COVID-19 – COMMERCIAL LEASES

Rent defaults where there is a rent bond

BY **MICHELLE HILL** AND **AMY JOHNS**

Michelle Hill

Amy Johns

It has been a testing year for us all, but especially commercial landlords and tenants. Many spent a good period following the first lockdown in March negotiating what a "fair proportion" of rent and outgoings to abate should be, and some have yet to reach an agreement. Matters remain unsettled for others, particularly those where their lease has no right to a rent reduction and have not become entitled to relief due to the changing stance of the Government regarding a mandatory abatement regime. It's clear that many businesses are feeling the Covid-19 pinch and meeting ongoing rent obligations is difficult.

We are yet to see a Covid-19 rent abatement issue in the Courts. However, the recent case of *Knights (New Zealand) Property Holdings Limited v Engel* [2020] NZHC 1116 was heard in the High Court following the first lockdown and does touch on the right to an abatement. It is most useful for property lawyers in providing caselaw on a tenant rent default in circumstances where the landlord is holding a rent bond.

Background facts

The tenant had failed to pay rent on time on seven occasions throughout 2019 and early 2020 (although all but one late payment was remedied within the same month).

The landlord held a rent bond, of approximately six months' rent, to be used if the tenant was more than 10 days in arrears. The lease did not make it mandatory for the landlord to use the rent bond before exercising any remedy relating to the tenant's default. The lease required the tenant to replenish the rent bond, if funds had been taken from it to remedy arrears, within 20 working days of notice.

The landlord chose not to satisfy the rent arrears by using the bond, despite being asked to do so by the tenant. Instead, it issued a notice of intention to cancel the lease and re-entered in December 2019. The tenant continued to pay rent in the early months of 2020 even though the landlord had cancelled the lease.

The tenant sought relief for the wrongful cancellation of the lease. The issue at hand was whether the lease was validly cancelled by the landlord for non-payment of rent given that it could have satisfied the arrears by drawing down funds from the rent bond.

High Court Decision

The Court determined that the landlord was under no obligation to use the rent bond to pay the arrears as the wording of the lease made it clear that this was an entitlement, not an obligation, and did not limit the landlord's rights under the Property Law Act to cancel the lease for non-payment of rent. However, if the landlord had used the rent bond and subsequently served a notice on the tenant to replenish it but failed to do so within 20 days, the landlord could have validly cancelled the lease. The landlord would then still have a cushion of funds available to mitigate its losses until a suitable new tenant was found.

The Court considered the fact that the landlord was holding a deposit bond, but refused to use it, in considering whether relief against cancellation should be granted to the tenant. It also took into account the fact that the tenant continued to pay its monthly instalments of rent after the landlord had purported to cancel the

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lease and regarded this as an act of good faith on the tenant's part. There was nothing to displace the Court's presumption in favour of relief if all arrears were paid up-to-date.

The Court determined that the tenant had a right to raise a claim for rent abatement during the Covid-19 lockdown period but did not provide any guidance as to how this should be quantified.

Commentary

Although potentially a harsh approach taken by the bench, as the Court noted that the landlord was not required to use the deposit bond before exercising its rights, it shows that even a series of late payments of rent may not displace the Court's tendency to grant relief against cancellation and that refusal to grant such relief would be exceptional, even where the tenant has had an abysmal record of late payments.

The COVID-19 Response (Further Management Measures) Legislation Act 2020, which was passed into law on 15 May 2020, has extended the length of time the tenant must be in arrears to 30 working days and the period which the breach must be remedied by has been extended to not less than 30 working days after the date of service of the notice. Accordingly, if the tenant's failure to pay rent on time occurred during the period after 25 March 2020, the extended periods would have applied.

This case illustrates that, if the parties intend that the landlord should first have to draw down on a rent bond to satisfy arrears before taking further action, this needs to be expressly drafted into the lease. ■

Michelle Hill is a Partner at Dentons Kensington Swan in Auckland. This article was written with assistance from **Amy Johns**, a Senior Associate at the firm.

AML/CFT

Legal Sector Regulatory Findings

BY **TE TARI TAIWHENUA | DEPARTMENT OF INTERNAL AFFAIRS**

THIS ARTICLE IS A SUMMARY OF THE Department's findings for the legal sector (law firms and sole practitioners) from its compliance assessments undertaken from January 2019 to January 2020.

Top 5 "compliant" areas

1. Compliance Officer

An area that lawyers are getting right is the compliance officer role. Under the Anti-Money Laundering and Countering Financing of Terrorism Act (the Act), a reporting entity must appoint a compliance officer. This is an important role as the compliance officer is responsible for administering and maintaining the AML/CFT programme.

We check that you have appointed someone to this role and look at whether they are an employee who reports to a senior manager. If you are a sole practitioner, we expect you to be the compliance officer in most situations.

2. Risk-based customer due diligence

Your AML/CFT requirements are "risk-based". This means you must assess the risk your business faces from money launderers and terrorism financiers in a written risk assessment. You must then apply procedures, policies, and controls to effectively manage your risks.

Customer due diligence (CDD), the process by which you understand your customers and understand the ML/TF risks they pose to your business, must also be risk-based. We found that this obligation is understood by the legal sector in its AML/CFT documents.

3. Regard to applicable guidance material

We found that most lawyers have considered guidance material produced by the AML/CFT supervisor and the Financial Intelligence Unit (FIU). This includes the *New Zealand National Risk Assessment of Money Laundering and Terrorism Financing* (November 2019, *www.police.govt.nz*) and the *Designated Non-Financial Businesses and Professions (DNFBPs) and Casinos Sector Risk Assessment* (December 2019, *www.dia.govt.nz*). These documents assist you to understand the types of money laundering or terrorism financing risks your business may face.

When undertaking a compliance review, we check to see if you have considered these documents in your risk assessment and in developing the policies and procedures for your AML/CFT programme.

4. Assessing the risk of your methods of delivery

When undertaking your risk assessment, you must have regard to the methods by which you deliver your products and services to your customers.

We found that the legal sector is sufficiently assessing the risk concerning their methods of delivery. For example, they consider the risks of dealing with customers face-to-face, non-face-to-face, and the use of agents and intermediaries.