



COVID-19 - The epidemic's impact on New Zealand commercial leases

Introduction

Following the Prime Minister's announcement on 23 March 2020, New Zealand moved to COVID-19 Alert Level 4 at 11.59 p.m. on Wednesday, 25 March 2020. Anyone in New Zealand who is not working in an [essential business](#) or who is not critically needed to support the operation of an [essential business](#), must now stay at home and stop all physical interactions with others outside of their household.

Guidance published on the [Government's official COVID-19 website](#) sets out which businesses are considered essential or critical to the support of such businesses. Those businesses not deemed essential or critically supporting essential businesses were required to close with effect from 11:59 p.m. on Wednesday, 25 March and remain closed until further notice.

This will undoubtedly cause financial stress for many New Zealand businesses, both small and large, as revenue streams drop away. Almost immediately, tenants have reacted to the situation that they have found themselves in, by either seeking assistance from landlords, or by taking unilateral action in ceasing rental payments, without consulting their landlords. We strongly recommend that landlords and tenants consult, before taking unilateral action, to discuss constructively what is the best way forward. Each situation will be different and lease terms and conditions will vary widely. What follows is a general overview of some of the issues. It is not legal advice, which should be sought by landlords and tenants who have particular issues.

Are rental and outgoings still payable?

Typically, the rental and outgoings payable under a commercial lease will be a substantial cost to a business, but they are also essential revenue for landlords. In the case of common outgoings such as body corporate fees, rates and insurance, and some opex such as electricity that is not separately metered and allocated to a particular tenant, landlords will continue to be obligated to meet such payments. Both landlords and tenants may also have mortgage payments to make. Landlords and tenants, therefore, have a mutual interest in ensuring that their respective businesses can continue.

Are rental and outgoings still payable if a tenant is unable to access its business premises? This will depend upon the specific terms of the premises lease. Many bespoke commercial lease forms do not make provision for this situation in which case the payment obligations will continue to apply. However, there may be an applicable abatement provision for rental and outgoings if:

- the tenant requires access to the premises during the current lockdown period, to conduct its business; and
- the parties have signed the current edition of the Auckland District Law Society Inc. (**ADLS**) Deed of Lease (Sixth Ed. 2012(5)), or, if there is no such Deed of Lease, that form is applicable because they have signed the current standard ADLS Agreement to Lease, which effectively imports that ADLS Deed of Lease form; and
- the standard terms of the current edition of the ADLS forms have not been modified to exclude the abatement provisions.

ADLS lease

The form of Deed of Lease which has been produced by the ADLS for many years is the most common form of commercial lease used in New Zealand. The form has been regularly updated over the last 30 years. A separate Agreement to Lease is also produced by the ADLS, which is used in conjunction with the Deed of Lease.

The current edition of the ADLS Lease is the Sixth Ed. 2012(5) and the corresponding Agreement to Lease is the Fifth Edition 2012. The Sixth edition Deed of Lease was released in November 2012 and incorporated *No Access* provisions in clauses 27.5 and 27.6.

The tenant generally has an overriding obligation to pay rental and outgoings without deduction. However, clause 27.5 provides that where there is an emergency and the tenant is unable to gain access to the premises to fully conduct the tenant's business from the premises because of reasons of safety of the public or the need to prevent, reduce or overcome any hazard or harm that may be associated with the emergency, (including where this access prohibition is imposed by a Government or other competent authority), a *fair proportion* of the rent and outgoings will cease to be payable. This abatement, as it is called, applies for the period commencing on the date when the tenant became unable to gain access to the premises to fully conduct the tenant's business until the inability ceases.

Under clause 27.6, if this situation continues, either party may terminate the lease on 10 working days' notice if the tenant is unable to gain access to the property for the "no access period" that the parties agreed in Schedule 1 of the ADLS Deed of Lease (9 months is the default position), or it can be established with reasonable certainty that the premises will not be accessible for that period.

But what is an emergency? Clause 47.1(d) defines an *emergency* under clause 27.5 as a situation that:

- is a result of any event, whether natural or otherwise, including an epidemic; and
- causes or may cause loss of life or serious injury, illness or in any way seriously endangers the safety of the public or property; and
- the event is not caused by any act or omission of the landlord or tenant.

In the current context, the issue of an epidemic notice under section 5 of the Epidemic Preparedness Act 2006 and the declaration of a State of Emergency by the New Zealand Government have added weight to the legal argument that an *emergency* has occurred under the ADLS lease form. It is also obvious that the COVID-19 virus causes or may cause loss of life or illness, and that the event has not been caused by either the landlord or tenant.

Abatement of a fair proportion of rental and outgoings

On the basis that an emergency has occurred for the purposes of the ADLS lease form, under clause 27.5 a *fair proportion* of the rent and outgoings will cease to be payable. However, the level of this abatement of rental and outgoings is not something that can be determined unilaterally by the tenant. It should be negotiated and agreed with the landlord.

The assessment of a *fair proportion* of rental and outgoings will depend on each tenant's circumstances, such as the type of business, what the leased premises are used for, and the extent to which the tenant can continue to operate its business without access to the premises. If physical access to the premises is essential to operate the business, it may be that a minimal amount of rental is payable. However, if equipment such as computers and servers are still being stored on the premises and are being remotely accessed to conduct business, it may be that a large portion of rental remains payable. Outgoings are likely to be regarded as being in a different category as the landlord will continue to be liable to pay common outgoings such as rates, insurance premia and body corporate levies for the benefit of the tenant and the landlord, and other tenants if in a multi-tenanted building.

Both tenants and landlords should note that clause 27.5 applies on the occurrence of the emergency (and when the inability to access the premises starts). No form of notice by either party is necessary to trigger the commencement of the abatement period, but, as noted above, the level of abatement is a matter of negotiation.

Other possibilities

Earlier versions of the ADLS Deed of Lease do not contain any abatement provisions which could be applicable to the current COVID-19 Alert Level 4. Bespoke leases, usually provided by larger landlords, may or may not contain such provisions.

It is possible that some lease forms may also contain *force majeure* provisions. The purpose of such provisions is to suspend the obligations of the parties where performance is prevented by events beyond their control. Whether such clauses would have any application to the current situation, if included in a commercial lease, would depend on the particular drafting. The standard ADLS lease forms do not contain *force majeure* provisions.

The doctrine of frustration of contract also applies to commercial leases. It can apply to allow termination of a contract where an unforeseen event makes performance of the contract either impossible or performance is possible only in a radically different way. It is far from certain whether this doctrine would be applicable to the current situation in New Zealand.

Insurance

Landlords and tenants should consult their insurers to ascertain whether their existing insurance cover provides any relief in respect of losses arising from the current lockdown. While it is common for landlords to have insurance cover for damage or destruction to buildings resulting in a consequential loss of rental and outgoings, and for tenants to have business interruption cover, whether such cover will extend to the current situation will depend upon the terms of each policy.

Summary

Tenants and landlords should review their respective obligations under their commercial leases. Terms and conditions vary widely. Unilateral action on the part of landlords and tenants should be avoided. These are testing times and both parties should bear in mind that any commercial relationship that continues once the lockdown has ceased will be affected by their actions now. Good faith negotiations to seek a fair agreement between the parties are therefore advisable.

Many landlords are working constructively with tenants to consider their individual circumstances and discussing assistance, including rental deferment, amended lease terms such as rent holidays in exchange for longer rental terms, and for the rental relief to be amortised over the remainder of the lease term.

Important: This document does not constitute legal advice to any person. Landlords and tenants need to seek specific advice on their own lease terms and the impact of the current lockdown on their legal rights and obligations.

This document was created on 30 March 2020 and reflects developments as at that date.