

COMMERCIAL LEASES

Negotiating commercial leases

Certainty vs flexibility

BY MICHELLE HILL

AS I REFLECT BACK ON THIS YEAR, and the issues and challenges presented by Covid-19, the question of certainty versus flexibility when it comes to commercial lease provisions has stood out as we have examined rent abatement provisions and how they should operate during the pandemic.

Our unique commercial leasing framework

We have led the world in many respects with our response to Covid-19. I have been particularly proud of the fact that our most commonly used deed of lease form (ADLS Sixth Edition) already caters for a pandemic situation. I have been examining the responses to Covid-19 in many of the jurisdictions across the globe and it appears that none have standard lease documentation that deals with a pandemic situation as do our most commonly used deeds of lease forms.

There have been a number of key events that have occurred over time which have revealed inadequacies in our standard lease documentation. During my career, the earliest of these was the Auckland power crisis of 1998 when the 5-week long power outage affected central Auckland. Commercial leases at the time did not have provisions dealing with this situation so many standard leases were amended to clarify that the landlord shall not be liable for the cessation of supply of electricity and other consumables.

The devastating and catastrophic Christchurch earthquakes in 2011 again revealed inadequacies in standard lease documentation that



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did not accommodate the scenario that leased premises might not be damaged but could not be accessed due to the cordoned-off red zone. There was an overwhelming number of requests to the ADLS that it amend its lease to cater for the concern that tenants should not have to pay the full rent for premises they could not access. In the 2012 revision of the ADLS Lease, clause 27.5, the 'No Access in Emergency' clause, was drafted into the ADLS lease in direct response to that concern. (There is a similar clause in the PCNZ office and PCNZ retail leases, but it limits the rent suspension to what the landlord can claim under its loss of rent insurance.)

There was great foresight on the part of the ADLS drafting committee as the definition of 'emergency' was very broadly defined so that it applied to not only natural disasters, but also civil emergencies – and hence it specifically includes an 'epidemic' (and, therefore, a pandemic). So too, the reasons for inability to access the premises were broadly described to include not only a physical barrier (such as a cordoned-off red zone) but also non-physical restriction on access where this is imposed by a 'competent authority'. The Health Act Order which was made closing all (commercial) premises other than those operating essential services being such restriction by a competent authority.

Difficulties with flexibility

Although the clause was drafted widely and a pandemic was contemplated as an emergency, the ADLS have indicated that a nationwide lockdown (rather than a restriction to a localised area) was probably not contemplated. Further, although the No Access and Emergency clause has been in the ADLS lease for seven and a half years, it has not been interpreted by the Courts. Accordingly, the vexed question of what is a 'fair proportion' for the rent and outgoings to abate has thrown many a landlord and tenant into dispute.

There was some suggestion that a declaratory judgment be sought from the Courts as to how to interpret a 'fair proportion'. This would have been an expensive thing to obtain and no organisation put their hand up to obtain this. Instead, the New Zealand Law Society's Property Law Section provided some guidance as to some factors that may be considered. But, there is no 'one size fits all'. Each lease and business needs to be considered, and there may be many permutations.

Choosing certainty over flexibility

Generally speaking, when it comes to drafting, you sacrifice certainty for flexibility. For example, use of words such as ‘reasonable’ and ‘fair proportion’ allow flexibility to provide for a myriad of scenarios that cannot be known at the time a lease is drafted – and we have certainly seen that with clause 27.5. However, if what the parties want is certainty then they can have that, but generally speaking that is going to be at the expense of flexibility. For example, by putting some prescription around what is a ‘fair proportion’, the parties may sacrifice the wide ranging flexibility that comes with that term.

When ADLS drafted this revision of the lease, it was decided that a fair proportion would not be defined in the lease by, for example, prescribing percentages. It was recognised that each situation would be different, and it was not workable for a precedent to have universal solution.

ADLS have said that they will take the lessons from Covid-19 into consideration in the current revision of the lease, but given the wide range of different circumstances facing each landlord and tenant relationship, it is unlikely that a prescriptive approach would be taken to ensure that fairness prevails.

I’m finding, in new lease negotiations in our post-Covid environment, that landlords and tenants are opting for certainty over flexibility. And, although it is not realistic to draft a one-size-fits-all for all pro-forma lease documents, this is something that can be easily agreed on a lease by lease basis. For example, they are agreeing now what a ‘fair proportion’ of rent abatement would be, if there are restrictions commensurate with the level 2, 3 and 4 alert levels and most are basing it on a fixed percentage.

There are, however, options for more sophisticated measurements if a flat rate reduction is not palatable. For example:

- pegged to availability of insurance (I am not aware of any insurance policies covering loss suffered from the pandemic but insurance may be applicable for other types of emergency and there may be types of cover available in the future responding to pandemics)
- percentage based on the proportion to which the premises may be used for non-people purposes e.g. storage
- based on reduction in revenue
- rent reduced to cover the landlord’s costs (such as mortgage, rates etc)
- perhaps for retail the measure

should be gross sales with no base rent during an emergency?

Conclusion

Although it is not possible to draft a one size fits all, the parties to a specific lease transaction can tailor an arrangement that best suits their situation and negotiate upfront how the allocation of cost and liability should fall. Knowing the type of premises, and business being conducted, these types of formula are much easier to devise – and parties are much quicker to reach agreement on these matters during the course of negotiations. ■

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