

Commercial Leasing Special Bulletin: The Canterbury Earthquake

We hope that this report finds you and those close to you safe and well.

In a time like this, all parties in commercial situations need to work together to find pragmatic and sensible solutions to pressing problems.

That said, it is also important that parties understand their legal rights and obligations. The purpose of this report is to outline where landlords, in particular, stand under the ADLS Lease of commercial premises. The comments in this report may not apply for landlords who use other forms of leases, or have negotiated bespoke documents with their tenants. Landlords will need to check the terms of their particular lease.

The legal position is only one facet to take into account in the current circumstances. Landlords will need to communicate fully and openly with their tenants, and with their insurers, to ensure that the best outcome is delivered. Hopefully, full utilisation of material damage, loss of rents and business interruption policies will ensure that financial hardship is minimised.

We are pleased that HSBC Tower has fared well, and that the slight damage caused is cosmetic only. The building has been signed off by a structural engineer, and we are in and operating business as usual.

Best regards

The Anthony Harper Property Group



Damage and Destruction – the position under the ADLS Lease

By Tim Barclay, Partner

The most commonly used form of lease for commercial premises in Canterbury is the ADLS Deed of Lease.

Damage to or destruction of premises is dealt with in clauses 26 and 27 of the ADLS Lease, and the wording of those clauses has largely remained consistent throughout the Third, Fourth and Fifth editions of that lease.

Total Destruction / "Untenantable" premises

Clause 26.1 of the ADLS Lease provides that:

If the premises or any portion of the building of which the premises may form part shall be destroyed or so damaged

- (a) *as to render the premises untenantable then the term shall at once terminate; or*
- (b) *in the reasonable opinion of the Landlord as to require demolition or reconstruction, then the Landlord may within 3 months of the date of damage give the Tenant 20 working days notice to terminate and a fair proportion of the rent and outgoings shall cease to be payable as from the date of damage.*

Any termination pursuant to this clause shall be without prejudice to the rights of either party against the other.

The effect of clause 26.1 is that:

- Where a building has clearly been destroyed as a result of the earthquake, the lease will have terminated, as from the time of destruction.
- For buildings that have sustained damage, the key question is whether the premises are "untenantable". It is important to know what that term means. The courts have held that:
 - As the term suggests, premises are "tenantable" if they are able to be used and enjoyed by a tenant.
 - Importantly, in the context of clause 26.1(a) of the ADLS lease, there needs to be some degree of permanence. A transitory or temporary closure will not make a building untenantable.
 - However, where there is a substantial interference with the tenant's ability to enjoy, use and operate the premises then you have "untenantability".

To put this in context, the closure of a building for a relatively short period, until structural analysis of

damage is complete, should not entitle tenants to terminate their leases under clause 26.1.

However, where there is a prolonged period of closure, causing substantial interference to the tenant's use and enjoyment of the premises, then the right to terminate *may* arise. Each situation will turn on its particular circumstances, and the length of the lease and other factors may well play a part.

[Please note that the above analysis relating to untenantable premises is only relevant in the context of commercial leases – the same analysis does not necessarily follow for sales and purchases of damaged residential or commercial properties where "untenantability" is also a key issue]

- It is important to bear in mind that clause 26.1 only applies in the event of destruction of, or damage to, the premises *or the building which houses the premises*. A closure to premises caused solely by damage to an adjacent building would not bring clause 26.1 into play. For instance, if there is a risk of collapse of an adjacent building, which causes prolonged evacuation of the building in which the premises form part (but which is otherwise undamaged), then clause 26.1 would not apply.
- The second limb of clause 26.1 enables a landlord, on determining that the premises require demolition or reconstruction, to give notice terminating the lease within 3 months of the date of damage (so any time up until 4 December 2010 for buildings affected by the initial earthquake). In that case, a fair proportion of the rent and outgoings ceases from the date of damage.
- Any termination of the lease pursuant to clause 26 will not prejudice any claims by either party for prior breaches of the lease, including for unpaid rent and outgoings.

Partial damage or destruction

Where the premises or the building is damaged, but not so as to render the premises untenantable, then clause 27.1 of the ADLS Lease requires the landlord to, with all reasonable speed, use its insurance proceeds to repair/reinstate the premises and/or the building.

In these circumstances:

- The landlord has a reasonable degree of flexibility in the manner of repair or reinstatement, so long as the resulting premises are reasonably adequate for the tenant's occupation and use.
- The requirement for the landlord to use "reasonable speed" will be dependent on the

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circumstances that exist. Landlords should not be prejudiced by the inevitable delays that will occur given the scale of this disaster.

- A fair proportion of the rent and outgoings will cease to be payable from the date of damage. If the premises cannot be occupied at all during this time, then there would be a full abatement of the rent and outgoings. See the further comments below in relation to potential rental abatement
- The landlord is not obliged to spend any more on repairs or reinstatement than the insurance moneys it receives.
- If the insurance proceeds are inadequate to carry out the repairs, or if the landlord cannot obtain any necessary consents or approvals, then the lease terminates. However if that is the case, the tenant may have recourse against the landlord if it has failed to insure to the extent required by the lease.

The obligation to pay rent

Generally, if premises are deemed to be fit for occupation, are undamaged, and the landlord is not otherwise preventing occupation, the tenant will be obliged to pay full rent.

If premises are fit for occupation, but partly damaged, then the tenant could argue for a partial abatement of the rent and outgoings under clause 27 of the ADLS Lease. It should be relatively easy to determine the extent of any abatement which relates to lost amenity, if a part of the premises cannot be occupied. Determining whether an abatement should also apply for parts of the premises which can be occupied, but which may be unsightly (until the damage is fixed) would be more difficult and will depend upon the particular circumstances of each case.

A decision by a tenant not to occupy, due to concerns of its staff for example, should have no bearing on the obligation to pay rent, if the premises are otherwise suitable and available for use and there is no damage triggering an abatement under clauses 26 or 27.

Landlords should communicate that fact to their tenants, in case they are under the mistaken impression that the landlord's loss of rent policy will automatically apply if they choose to stay away. We expect that would not be the case.

Recovery of insurance excess

The Fourth and Fifth Editions of the ADLS lease include insurance excesses (but limited to \$500) within the

standard list of outgoings recoverable from tenants. Unless landlords have removed the \$500 limit, they will wear the cost of insurance excesses over that amount.

And it should be noted that any Third Edition leases still on foot do not include insurance excesses within the standard list of outgoings, so under those leases the landlord will have to pay the entire excess from its own pocket.

Dispute resolution process

The parties may be able to reach an agreement over these issues. If not, the ADLS Lease provides for arbitration of disputes. However, these issues need a quick answer and are unlikely to be suited to arbitration. Parties should consider alternative processes which provide a faster and cheaper decision. For example, the parties could decide to ask for an independent expert to determine the issues, without the need for a formal arbitration process.

Non-standard leases and other lease forms

This article focuses on the standard wording of the ADLS lease provisions. In many cases that standard wording may have been altered. When considering these issues, it will be important to look at the actual lease and any variations to it.

Please also note that this analysis does not apply to other standard leases in existence – the damage and destruction clauses in BOMA/Property Council leases are generally more landlord friendly.

Conclusions

For most landlords and property managers, these are uncharted waters. These issues have certainly never been considered in Canterbury on the same scale as they are being now.

Whatever rights landlords or tenants may have under the lease, the parties need to bear in mind the practicalities of the situation. While there has been increased vacant space available in Christchurch as a result of the recession, that will quickly change.

Any landlords signing up new tenants on a permanent basis, on the tenant's assurance that they have clear rights of termination under their existing lease, would be wise to check that for themselves. Otherwise, they could find themselves with a new tenant facing a hefty damages claim from an aggrieved former landlord (or that landlord's insurer).

We are happy to discuss these issues further with affected parties.

This publication is intended to provide general information and is necessarily brief. The contents of the publication do not constitute legal advice and should not be relied upon as such. Specialist legal advice should be sought before any action is taken in respect of the matters covered in this publication.

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The Property Group

We are excited to introduce the senior members of Anthony Harper's Property Group. As well as having extensive experience in all aspects of property and development projects, each of our senior Property Group members has particular areas of expertise, in which they are leaders in their respective fields.

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- large development and construction projects
- complex subdivisions involving communally held assets or infrastructure (e.g. farm parks, country clubs)
- hotel and tourism developments
- "green" building and leasing issues
- Overseas Investment Act compliance
- large scale greenfields developments
- residential apartment developments
- fractional ownership proposals
- complex due diligence investigations

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