

A new implied term for commercial leases

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1 October 2021

The COVID-19 Response (Management Measures) Legislation Bill (the Bill) seeks to imply a new covenant into commercial leases. The covenant provides that a fair proportion of rent and outgoings shall cease to be payable while a tenant is unable to gain access to its premises as a result of the COVID-19 epidemic. However, it leaves determination of that 'fair proportion' up to agreement between the parties. One of the main reasons for this implied term is to try to better ensure that commercial landlords and tenants share the financial burden of the COVID-19 response, enabling more businesses to remain solvent for the duration of lockdowns necessitated by the COVID-19 epidemic.

Background

On 28 September 2021, the Minister of the COVID-19 Response, the Hon Chris Hipkins, introduced the [COVID-19 Response \(Management Measures\) Legislation Bill](#) to the House. The omnibus Bill aims to assist the Government and New Zealanders to manage, and recover from, the impacts of COVID-19. The Bill passed its first reading under urgency on 29 September 2021 and has been referred to the Finance and Expenditure Committee, with the select committee report due on 14 October 2021.

The Bill includes proposed amendments to various legislation, including the Property Law Act 2007 (PLA). The amendments aim to:

- Support commercial tenants and landlords to agree adjustments to their rent (and outgoings) during any period that landlords/tenants are unable to access their premises due to an epidemic
- Provide a way to resolve disputes if no agreement can be reached.

This will be achieved by implying a covenant to this effect into commercial leases - for those familiar with clause 27.5 of the ADLS (Auckland District Law Society) form of lease, it looks very similar.

New covenant - a fair proportion of rent otherwise payable will cease to be payable

The implied covenant states that a fair proportion of rent (and outgoings) otherwise payable will cease to be payable for the period —

- Starting on the date when—
 - there is an epidemic, and
 - the tenant (or any subtenant), is unable to gain access to all or any part of the premises to conduct fully their operations from all or any part of the premises, because of reasons of health or safety related to the epidemic, and
- Ending when the inability to access the premises ceases.

Application of the implied covenant

The implied covenant will apply **only**:

- To leases that:
 - are in force during the affected period starting on 28 September 2021, and ending on the date on which the Epidemic Preparedness (COVID-19) Notice 2020 is revoked or expires (being the Government order declaring COVID-19 is likely to disrupt essential governmental and business activity in New Zealand significantly), and
 - do not include any 'no access in an emergency clause' that already covers an epidemic. (For example, clause 27.5 of the ADLS lease)
- If, in the relevant rental period:
 - there is an epidemic, and
 - the tenant (or any subtenant) is unable to gain access to all or any part of the premises to conduct fully their operations

because of reasons of health and safety related to the epidemic.

Recognising that parties may have already reached agreement on how their lease should operate in these circumstances (ie restrictions on access due to epidemics), the implied covenant will only apply to the extent that the parties have not, prior to the commencement of the Bill, previously reached such an agreement.

The implied covenant may be negated, varied or extended by the express terms of the lease, or by a variation of lease provided this is done following 28 September 2021. Any pre-existing general exclusions of all implied covenants that were agreed or made before this date will not apply to the new implied covenant.

Agreeing a 'fair proportion'

As set out in our [June 2020 update](#), when this proposal was initially introduced in 2020, the Government released guidance in the form of a Cabinet Minute dated 3 June 2020 (Cabinet Minute). The Cabinet Minute proposed that any legislation enacting the implied covenant should clarify how the parties determine a fair proportion. The Cabinet Minute recommends that the fundamental consideration be the respective financial positions of the landlord, tenant and any other relevant parties. This includes:

- The impact of the COVID-19 restrictions on their respective businesses, including the impact of restrictions that are no longer in place
- Any mortgage obligations relevant to the premises
- Any financial support available to the parties
- Each party's revenue and profit levels in recent years
- Each party's financial ability to survive the effects of COVID-19 restrictions
- Any difference in size and resources between the landlord, the tenant, and any other relevant party
- Any other factor that is reasonably relevant.

However the Bill has not included these clarifications, or provided any guidance as to how the parties will determine a fair proportion, beyond stating:

- The fair proportion will be agreed between landlord and tenant
- The parties must consider whether any relevant agreements (written or verbal) had been reached in respect of the rental period from 18 August 2021 (ie the latest lockdown) onwards in respect of restricted access due to the epidemic.

As always, what is 'fair' will have to be assessed in light of the circumstances, and the factors proposed by the Cabinet Minute will be relevant.

In our experience, landlords often want to work constructively with tenants in discussing possible rent relief, rather than requiring the tenant to pay full rent when they are unable to. Taking this approach, landlords potentially can avoid having to deal with expensive enforcement action and possible default by a tenant (along with empty premises). We expect landlords will become more motivated in this regard under the new Bill - noting that if the implied covenant applies, landlords cannot take enforcement action in respect of recovery of rent, until the parties have agreed a fair proportion.

Disputes

The Bill sets out that any dispute arising under the new implied covenant (ie if the parties cannot agree a fair proportion) will be referred to arbitration under Arbitration Act 1996. However this requirement is not intended to prevent the use of other processes such as mediation or expert determination.

Please get in touch with our [property and construction team](#) should you wish to discuss the Bill and your options.

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