What a difference a pandemic makes – mediating leasing disputes during COVID-19

Kluwer Mediation Blog
October 22, 2020

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Please refer to this post as: Alan Limbury, 'What a difference a pandemic makes – mediating leasing disputes during COVID-19', Kluwer Mediation Blog, October 22 2020, http://mediationblog.kluwerarbitration.com/2020/10/22/what-a-difference-a-pandemic-makes-mediating-leasing-disputes-during-covid-19/

Under Section 68 of the New South Wales Retail Leases Act, and in other Australian jurisdictions, parties to a commercial lease dispute may not sue until the applicant has obtained a certificate that mediation has failed to resolve the dispute or the court is otherwise satisfied that mediation is unlikely to do so.

In response to the current COVID-19 pandemic, the Premiers of the Australian States and Territories and the Prime Minister combined to form a "National Cabinet" to find consistent ways to tackle the economic impacts. On April 7, 2020 a Mandatory Code of Conduct was announced, subsequently reflected in State and Territory legislation, containing leasing principles applicable during COVID-19 to landlords and small to medium enterprise (SME) tenants: "the Code".

In brief, under the Code, tenants whose trade has suffered and their landlords are obliged to renegotiate their arrangements in good faith. Leasing Principle 3 requires landlords to offer tenants proportionate rent reductions, in the form of waivers and deferrals. This may amount to up to 100% of the rent ordinarily payable, on a case-by-case basis, based on the reduction in the "tenant's trade" during the COVID-19 pandemic period and a subsequent reasonable recovery period.

How this works in practice
A tenant suffering a 60% loss of turnover (subject to negotiation and agreement in good faith), would be required to pay only 40% of the normal rent during the pandemic and would receive both a rent-free waiver of 30% of the normal rent and a deferral of 30%, payable over at least 24 months, commencing after the pandemic is declared over. Meantime, landlords may not increase the rent nor take any of the usual actions available under a lease – including termination, drawing upon security for non-payment of rent or imposing penalties for non-trading.

In New South Wales, the Code was implemented on April 24, 2020 by a Regulation that was amended on July 3, 2020 to make it clear that lessees must provide evidence that they are "impacted". The Regulation affects both retail leases and commercial leases. For a lessee to qualify as "impacted" its turnover in the 2018-2019 financial year must have been less than $A50 million. However, the way in which that is calculated differs depending on the nature of the lessee and this has led to much argument during landlord/tenant mediations.

The Regulation includes consideration of franchisees, which creates a more complex landscape. If the lessee is a franchisee, the relevant turnover is the turnover of the business conducted at the leased premises. If the lessee is a member of a corporate group, the relevant turnover is the turnover of the entire group. In any other case, the relevant turnover is the turnover of the business conducted by the lessee.

In a real-life example, the landlord was an elderly individual whose sole income was the rent from a shop. The tenant carried on business from numerous shops and had closed them all except the one owned by the landlord, where trading had actually increased. The tenant was able to claim at the mediation that it was entitled to rent relief under the Regulation, proportionate to the overall reduction in its business turnover.

What the cases say
Despite the extraordinary volume of leasing disputes being mediated, there are few cases reaching the courts.

In Sneakerboy No. 2, one of very few cases to consider the COVID-19 leasing regime, the judge said:
"The issue of whether the phrase "tenant's trade" in leasing principle 3 refers to the whole of the tenant's turnover, or only the turnover at the premises the subject of the particular lease, does not in my view always require the same answer. The overarching principles stated in the Code include: "It is intended that landlords will agree tailored, bespoke and appropriate temporary arrangements for each SME tenant, taking into account their particular circumstances on a case-by-case basis". The overarching principles include that arrangements "will take into account the impact of the COVID-19 pandemic on the tenant with specific regard to its revenue, expenses and profitability". They also include: "All premises are different, as are their commercial arrangements; it is therefore not possible to form a collective industry position". However, in my view it will generally be the case that the phrase "tenant's trade" in leasing principle 3 will require a consideration of the whole of the particular tenant's turnover, as well as costs and profit, from all locations at which the tenant conducts retail businesses."

To my mind, the Code and the Regulation are based on the assumption that tenants are likely to be more adversely affected by the loss of trade attributable to the pandemic than landlords, who are assumed to be the ones required to make concessions to their tenants. This may generally be so and, indeed, the stated objective of the Code is "to mitigate the impact of the COVID-19 pandemic on the tenant". Accordingly, there are no provisions requiring tenants to agree tailored, bespoke and appropriate temporary arrangements for landlords, nor do the overarching principles take into account the impact of the COVID-19 pandemic on landlords. These deficiencies make it harder for mediators to encourage tenants having multiple leased locations and enjoying full trade at the landlord's premises to have regard to the circumstances of sole individual landlords dependent entirely on rent from one shop.

A reassuring outcome
The good news is that despite the remarkable increase in disputes in the retail and commercial lease space and the financial distress they reflect, mediation continues to demonstrate its value. Evidence reveals that the online mediation environment has not been a disincentive for parties and in fact online mediations appear to resolve faster. Most encouraging is that the settlement rates of about 85% have continued to hold up – a great endorsement of mediation's value.