

COVID-19 -Commercial Leases

COVID-19 Response Legislation Bill - Commercial Leases

September 2021

INTRODUCTION

The COVID-19 Response (Management Measures) Legislation Bill (**Bill**) was introduced to Parliament on 28 September 2021. In this guide we are focusing on the changes to the Property Law Act 2007 (**PLA**) included in this Bill which impact on the payment of rent during the COVID-19 pandemic. The stated aims of the proposed amendments to the PLA included in the Bill are to:

- support commercial tenants and landlords to come to agreements to adjust the rent (including outgoings) due under their leases, so that the parties share the financial burden of the COVID-19 response; and
- provide a way to resolve disputes if no agreement can be reached.

KEY CHANGES INTRODUCED BY THE BILL

The Bill (when enacted) will amend the PLA to include an implied covenant that a “fair proportion” of the rent otherwise payable by the tenant will **not** be payable for the period where a commercial tenant has been unable to fully conduct their business in their premises as a result of COVID-19 lockdown restrictions.

The landlord and tenant would need to agree on the amount of rent and outgoings that is fair, and if there is a dispute, the parties must take the matter to arbitration under the Arbitration Act 1996, unless they agree to alternative dispute resolution processes such as mediation.

The Bill will come into force retroactively, meaning that its provisions will apply from 28 September 2021, regardless of when the enactment is passed into law.

WHICH LEASES ARE AFFECTED?

The law change will apply to all leases **unless**:

1. the lease already includes a “no access in emergency clause”, such as the “no access” clause 27.5 in the current version of the Auckland District Law Society (**ADLS**) lease; or
2. prior to 28 September 2021, the landlord and tenant have already agreed to vary the rent and outgoings during any rental period covered by the Bill as a result of the COVID-19 pandemic; or
3. the parties to the lease agree that the new law will not apply, but only if:
 - that agreement is made after 28 September 2021; and
 - the agreement is included as an express term of the lease, or by an executed written memorandum between the parties, or, in the

case of an undocumented short-term lease, by express or implied agreement.

WHAT PERIODS ARE COVERED?

The proposed new provisions will apply when there is an “epidemic” (such as COVID-19) and the tenant is “unable to gain access to all or any part of the leased premises to conduct fully their operations in all or any part of the leased premises, because of reasons of health or safety related to the epidemic”.

The Bill is unclear as to which period the abatement for rent and outgoings would apply. The most important date is 28 September 2021, being the start date of the “affected period” and the law changes will come to an end when the Government’s Epidemic Preparedness Notice expires or is revoked. Once triggered, relief is available, not for the whole affected period but, for that part of the “rental period” the premises were leased and were not fully accessible for health and safety reasons related to the epidemic.

One inference to be drawn from this drafting is that where rent is calculated on a monthly basis, the new provisions would apply for any rental due for any lockdown periods which include 28 September 2021 (i.e. September’s rent and outgoings) and beyond, but not for any lockdown periods in August, but this is unclear as neither the Bill nor the PLA provide a definition of “rental period”. We are hopeful that Government will address this drafting gap as the Bill progresses to provide more clarity for landlords and tenants.

The new law will not apply to any previous COVID-19 lockdown periods.

WHAT IS A FAIR PROPORTION?

The Bill is silent on what constitutes a “fair proportion” of rent and outgoings, but for one exception, which is that the matters that the parties will consider must include the taking into account of any rent relief provided between 18 August 2021 and 28 September 2021 because of access restrictions relating to the epidemic. We cannot look to the current ADLS lease for guidance as there is no calculation mechanism in that document, and there are currently no judicial decisions on point. This issue has already caused considerable debate as to which factors should be taken into account.

Earlier Government proposals suggested that factors including the impact on the tenant’s business, the landlord’s mortgage obligations, the parties’ respective profits in recent years, and the parties’ ability to survive financially should all be relevant. However, these elements have not been included in the Bill, meaning that the parties are left to come to an agreement on their own.

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In our article of March 2020 we suggested that the individual circumstances of the building and tenant should be considered when calculating a *fair proportion* in relation to the current ADLS lease and, in our view, these factors remain relevant. For example:

- a warehouse could arguably be treated differently from an office as the warehouse tenant gets the benefit of continuing to be able to store goods but the office tenant cannot continue operating from the office;
- some landlords of retail stores have provided a greater reduction as smaller retail stores often have limited resources to pay rent while they are closed;
- some landlords have agreed to a 50% reduction in rent on the basis that logically any proportion other than 50% means that one party is favoured more than the other which they see (in the absence of any judicial guidance) as unfair. However, at the same time landlords have not wanted to reduce outgoings under the lease as the landlord continues to pay outgoings over any lockdown periods;
- some landlords have assessed the capacity of the tenant to pay and have reduced the rent accordingly - on the basis that it will be likely to be difficult and expensive to replace the tenant; and
- as different parts of the country transition between different alert levels, the precise circumstances surrounding the non-access to the premises and the specific circumstances of the tenant would need to be considered carefully.

WHAT HAPPENS IF AGREEMENT CAN'T BE REACHED?

The Bill provides that any dispute arising under this new clause must be referred to arbitration under the Arbitration Act 1996. This process is likely to be too expensive for many tenants, particularly the most vulnerable, leaving all but the largest tenants with little effective recourse.

It must be noted that a landlord cannot take any enforcement action against a tenant for non-payment of rent during the affected period of the Bill if such action is inconsistent with the rent relief provisions in the Bill. That is, no action can be taken, e.g. issuing a PLA default notice, if the parties have not yet agreed the fair proportion of rent to be abated.

WHAT SHOULD YOU DO?

The key issue for consideration by parties to a lease is whether the specific provisions of the Bill apply to their lease(s) thereby permitting the tenant to claim a rent and outgoings abatement while the premises are temporarily unable to be accessed due to COVID-19.

If agreement cannot be reached between the landlord and tenant on the amount of the abatement or whether the temporary new clause applies to the lease, then the matter will be referred to arbitration, unless the parties agree to a different alternative dispute resolution method such as mediation.

CONCLUSION

The Bill has been referred to a select committee and has not yet been enacted. We will provide further commentary as the Bill progresses and as any amendments are made.

We recommend that lease parties enter into good faith discussions to see if a reasonable resolution can be reached in the circumstances, and take legal advice prior to committing to any lease variation agreement. In this regard, we recommend that the parties are prepared for any such discussions by understanding their respective legal positions beforehand. We can review leasing documents and advise on them accordingly, as well as providing assistance with negotiations as needed.

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