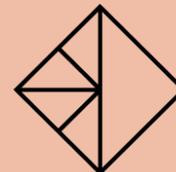


# Commercial lease issues amidst covid-19



## Commercial leases

Never has there been a time of greater scrutiny of commercial lease provisions than now as both landlords and tenants grapple with the impact of COVID-19.

Many tenants are assessing their ability and obligation to meet ongoing rental and operating expense (opex) payments, and the inevitable conversations they may need to be having with their landlords.

Many landlords will have been advised by their tenants that they are either not now paying or only partly paying their rental, or need to renegotiate their ongoing rental and opex obligations in any event based on sheer affordability.

Banks are dealing with requests for financial support from both tenants and landlords and will have an important role to play in supporting parties as the impact of COVID-19 plays itself out for some time to come.

## Key issues

There are both legal and commercial issues arising at this time which parties will need to balance for the go forward. Key issues include:

- The tenants obligation to pay rent and operating expenses during the lockdown
- The tenants entitlement to abatements and for what period
- If an abatement is applicable , what is a "fair proportion"
- What is the impact of the tenant being an "essential service".

These legal issues will in any event be subject to the simple commercial reality of tenant affordability which will be a common theme as parties navigate their way through the above issues.

The answers to each of the above will depend on the specific wording of each lease. There is no one size fits all answer to the above. However for the purpose of commenting on these issues we have focused on the current edition of the ADLS Deed of Lease Sixth Edition (2012)(5) (**ADLS Lease**), given its wide use and general acceptance in the market.



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However many parties will have varied the terms of the ADLS Lease to suit their own circumstances, in which case those variations may well impact any of our comments below which assume no variations to the ADLS Lease template.

## ADLS Lease

The current edition (including some earlier versions) contains a no access provision under clauses 27.5 and 27.6 (“**no access clause**”). The first of those clauses entitles a tenant to have the rental abated during an emergency event and where the tenant is unable to gain access to the premises to fully conduct its business 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 event, including (among other things), any restriction on occupation of the premises by any competent authority.

## What is clear

The following are clear under clause 27.5:

- That an epidemic qualifies as an emergency event;
- The clause is generally applicable in an Alert 4 COVID response lockdown;
- The tenant is entitled to a “fair proportion” abatement of rental and opex until the inability to fully conduct business from the premises ceases.

## What’s not clear

The following are less clear:

- **What is a “fair proportion”** noting this is not defined under the ADLS Lease. The cases where abatement has been considered are very much in the context of partial damage where a tenant can still partially occupy/conduct its business from the premises. It is not clear how relevant the principles established in these cases will be to how “fair proportion” is assessed under the no access clause which has yet to be tested in the courts.
- **Whether 100% abatement is a fair proportion** or whether it is something less than that, and what are the factors relevant to this? For example does the ability of the tenant to work and generate income remotely, count in the context of a clause which is about access and use of the premises, noting that the tenant’s ability to generate income can be due to other and unrelated



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factors? Does the tenant still have some inherent benefit through the storage of the tenant's property in the premises i.e. servers, which continue to function? Signage on the other hand would presumably be less of an inherent advantage during a lockdown.

In regard to opex the level of abatement may depend upon the extent of shared interests which might continue to exist despite the lockdown i.e. having the premises remain insured during this time.

Some of these issues might have been informed in part by which party was best able to insure for the risk and associated loss in the circumstances. However it appears generally that neither loss of rents or business interruption policies, are likely to assist in the circumstance of an epidemic- although each individual policy should be checked.

It remains to be seen what view the courts will take in regard to these factors in assessing a "fair proportion" abatement in these circumstances and the factors affecting that. What we can say however is that these inherent benefit type arguments might well become relevant considerations for assessing what is fair in the future.

- **Whether the no access clause is triggered at an alert 3?**

While on the face of it not considered to date in any depth given the focus on alert 4, tenants might take a closer look at that as we descend back down the alert levels or indeed oscillate between levels 4 and 3. Either way, a clear track of the alert levels and corresponding dates should for now be kept for the purpose of addressing rental abatements during the overall no or limited access period.

- **Whether the no access clause and entitlement to abatement, equally apply where the tenant is an "essential service".** On the one hand you might say that the premises remain accessible and available for use by tenants in this category and the tenant's election not to access and use is not relevant. On the other hand however you might say that a tenant which is an essential service does not necessarily have all parts of its business which are essential and are in any event themselves subject to strict restraints under the Governments COVID-19 alert 4 directives which include working from home if possible, distancing within the work environment and a number of other restraints that must



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inevitably impact an ability to fully conduct business from the premises.

### **What's happening in the market?**

Tenants at this time will be faced with the issue of how they go forward with their landlords, either with the benefit of a no access clause and the inherent uncertainties arising from it, or indeed without it but where affordability is an issue. It will be a time to balance both legal and commercial considerations. Landlords will want to retain their tenants and for the longer term larger leases you might see a more partnering approach between parties to resolve rental abatement issues. Parties are encouraged to open up a discussion around a proposed level of abatement for a specified period of time. Many parties will reach a commercial arrangement which should be recorded in a formal Deed of Variation of Lease to ensure the parties achieve the outcome which they are seeking.

We are seeing a range of positions being taken in the market at this point. These range from some large national/multi-national tenants applying a 100% abatement regardless of whether their lease provides for an abatement or not, but in other cases an agreed sharing of the pain by a 50% abatement of rental but coupled with full payment of opex – the latter suggesting more of a partnering approach governed by commercial/long term relationship considerations rather than a straight application of the legalities. Within that range we are seeing varying degrees of abatements being applied whether unilaterally assessed by the tenant and now disputed by the landlord, or agreed between the parties.

For those tenants subject to lease renewal notice periods impacted by the uncertainty brought about by COVID-19, this should be included as part of the parties discussion with some possible flexibility required around time of the essence renewal notice periods.

### **Government intervention**

Property Council New Zealand has taken some proposals to Government which are currently on the table for consideration, to ease the pressure for both commercial landlords and tenants. To date the Government has not intervened on the treatment of commercial leases and rental obligations, amidst the current lockdown. Should the Government see fit to do so, then a decision could be expected very soon. Landlords and tenants should keep an eye on developments here and any Government announced directives which may assist them. Our comments above are subject to any such directives which might override these – so watch this space!

