutual good faith and understanding, both parties can survive the tough economic times ahead.

To assist landlords and tenants, Hillhouse Legal Partners has developed a Variation Deed to give certainty to both landlords and tenants about their respective obligations under leases in the event of a government-forced closure of businesses and lockdowns.

The Variation Deed includes the following provisions:

- ◆ Suspension of the obligations under the lease.
- ◆ Reduction or the suspension of the obligation to pay rent, in the event of a government-forced closure of businesses and lockdowns.
- ◆ Mechanisms to accurately determine the length of the suspension based upon government directions.
- ◆ Mechanisms to require a tenant that receives rental contribution under any stimulus package to pay those contributions to the landlord.
- ◆ An ability to increase the term of the lease for the period of suspension.
- ◆ A mechanism for the systematic repayment of any suspended rent obligations afforded to a tenant by the landlord.

The importance of the deed is to give the parties to commercial leases certainty, not only about when the obligation to pay rent is reduced or suspended, but also when the payment of rent as provided for in the lease must commence again.

In addition to the deed, Hillhouse can also review your lease to determine such things as:

- ◆ Whether the commercial lease already has a Force Majeure clause and the proper operation of that clause.
- ◆ Whether a tenant is entitled to an abatement of rent.
- ◆ Whether a lease should be terminated on the basis of Frustration.
- ◆ What obligations the parties have under the commercial lease, in light of the pandemic.

Crucially, we can also provide commercial strategies and negotiation assistance so that both parties can reach agreement to maintain a strong working relationship to successfully navigate this difficult economic period, both in the short term and to ensure long term sustainability and success.

We are here to help.

Key Takeaways

- ◆ If the government orders the closure of a business, the tenant is required to comply with that direction, over-riding the requirement of a commercial lease to keep the premises open for business.
- ◆ In these very trying and uncertain times, candid dialogue between tenants and landlords is best.
- ◆ With mutual good faith and understanding, both landlords and tenants can survive the tough economic times ahead.
- ◆ To assist landlords and tenants, we have developed a “Variation Deed” to give certainty to both landlords and tenants about their respective obligations under leases in the event of government-forced closures of businesses and lockdowns.

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