

# Extension of the COVID-19 commercial leasing regulations

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## Extension of COVID-19 commercial leasing regulations

The New South Wales Government announced on 23 September 2020 that the *Retail and Other Commercial Leases (COVID-19) Regulation 2020* (the **Regulation**), which was set to be repealed on 25 October 2020, will now be extended to 31 December 2020. The statutory rules to give effect to the extension are yet to be seen but the New South Wales Government has confirmed that “tenants will be required to re-establish their eligibility under the extension to the Regulation if they wish to request further rent relief”.

The Regulation implements the Mandatory Code of Conduct – SME Commercial Leasing Principles During COVID-19 (the **Code**) in New South Wales. You can read more about the Code in our previous paper which can be found [here](#).

## The Court’s interpretation of the COVID-19 commercial leasing regulations

News of the extension comes after the first Supreme Court decision that examines the operation of the Regulation and the Code, *Sneakerboy Retail Pty Ltd trading as Sneakerboy v Georges Properties Pty Ltd (No 2)* [2020] NSWSC 1141 (**Sneakerboy No 2**).

The relevant facts are as follows:

- Sneakerboy sells luxury footwear and leased a retail shop at the rear of 56-58 York Street, Sydney from Georges Properties Pty Ltd.
- Commencing in February 2020, Sneakerboy experienced a sudden decline in revenue which it attributed to the COVID-19 pandemic. By March 2020, Sneakerboy had failed to pay rent for February and March 2020.
- On 25 March 2020, Georges Properties terminated the lease due to non-payment of rent.
- On 15 June 2020, Georges Properties called on Sneakerboy’s bank guarantee and used the bank guarantee to pay the outstanding rent.
- On 20 July 2020, Sneakerboy applied to the Court for relief against forfeiture on the basis that all outstanding rent was paid using Sneakerboy’s bank guarantee (*Sneakerboy Retail Pty Ltd trading as Sneakerboy v Georges Properties Pty Ltd* [2020] NSWSC 996 (**Sneakerboy No 1**)).

In *Sneakerboy No 1*, the Court held the lease should be reinstated on the condition that the bank guarantee is reinstated. However, the Court held Sneakerboy should not have to immediately reinstate the bank guarantee in full as such a requirement would be inconsistent with the underlying principles of the Code. The Court left the parties to renegotiate the terms of the lease and to agree amongst themselves the timing for reinstating the bank guarantee.

Sneakerboy and Georges Properties were unable to reach agreement in the renegotiation of the lease and so the Court was asked in Sneakerboy No 2 to determine, amongst other issues, the timing for Sneakerboy to reinstate the bank guarantee. The Court eventually determined that Sneakerboy should have until 31 March 2021 to reinstate the bank guarantee in full. To get to this determination, the Court had to make a findings as to the outcome of a notional renegotiation of the terms of the lease as required by the Regulation. By going through a notional renegotiation, the Court examined the manner in which the Regulation and the Code operated and made findings on the likely outcome if the parties had implemented the Regulation and the Code themselves.

## Key Outcomes of Sneakerboy No 2

The Court's findings and comments on the implementation of the Regulation and the Code, which should be important for both lessors and lessees, included the following:

### 1. **"Retrospective application of the Regulation"**

In respect of lease renegotiations under clause 7 of the Regulation, the Court confirmed that lessees are entitled to rent reductions for the period during the COVID-19 pandemic period, which is period during which the jobkeeper program is operational. This means that any rent that is due and payable after 30 March 2020 should be reduced even though the Regulation was made on 24 April 2020.

### 2. **"Tenant's trade"**

Leasing Principle #3 states that a lessor must offer a lessee proportionate reductions in rent (of up to 100%) based on the reduction of the "tenant's trade". On the meaning of "tenant's trade", the Court stated the meaning will need to be decided on a case-by-case basis. However, the Court noted that "tenant's trade" will generally require a consideration of the whole of the lessee's turnover from all locations at which the lessee conducts business. In the case of Sneakerboy, the Court decided that "tenant's trade" included turnover from all retail premises and Sneakerboy's internet business.

The Court also provided some commentary on which trading periods to compare when calculating the reduction of the "tenant's trade". For lessees whose trade is sufficiently regular, comparing turnover for a month during the COVID-19 pandemic period to a period immediately preceding the pandemic period may provide an accurate representation of the reduction in turnover. For those lessees whose trade is seasonal, it may be more appropriate to compare the turnover for a month during the pandemic period with the equivalent period in the previous year.

### 3. **"Subsequent reasonable recovery period"**

The Court did not provide much commentary on the duration of "a subsequent reasonable recovery period" for the purposes of the Code. However, the Court did accept Sneakerboy's submission that the subsequent reasonable recovery period for Sneakerboy should be no less than six months (ending on 30 April 2021). The Court also stated that it did not see six months as being "a long time for Sneakerboy's trade to recover after the COVID-19 pandemic period". "A subsequent reasonable recovery period" is referenced in the Code, including in Leasing Principle #3 which

states that lessees are entitled to rent reductions for the COVID-19 pandemic period and a subsequent reasonable recovery period.

4. **“Multiple renegotiations of leases”**

In relation to the right for lessors and lessees to renegotiate their lease under clause 7 of the Regulation, the Court stated a lease can be renegotiated multiple times under this clause so long as each renegotiation request is made in “good faith”. However, the Court acknowledged that in practice most leases will only be renegotiated once. The Court’s commentary suggests that further renegotiations may be possible if circumstances of the lessee and/or the lessor sufficiently change so that further lease renegotiations are warranted.

5. **“Failure of renegotiations”**

The Regulation envisages failed renegotiations would be resolved by mediation and, if mediation failed, by a Court or Tribunal. Although the Court went through the exercise of a notional renegotiation in this matter, the Court stated in clear terms that Courts and Tribunals do not have the power to decide an appropriate outcome of the renegotiation or vary the terms of commercial leases. Consequently, the Court noted that it was not entirely clear how a Court or Tribunal can resolve a failed renegotiation and this is a question for future cases.

6. **“Time-line for renegotiations”**

The Court confirmed its view that renegotiations of leases should be completed before the Regulation is repealed. This is consistent with the view that the obligation to renegotiate will end on the expiry of the Regulation unless the Regulation is amended to provide otherwise. Lease renegotiations which are finalised before the repeal will, subject to being properly documented, be binding on the parties beyond the repeal.

7. **“Effect of the lessee protections”**

The Court clarified the intention of clauses 5 and 6 of the Regulation is to prohibit the lessor from taking enforcement action at any time against the lessee in respect of certain lease breaches that occur during the ‘*prescribed period*’. The Court confirmed the protection offered by clause 6 does not fall away after the ‘*prescribed period*’ ends. Interestingly, the ‘*prescribed period*’ currently ends on the date the Regulation is due to be repealed. So, the effectiveness of the Regulation’s intention to protect the lessee after the ‘*prescribed period*’ depends on the extension, and any future amendment, of the Regulation.

## Continuing uncertainties with the Regulation

So far we know the Regulation is being extended, but the answers to the following questions remain to be seen:

1. which lessees will be eligible to receive protection under the Regulation after 25 October 2020;
2. what happens to the lessees who were eligible to receive protection under the Regulation prior to 25 October 2020 and fail to meet the new eligibility test after 25 October 2020;

3. will the amending statutory rules give specific powers to Courts and Tribunals to resolve failed renegotiations and to vary leases; and
4. will the amending statutory rules amend the Regulation so that its protections continue after 31 December 2020.

We will keep a close eye on the statutory rules giving effect to the extension and provide further updates in due course. In the meantime, we encourage lessors and lessees to contact us for assistance.

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