

The impact of the COVID-19 outbreak and government orders on commercial and retail businesses – what should landlords and tenants do?

Date: 26 March 2020

Like many other governments throughout the world, the state and territory governments in Australia have this week taken drastic measures to try and contain the rapid spread of COVID-19 and to enforce social distancing by enacting orders to close all non-essential venues/businesses (see the most recent [NSW order](#)), including:

- pubs, registered clubs and food and drink premises (e.g. restaurants, cafes and food courts) other than for the takeaway/home delivery of food or beverages;
- entertainment facilities (e.g. theatres, cinemas or concert halls);
- amusement centres;
- casinos;
- indoor recreation facilities (e.g. gyms or swimming pools);
- places of public worship (other than for certain wedding or funeral services);
- spas, nails salons, beauty salons, waxing salons and tanning salons;
- tattoo or massage parlours;
- auction houses and betting agencies;
- markets (other than markets that sell food);
- information and education facilities;
- caravan parks and camping grounds (other than for permanent residents); and
- community facilities.

Other retail shops, shopping centres and supermarkets can remain open.

Landlords and tenants are facing very challenging times. Although the federal government has already indicated that it will provide [support](#) for businesses, these government orders, which could be in place for at least 6 months, are going to have a detrimental impact on most commercial and retail businesses and will probably mean the end for many of them. Without any trade (or with restricted trade) for the foreseeable future, tenants will not be able to pay their rents and will likely request rent holidays or rent reductions or even an end to their leases while landlords will have to consider such requests and their options going forward. Most landlords and tenants also have certain obligations in assisting to prevent the spread of COVID-19.

So what should landlords and tenants do?

All commercial/retail landlords and tenants should immediately review their leases and consider their rights and obligations given the rapid outbreak and spread of COVID-19 and the subsequent government orders.

Here, we will review some of those rights and obligations, and their possible options going forward.

Tenants

What are tenants' existing obligations regarding the prevention of the spread of COVID-19?

- **Compliance with government orders.** Most commercial/retail leases require tenants to comply with any notices or orders issued by any government or other authority which affect the premises. If applicable, a tenant should comply with the recent government orders regarding closures and social distancing. Otherwise, it will be in breach of its lease.
- **Notifying a landlord about infectious diseases.** Most commercial/retail leases require tenants to notify landlords if any infectious disease occurs in its premises or, in the case of multi-tenanted buildings, to comply with building rules which require tenants to report infectious diseases. If applicable, a tenant should immediately notify its landlord if it suspects

that a person with COVID-19 has been in the premises or in the building. Otherwise, it will be in breach of its lease. If the tenant is an employer, it also has an obligation to provide a safe workplace for its employees.

Could COVID-19 claims be made against tenants?

- Tenants should check the product disclosure statements of their existing insurance policies or seek the advice of their insurers to find out if their existing policies cover claims relating to a COVID-19 infection in their premises. In any case, it is probably unlikely that a claimant would be able to successfully trace the source of his/her infection to the tenant's premises.

What should a tenant consider if it is facing financial hardship due to the government orders?

- **Legally binding contract.** Firstly, all tenants should note that a lease is a legally binding contract between a landlord and a tenant. A tenant is still bound to pay the rent (and any money payable under the lease) if the tenant is forced to close (or restrict) its business. If a tenant can no longer pay the rent or comply with its other obligations under a lease, it cannot just hand the keys back to the landlord and walk away. It will be in breach of the lease and there are consequences. A landlord may terminate the lease and re-enter the premises and claim damages (for the loss suffered by the landlord). A landlord may also consider enforcing the terms of any bank guarantee or drawing on any security deposit which were given to guarantee or secure the obligations of the tenant under the lease.
- **Trading obligation.** Retail leases usually require tenants to keep their leased premises open for trading during certain core hours. A tenant should check to see if:
 - its lease contains a trading obligation clause; and
 - the clause exempts the tenant from having to comply with the obligation if it is not permitted by law to trade (as in this case).

If a lease contains a trading obligation clause but not an exemption, a tenant affected by the government orders will be in breach of its lease. As in the case of the payment of rent (see below), a tenant could consider approaching the landlord to try and negotiate a release from the trading obligation.

- **Insurance cover.** A tenant should carefully review the product disclosure statement of its existing insurance policy or seek the advice of its insurer to find out if its policy provides business interruption cover (protecting the business against losses as a result of disruptions). A tenant may have been required to have such cover in place when entering into the lease. If this is the case, the tenant should find out if it covers pandemics such as the COVID-19 outbreak. Business interruption cover usually requires actual physical loss of, or damage to, property.
- **Force majeure.** Although unlikely, a tenant should check if there is a force majeure clause in the lease. A force majeure clause generally exempts a party from having to comply with its obligations and may even allow the party to terminate the lease if an unforeseeable event outside of the party's reasonable control (a "force majeure event") prevents it from being able to comply with its obligations. The outbreak and spread of COVID-19 or the current government orders may fall within the definition of a "force majeure event" in the lease; however, most commercial/retail leases do not generally contain force majeure clauses.
- **Break clause.** A tenant should check if there is a break clause (or an early termination clause) in its lease allowing it to end its lease early. A tenant would normally know if there is a break clause in its lease because it would have been negotiated when the lease was originally negotiated. Such clauses also tend to be quite specific. For example, a break may be conditional upon the happening of an event or only permitted after a period of time.

- **Security deposit.** A tenant could consider if any security deposit (paid to its landlord when entering into the lease) could cover the rent and other money payable to the landlord in respect of the remainder of the term of the lease.
- **Rent abatement or reduction.** A tenant's obligation to pay rent is usually an essential term of a commercial/retail lease, a breach of which gives the landlord an automatic right to terminate the lease and to re-enter the premises if the rent is 14 days overdue for payment (sometimes without notice being required). Commercial/retail leases don't normally provide for a situation when a tenant cannot pay its rent because it is forced by the government to close its business or restrict its trade. Nor is such a situation covered by the retail tenancies legislation. As noted above, a tenant is usually required under a commercial/retail lease to comply with government notices/orders. Commercial/retail leases usually only allow for rent abatement when there is physical damage to the premises, not a pandemic, e.g. in the event that the leased premises is destroyed or damaged to the extent that it is unfit for occupation or use by the tenant. A tenant could therefore consider approaching the landlord to try and negotiate a rent free period or a rent reduction (abatement). A landlord and a tenant can vary the terms of an existing lease at any time by agreement. If agreed, it should be properly documented in a deed of variation (to prevent disputes later arising) – setting out the details regarding the rent free period/rent reduction period, the payment of outgoings (if applicable), repayment (if required) and the consequences of non-repayment. A landlord is not legally obliged to agree to a rent free period or a rent reduction but, in the current climate, may consider it to be a better option to having no tenant at all or incurring costs in trying to find a replacement tenant.
- **Surrender.** A tenant could also consider approaching the landlord to try and negotiate a surrender of the existing lease by agreement. A surrender will end the lease. Again, a landlord is not legally obliged to agree to a surrender of the lease. If agreed, a landlord will usually require the tenant to pay the landlord a surrender fee to compensate the landlord for the early termination of the lease (effectively a break fee). It may also require the tenant to pay its legal costs. Duty is also usually payable by the tenant on any surrender fee (and registration costs). Any agreement to surrender a lease should be documented in a deed of surrender between the parties (to prevent disputes later arising).
- **Frustration.** A tenant could consider trying to terminate its lease by frustration. A lease can be automatically terminated by frustration if, through no fault of the parties, a post-contractual event occurs which makes it impossible for the parties to perform their lease obligations, e.g. if the leased premises is completely destroyed or the land is resumed by a government authority. It depends on the circumstances of the case but the courts generally only allow it in very limited circumstances and not if the event just makes compliance more expensive or difficult for a tenant or is only temporary in nature (see *Li Ching Wing -v- Xuan Yi Xion* [2004] 1 HKLRD 754). Accordingly, if the outbreak of COVID-19 and the government orders have made it absolutely impossible for a tenant to perform its obligations under a lease, the tenant may be able to argue that the lease has been frustrated and should therefore be terminated; however, this may not be possible if the government orders are only temporary or short-term. It will probably depend on how long the orders are in effect relative to the remaining term of the lease.

What if a landlord has already terminated a lease for breach?

- If a landlord has re-entered a premises and terminated a lease, a tenant may consider applying to a court for the lease to be re-instated (relief against the forfeiture, e.g. s129(2) *Conveyancing Act 1919* (NSW)). The relief is discretionary and, to be granted relief, a tenant usually has to prove that the breach was trivial and not wilful, that the landlord's conduct contributed towards the breach, that the tenant has remedied the breach (and paid any outstanding money owing) and that it can comply with its obligations going forward. Given that

the latter is probably not the case for many tenants affected by the government orders, it is unlikely that a court would grant relief to the many tenants affected.

Landlords

What are landlords' existing obligations regarding the prevention of the spread of COVID-19?

- **Reporting infectious diseases.** As noted above, commercial/retail leases usually require tenants to notify landlords if an infectious disease occurs in its leased premises, e.g. if a person with COVID-19 has been in the premises. Landlords should immediately respond to any such notifications and should also notify all tenants and visitors in the building if it has been reported that a person with COVID-19 has been in the building.
- **Cleaning obligations.** Most commercial/retail leases (e.g. in the case of multi-tenanted buildings) provide that landlords are responsible for cleaning the building, the common areas and the shared facilities and that the landlord will recover a portion of those cleaning costs from each tenant as part of the outgoings payable under the leases; however, they do not usually stipulate the extent and frequency of the cleaning. Landlords are therefore not strictly required under such leases to have any extra cleaning carried out to prevent the spread of COVID-19. Notwithstanding, in the present circumstances, it would definitely be recommended for landlords to ensure that:
 - deep cleanings are carried out regularly (especially in busy areas) and that hand sanitisers are readily available for all occupants of the building; and
 - procedures are in place to prevent the outbreak and spread of infectious diseases like COVID-19 in the building, e.g. regular deep cleaning, social distancing, screening access to buildings, the immediate reporting of any person with COVID-19 in the building, etc.

Landlords can try and recover these additional cleaning costs, but this may not always be possible, as in the case of gross leases. Retail landlords can also usually only charge outgoings if they were disclosed in the disclosure statement, charged in accordance with the lease and comprise expenditure which is properly and reasonably incurred (e.g. s12A, s22 and s29 *Retail Leases Act 1994* (NSW)).

Could COVID-19 claims be made against landlords?

- As is the case with tenants, landlords should review the product disclosure statements of their existing insurance policies or seek the advice of their insurers to find out if their existing policies cover claims relating to a COVID-19 infection in their building. Again, it is probably unlikely that a claimant would be able to successfully trace the source of his/her infection to the landlord's building.

What should a landlord consider if it has a tenant affected by the government orders?

- **Insurance cover.** A landlord should carefully review the product disclosure statement of its existing insurance policy or seek the advice of its insurer to find out if its policy provides loss of rent cover. If this is the case, the landlord should find out if the cover extends to pandemics or disease outbreaks such as the COVID-19 outbreak.
- **Abatement of rent.** A landlord should review the lease to see if there are any provisions permitting an abatement of rent or the termination of the lease if the premises cannot be occupied because of an unforeseeable event. In most commercial/retail leases, an abatement of rent or a termination right is limited to events which cause physical damage to the premises, not pandemics, e.g. if the leased premises is destroyed or damaged to the extent that it is unfit for occupation and use by the tenant. Otherwise, a landlord is not legally obliged to grant a tenant a rent-free period or a rent reduction. As noted above, a tenant is contractually bound to make its payments under the lease; however, upon request, a landlord could consider negotiating a rent-free period or a rent reduction (abatement) with the tenant. A landlord could, for example, allow for a rent-free period or a rent reduction subject to it being repaid at a later date (when the government orders are removed). A landlord and a tenant can vary the terms of an existing lease at any time by agreement. It should be properly documented in a deed of variation (to prevent disputes later arising) – setting out the details

regarding the rent free period/rent reduction period, the payment of outgoings (if applicable), repayment (if required) and the consequences of non-repayment. In the current climate, a landlord may consider it to be a better option to allow a rent-free period or a rent reduction to having no tenant at all or incurring costs in trying to secure a replacement tenant.

- **Termination of lease.** If a tenant is in breach of a lease (e.g. it cannot pay the rent), a landlord will usually have a right to terminate the lease. If a landlord decides to terminate the lease, then the landlord should ensure that it strictly adheres to the termination procedure set out in the lease and any applicable statutory requirements (e.g. s129 *Conveyancing Act 1919* (NSW)).
- **Guarantee/security deposit.** If obligations cannot be performed and a tenant is in breach of a lease and a bank guarantee or security deposit were given to guarantee or secure the obligations of the tenant when entering into the lease, a landlord may also consider enforcing the terms of the guarantee or drawing on the security deposit.
- **Unconscionable conduct.** In the case of a retail lease, it is probably unlikely that a refusal by a landlord to agree to a rent free period or a rent reduction and seeking to recover the rent (and any other money owing under the lease) from the tenant could be deemed to be unconscionable conduct within the meaning of the relevant retail leases legislation (e.g. s62B *Retail Leases Act 1994* (NSW)).

What about agreements for lease?

- Agreements for lease often require a landlord to construct a building or premises by a particular date and allow the tenant to terminate the agreement if it is not completed by that date (“sunset date”). It is possible that many of the previously planned completion dates are now unlikely to be achieved given the expected construction delays (due to the new social distancing orders and limited supplies and construction workers). In the circumstances, unless an existing agreement allows a landlord to extend the date due to external factors such as the outbreak of COVID-19, landlords should probably consider seeking to vary existing agreements to extend sunset dates.

Takeaway

This business disruption is not temporary. The Australian government has advised that these new measures could be in place for at least 6 months, to try and contain the COVID-19 virus. The state and territory government are also likely to implement more extreme measures if the current measures are not successful in containing the COVID-19 virus, e.g. the closure of all non-essential business and retail shopping centres.

While the state and territory governments are expected to provide some form of financial support, commercial/retail landlords and tenants are undoubtedly facing very challenging times ahead.

Those landlords and tenants affected should therefore prepare for the worst and start by:

- reviewing their leases;
- carefully considering their obligations and rights;
- confirming their existing insurance cover;
- identifying the risks; and
- deciding on their best options going forward.

Legal practitioners should also consider reviewing existing template clauses (e.g. by allowing rent abatement or termination rights for infectious disease outbreaks or government shutdowns) or adding extra clauses (e.g. force majeure clauses) when drafting leases in the future to help better protect the interests of the parties in the event that there is another outbreak of a pandemic such as COVID-19. Landlords and tenants should also ensure that they have appropriate business interruption insurance and loss of rent insurance which cover such events.