COVID-19 and No Access in Emergency – Commercial Leases

The global pandemic caused by the novel coronavirus known as COVID-19 has caused rapid and widespread change and disruption as countries respond to the threat of COVID-19.

In New Zealand, we rapidly progressed from the Prime Minister's announcement of a COVID Alert Level System on 20 March 2020, to the declaration of a national state of emergency and the implementation of COVID-19 Alert Level 4 restrictions, which resulted in an effective "lock-down" and the closure of all premises not required for "Essential Businesses" by 11:59pm on 25 March 2020.

The initial starting point will be the provisions of the relevant leases. While there are a number of different forms of lease in use in New Zealand, the most commonly used form is the Auckland District Law Society's Sixth Edition 2012 Deed of Lease (ADLS Lease). The ADLS Lease contains express provisions to cover situations where no access is available to the leased premises as a result of an emergency. However, many other forms of lease (including earlier editions of the ADLS Lease) do not directly cover this situation.

ADLS Lease

The current 2012 "Sixth Edition" of the ADLS Lease was introduced as a response to the Christchurch earthquakes, where the emergency red-zone cordon in the central city prevented tenants from being able to access their premises. The cordon meant that access to buildings was extremely limited or impossible, regardless of whether or not any physical damage was suffered. Where there was little or no physical damage, usual entitlements to rent abatements did not apply and leases did not terminate under the damage or destruction provisions.

Clauses 27.5 and 27.6 - No Access In Emergency - were introduced to deal with this situation and provide for an abatement of rent and outgoings and, potentially an entitlement to terminate the lease. The clauses apply where there is an "emergency" and the tenant is unable to access the premises to fully conduct their

business from the premises because of “reasons of safety of the public… or the need to prevent reduce or overcome any hazard, harm or loss that may be associated with the emergency including… restriction on operation of the premises by any competent authority.” An “emergency” includes a situation resulting from an “epidemic” and in our view the COVID-19 pandemic and the Government response to it will qualify as an “emergency”.

Access to the premises to fully conduct the Tenant’s business

For the clause to apply, the tenant must also be unable to access the premises to “fully conduct” their business from the premises. This is arguably different to the permitted or business use under the lease.

Under the Government’s Alert Level 4 restrictions means that only certain “essential businesses” can operate from their premises. An essential business is one that is essential to the provision of the necessities of life, such as pharmacies, and businesses supporting them, such as medicine manufacturers – the details are as described on the covid19.govt.nz internet site.

Most business, however, will not be able to operate from their premises at all or, in the case of essential businesses, will only be able to do so in a limited way. Where this is the case, the Tenant will not be able to access the premises to “fully conduct” their business and the No Access In Emergency provisions will apply.

What happens when the No Access In Emergency provisions apply

Where the No Access In Emergency provisions apply, clause 27.5 provides that a “fair proportion of the rent and outgoings” ceases to be payable for the period in which the Tenant is unable to access the premises to “fully conduct” its business.

The Alert Level 4 restrictions commenced at 11:59 pm on 25 March 2020, so it is generally taken that these affected businesses on 26 March. At this stage the Alert Level 4 “lockdown” is due to last for four weeks, but the Prime Minister has indicated that this level of restriction may continue beyond that period, at least for some parts of the country.

What is a “fair proportion” of the rent and outgoings?

A fair proportion will vary depending on the nature of the Tenant’s business, their premises and the terms of the lease. There will be a range of possibilities.

At one end of the spectrum will be Tenants, such as retailers, who cannot access their premises to conduct their businesses. However, even in those circumstances, it will at least be arguable that the premises continue to be used for the conduct of the businesses by way of storage and warehousing of stock in trade. In addition, parts of the premises may remain useable remotely, such as IT servers. Where that is the case, there will also be an argument that the extent to which the conduct of the business continues remotely should be taken into account.

The abatement must also be “fair”. This might well mean that an assessment of an

abatement goes beyond consideration of only the Tenant's business, and consider what may be more broadly "fair" as between landlord and tenant. It may be that obligations a landlord still has to perform under the lease will be relevant, such as payment of insurance. For reasons such as this, it may also be the case that there is difference between a fair proportion of rent and a fair proportion of outgoings.

As what constitutes a fair proportion of rent and outgoings will vary depending on the individual circumstances, the landlord and tenant will need to try and negotiate to reach agreement on what represents a fair proportion. If the parties cannot agree, the ADLS Lease requires that parties first attempt to resolve any dispute by agreement and mediation (provided that both parties agree to mediation). If the dispute is not resolved by agreement or mediation it will proceed to arbitration.

Termination

In addition to the rent abatement in clause 27.5, clause 27.6 provides either party may terminate the lease by giving 10 working days' notice where the Tenant is unable to gain access to the premises for the specified "No Access Period" set out in the First Schedule or the party giving notice can establish with 'reasonable certainty' that the Tenant will be unable to gain access during the period. The standard No Access Period in the ADLS Lease form is 9 months, but this is subject to negotiation between the parties and, as a result, will vary depending on the lease.

Other Leases

The situation for other forms of lease is less certain. Bespoke lease forms may address no access issues using a different approach, while older leases (i.e. leases that were entered into pre-2012/2013 and including earlier versions of the ADLS Lease, such as the Fifth Edition 2008), generally do not include an express right to a rent abatement in the current circumstances, unless a bespoke "no access" or force majeure clauses was included in the further terms of lease. This reflects "no access" clauses becoming a feature of lease drafting following the Christchurch earthquakes.

Where the lease does not include no access provisions, tenants may attempt to raise arguments based on the doctrine of frustration. Frustration allows a contract to be avoided where the obligations have become impossible to perform due to the occurrence of certain events that are beyond the control of the parties to the contract. However, establishing frustration of a lease is likely to be very difficult, as the tenant would need to argue that the "common object" of that lease can no longer be achieved. Additionally, case law resulting from the Canterbury earthquakes indicates that the Courts would be very hesitant and generally unwilling to get involved in a claim for frustration for a commercial lease, particularly where the timeframes around the restrictions are so uncertain.

Should a tenant pay April's rent?

We are seeing a number of tenants taking an aggressive approach to this issue by advising landlords that they will be withholding all rent and outgoings. Whilst that approach may represent a litigator's preferred option, our view is that this approach

will be counter-productive in the long-run. In all but the most clear-cut cases, landlords will have good legal arguments available to them that some rent and outgoings should be payable during the lockdown period. If a tenant simply does not pay, it will open itself up to allegations of breach and, potentially, termination of its lease.

In addition, by simply stopping payments without prior consultation, tenants are likely to simply annoy their landlords, resulting in any goodwill being eroded and landlords taking a more combative and robust approach than might otherwise be the case.

On this basis, our view is that where tenants can afford to pay a fair proportion of their rent and outgoings, they should do so – if that assessment cannot be undertaken in time, they should reserve their rights to review the contractual position and seek a refund later. If there are concerns about the solvency of a landlord, then tenants may perhaps pay amounts into a solicitor's trust account (or other escrow) pending resolution of the matter as a show of good faith and good financial standing.

Of course, many tenants are in a difficult position and unable to pay. In those circumstances, we are advising tenants to talk openly to their landlords about their situation. We are seeing many landlords prepared to agree to non-payment or deferral in order to support vulnerable tenants. Again, this can potentially be done on a without prejudice basis – buying time for the parties to have a sensible discussion about the permanent solution. However, where a tenant starts from the position that it will not pay, a landlord may be significantly less accommodating.

What should a landlord do if its tenants do not pay rent?

As mentioned above, in almost all cases, there are good arguments a landlord can mount that rent and outgoings (or a proportion of them) should be paid.

In this respect, some media reporting and even some initial legal advice in this area may be problematic, and may have built an unrealistic expectation amongst tenants that a 100% abatement is possible or even to be expected. We have already developed a series of strategies for our landlord clients to employ when dealing with tenants and we expect many tenants will need to adjust their expectations as negotiations play out.

Where possible, we recommend reserving robust legal arguments until needed. In the interim, landlords should be (and most are) reviewing their lease terms and engaging with their tenants to assess how they have been impacted by the Alert Level 4 lockdown, and whether a commercial deal can be struck. Of course, that will not be easy if a tenant has already stated it will not pay rent and outgoings and, in such cases, dialogue will almost certainly be more fraught – and a more legal approach may be needed from the landlord to bring the tenant to the table before open discussions and negotiations can begin.

What if a lease does not provide for abatement?

Regardless of lease terms, many of our landlord clients are keen to find ways to accommodate their tenants and secure their rent roll in the long-term.

Even if a tenant has no right to an abatement under its lease, it may find that its landlord is willing to allow rent to abate, or be deferred. In the medium to long term this is likely to be in everyone's interest. Already we are seeing deals being struck that allow a percentage (40/50%) of rent and outgoings to be paid for a finite period (3 months seems to be the norm). Many landlords are prepared to agree the arrangement as a simple abatement, others are agreeing the unpaid rent will be deferred and amortised over the balance of the lease term. Another option may be to extend the term of the lease, (if possible) increase security provided and/or vary future rent review mechanisms in return for the abatement.

We strongly recommend that tenants open discussions with their landlords, to investigate what options may be available – regardless of the strict legal position.

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