
COVID-19 – Implications for Commercial Leasing

COVID-19 is having a significant and unprecedented effect on people and businesses in New Zealand.

At 11:59pm on Wednesday 25 March, New Zealand will be at Alert Level 4 of the Government's COVID-19 Alert System. People must stay at home, travel is severely limited and all non-essential businesses must close. Further information is available at <https://covid19.govt.nz/>.

All aspects of business will be affected by the restrictions, including commercial leasing. Landlords and tenants will be considering their obligations under their leasing arrangements, what health and safety duties they have and how rental streams and contractual obligations may be affected.

Health and safety

An immediate focus for landlords and tenants will be on health and safety and their respective duties under the Health and Safety at Work Act 2015. Provided the parties work together and comply with government directives and requirements, there should be less risk of breaching the Act.

WorkSafe New Zealand has given a clear directive that, at this time, employers (including both landlords and tenants) must keep their workers (and all other persons) healthy and safe and comply with government directives and requirements. Once Alert Level 4 is in place all non-essential businesses and offices must be closed and workers are required to work from home. Building owners, property managers and tenants will want to communicate with each other, and to consider such things as ensuring that the building is secure, that they are not available to the public and who may enter the building during the lockdown.

Agreed rent abatement

The restrictions imposed by Alert Level 4 will affect business revenue streams very quickly. Therefore, businesses will look to reduce costs, and assess whether

contractual obligations must continue. Rent represents a large cost to most business. Landlords and tenants may consider working together to share the burden of rent costs and improve cash flow for both parties in the short term. Parties may be more amenable to this approach to preserve a long-term leasing relationship.

Options that landlords and tenants may consider are:

- rent holidays or incentives to assist tenants;
- temporary rent suspensions for a period of time, with the suspended rent to be paid off through a payment plan once restrictions ease; or
- reverting to a turnover-based rental with rent reduced, for example, by the same proportion as the tenant's reduction in monthly turnover as against the previous year.

It will depend on the terms of the particular lease what option may work best. Care would need to be taken to ensure that neither party waives any existing rights under the lease in agreeing any interim arrangements.

No access and force majeure provisions

It is possible that relief may be available to tenants under the terms of the lease. Some more modern leases may include "no access" provisions that allow a tenant to rent abatement or possibly a right to terminate the lease in certain circumstances, including where access to the premises is prevented or substantially affected. It is highly dependent on the wording of the particular clause whether the current circumstances would allow the clause to apply.

Similarly, a lease may include a force majeure clause. Although there is no standard force majeure clause, ordinarily this clause would provide that if a certain set of circumstances arise, that are outside the parties' control (e.g. Acts of God, war, strikes) and, as a consequence, performance of the lease is impossible, impracticable or adversely affected, the lease may be able to be terminated.

However, the criteria to prove that a force majeure clause applies can be difficult to meet and the wording of the clause would need to be carefully considered, before determining that the effects of COVID-19 were sufficient to constitute a force majeure event in a particular lease.

Doctrine of frustration

If there are no lease provisions that may provide rental relief, a tenant could

consider applying to the court under the common law doctrine of frustration. If successful, the lease would be terminated from the date of the frustrating event. Frustration occurs where the entire “common object” of the contract is frustrated. It is not enough if only one party’s advantage gained by the contract has been frustrated.

The courts have determined that a very high bar must be reached to prove frustration, and the circumstances of the particular lease and the effects of COVID-19 on that lease would need to be carefully weighed up. Court action may also be expensive and uncertain and in the current environment, and may even be practically impossible. The case law also suggests that frustration relief will not be available where the contract itself deals with the circumstances, whether through a force majeure clause, a change in circumstances clause or otherwise.

Insurance

Both landlords and tenants may have business interruption insurance available to them. However, the policy would need to be reviewed in light of the current situation as often pandemics are excluded in these policies. Landlords may have loss of rent policies but again individual policies would need to be checked as they will often cover claims that arise from physical damage only.

Given the rapidly changing environment, both landlords and tenants will want to carefully review their particular lease arrangements to assess what options may be available to mitigate risks and reduce costs. If you need any advice in reviewing your lease options, we would be happy to assist you.

For more advice, please contact any Greenwood Roche partner or your usual Greenwood Roche lawyer.
