

COMMERCIAL LEASE ISSUES

A lease is a long term contract involving property. Because property is involved, it is not easy to terminate a lease (this follows from the principle that an Englishman's house is his castle so it is not easily taken away).

There are a number of ways a lease can terminate after an earthquake:

Termination by agreement

The landlord and the tenant could agree to terminate the lease. However, before doing this the landlord and tenant should discuss the ramifications with their security holders (banks) and insurers, and where necessary, obtain their approval.

Termination by frustration

The lease could be frustrated. Frustration of a contract (in this case the lease) happens when an intervening event occurs making the performance of the contract so radically different that the parties could not be expected to perform it. The event has to be outside the parties' control and must not be a risk the parties contemplated in the contract.

Frustration of a lease is a very high hurdle so is quite rare. One reason for this is that a lease is a long term contract. So for performance of the contract to be radically different, the intervening event has to have very long term effects. In one case, a tenant could not get access to their premises for a 2 year period out of its 10 year lease because a neighbouring building needed repairs. The English House of Lords found that this was not enough for the lease to be frustrated.

Break out clauses

The lease could contain a break out clause. Break out clauses are commonly included in leases. This is because frustration is such a high hurdle that the parties need something more workable. Break out clauses lower the hurdle so long as the particular event and resulting situation falls within the scope of the break out clause.

ADLS lease

The Auckland District Law Society (ADLS) lease is a common form of commercial lease in Christchurch and this contains a breakout clause.

An ADLS lease will automatically terminate if the premises or the building they are in are damaged by an earthquake making the premises "untenantable".

What does "untenantable" mean?

The case law says that for premises to be untenable:

- (a) the premises must be unfit for use by the tenant for the permitted use under the lease, and
- (b) this status must not be just temporary so that there is a substantial interference with the tenant's ability to use the premises.

This raises the important question of what "temporary" or "substantial" means. Unfortunately, the test for is not clear from the cases. This is no surprise given that "substantiality" type tests are notoriously difficult to apply in real world situations. Unfortunately, this can make it difficult to advise landlords and tenants about what to do.

What we do know is that we need to look at the period of potential reinstatement in the context of the remaining term of the lease. In one case, a period of 3 weeks to reinstate

premises in the context of a 6 year lease term was considered only temporary by the New Zealand Court of Appeal. Therefore, the premises were not untenable.

In a more recent case the New Zealand District Court found that a period of 10 months to reinstate premises in the context of a 4 year lease term (plus a 4 year right of renewal) was more than just temporary and the premises were untenable.

While those cases help to illustrate the point the issue of whether particular premises are "untenable" will be a question of fact in each case. In some situations there will be considerable scope for argument about it. This is particularly so given that the sort of situation we have in Christchurch, with all of its delay and uncertainty, has not been considered by the Courts before.

Where the premises are not untenable but in the landlord's reasonable opinion the premises, or a building of which the premises forms a part, require demolition or reconstruction the landlord may terminate the lease within 3 months of the date the damage occurred. This means landlords should be looking at their buildings and leases as soon as possible as they may inadvertently miss an opportunity to terminate the lease where it is advantageous to do so.

Not all break out clauses are the same

You should always look at the specific wording of the lease to see what the break out clause actually says. For example the Property Council Lease (formerly called the BOMA Lease) is also a common form of lease. The break out clause in it is quite different to the ADLS one and is more favourable to a landlord. For example termination is not automatic. Instead, termination is at the landlord's option under the Property Council Lease.

Breach of lease

A large number of tenants have stopped paying rent on their damaged or inaccessible premises and have leased alternate premises. If the tenant is not entitled to do this the landlord may cancel the lease (so long as the landlord complies with whatever steps are required under the lease and the Property Law Act). If that happens the tenant will be liable for damages which are usually equal to the rent the tenant would have been liable to pay for the rest of the term of the lease (with some adjustments).

Many tenants have been left with little choice but to try and lease alternate premises even though the position on their damaged premises is uncertain. Tenants should try and manage that risk by (a) getting as much information as they can about the condition of their damaged premises and how long it might be before they are fixed (and if this cannot be predicted then why this is so and what the time parameters might be), (b) get good legal advice on the break clause in their lease, (c) get good legal advice on negotiating or discussing the issue with their landlord, (d) factor the risk of being liable for damages into their future business decisions.

Repair or reinstatement

Where the premises are tenantable, despite any damage suffered, the ADLS lease says the landlord must with all reasonable speed, once consents have been obtained, use the insurance money it received to repair or reinstate the premises. If the consents cannot be obtained, or the insurance payment isn't enough to cover the cost of repair or reinstatement, the lease terminates. Again you should always look at the specific wording of the lease to see what the clause actually says. The clause in the Property Council Lease is similar but not identical to the ADLS clause.

Abatement of Rent

Under the ADLS lease rent and outgoings cease to be payable by a fair proportion having regard to the extent of the damage until repair or reinstatement is completed. No rent reduction is available to the tenant under the Property Council Lease unless the landlord re-enters possession of the premises to effect repairs.

In the absence of a lease between landlord and tenant (or where the lease is silent), the Property Law Act governs the relationship. The Act says that, if the premises are destroyed or damaged by an earthquake, then to the extent that they become unfit for occupation by the tenant, the rent or any outgoings will abate, in fair and just proportion to the destruction or damage. Abatement will continue until the premises have been repaired and reinstated and are, again, fit for occupation by the tenant.

What happens if the tenant can't get access because of the cordon?

You need to look at the break out clause (and other clauses in the lease such as the rent abatement clause) to see whether they say the tenant has the right to terminate the lease or stop paying rent because the tenant cannot get access. Unfortunately for tenants, these clauses are unusual in Christchurch. For example, under the ADLS lease and the Property Council Lease, no abatement of rent will be available and the tenant will need to rely on business interruption insurance if that is held.

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