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law news for commercial landlords, tenants and property managers

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Acts of God: lessons from Christchurch

In the late 90's, we had the previously unimagined power crisis expose deficiencies in standard commercial leases. This spawned new lease clauses specifically dealing with "continuity of power supply" issues. The recent experience in Christchurch has similarly caused the microscope to be used in studying lease clauses: this time those relating to partial or total damage or destruction of the premises. Are they sufficient to withstand an act of God as we have seen? A High Court case out last month has been timely in giving judicial interpretation of those clauses. This article considers the adequacy of the damage and destruction provisions in our standard commercial leases and looks at the lessons that can be learnt for the negotiation and drafting of leases in the future.

Express lease provisions

The starting point in determining the rights and obligations of landlord and tenant in an act of God situation is the express wording of the relevant lease: this sets out the terms of the commercial bargain agreed by the landlord and tenant as to such matters. The Courts are loath to override the parties' express commercial agreement.

Most leases contain specific clauses regarding the damage or destruction of premises. There is a wide variety of types of such clauses. Each lease needs to be considered on its own terms. Generally, however, leases provide for the scenario of either the total, or partial, destruction of the premises.

Total destruction

In the case of total destruction, most leases provide for the automatic termination of the lease (although some make this optional at the landlord's discretion). In the Auckland District Law Society (ADLS) form of lease, for example, the lease is to automatically terminate if the premises have become "untenantable." It also allows the landlord to terminate the lease if "in the reasonable opinion of the landlord" the premises require "demolition or reconstruction."

Last month's High Court case referred to above, *Russell v Robinson*, gives further meaning to such provisions. In that case, the premises were extensively damaged due to fire caused by the tenant's painting contractor and took 10 months to be reinstated. The landlord gave the tenant notice that, in its opinion, the premises required demolition and reconstruction and therefore that the lease was to terminate. In the same notice, the landlord also asserted that the premises were untenantable.

The Judge considered previous judicial interpretation of what "untenantable" means. This included early English authorities such as *Belcher v McIntosh* (1839).

In that case it was said that "“untenantable” must both import such a state as to repair that the premises might be used not only with safety, but with reasonable comfort, by the class of persons by whom, and for the sort of purposes for which, they were to be occupied."

In *Russell v Robinson*, the tenant in fact wanted the lease to be kept alive (they had entered into a sublease arrangement for which they had envisaged a good income flow). The tenant accordingly argued that premises could not be "untenantable" (and therefore the lease should not come to an end) if there was a willing tenant actually wanting to lease the premises. The Judge rejected that argument. He concluded that the word "untenantable" is an objective state to be determined on the specific relevant facts: if, determined objectively, the premises have become untenantable, then the lease must terminate (despite the tenant wanting to continue to lease them).

"Ideally a tenant would have the right to insist that the lease be kept alive … if this is what it wants. From a landlord's perspective, discretion is key"

So are the standard total destruction provisions adequate? As *Russell v Robinson* illustrates, for a tenant, probably not. Ideally a tenant would have the right to insist that the lease be kept alive, and that the premises be reinstated, if this is what it wants. From a landlord's perspective, discretion is key: ideally a landlord would have the final say as to whether the lease terminates rather than this occurring automatically.

Partial destruction

If there is only partial damage to the premises (and they are still "tenantable") then different lease provisions usually apply. The ADLS lease provides, in such case, that so long as the landlord's insurance money is not going to be refused due to the tenant's fault, and all necessary permits and consents are obtainable, then the landlord must "with all reasonable speed expend all the insurance money ... towards repairing such damage or reinstating the premises the premises."

Are such partial destruction provisions adequate? From a tenant's perspective probably not for the following reasons.

Firstly, they could cause a tenant to be left in limbo while it waits for the landlord to obtain its consent and complete its reinstatement. In the Christchurch example, this could see tenants bound by their leases until they know whether the landlord can in fact repair or reinstate the premises on Council consent terms (which presumably will have a focus on structural work and earthquake strengthening) within the price to be paid out under the landlord's insurance policy.

Secondly, they do not provide any relief for a tenant in a situation where the premises cannot be accessed (for example, if they are in a cordoned off area).

To compound a tenant's situation, there is the possibility that their landlord may seek to charge an "improvements rent" if it can show it is obliged by legislation or other legal or local authority requirement to expend money on the property (although the tenant may be able to argue that such action involves the landlord requiring the tenant to indemnify it against the cost of

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making good destruction or damage to the property which is prohibited under the Property Law Act 2007).

Implied lease provisions

Tenants should also be aware that their rights and remedies outside the express lease provisions, in the face of the damage or destruction of the premises, are limited. Some such rights and remedies include:

- **Quiet enjoyment:** all leases contain a covenant by the landlord (either expressly set out in the lease or otherwise implied by law) that the tenant may enjoy the premises without any interruption or disturbance by the landlord (or any other person lawfully claiming under the landlord). However, for the landlord to be found in breach of this covenant, it must have actually caused the interruption or disturbance; which is not the case in an act of God situation.

- **Frustration:** if a party to a contract can establish that it has been “frustrated” then the parties may be discharged from their obligations under it. Frustration applies where the performance of the contract is radically or fundamentally different from what the parties could have contemplated when entering into it (and as provided in it).

  However, the express total and partial destruction type clauses (referred to above) clearly show that the parties did contemplate such events when entering into the lease. Accordingly, an argument of frustration is unlikely to be successful. A case following the Napier earthquake (*Hawkes Bay Electric-Power Board v Thomas Borthwick & Sons* [1933]), contained an argument by the defendant that earthquakes were not common and not contemplated by the parties and therefore the basis of an argument in frustration. This argument did not find favour by the Court.

- **Right to cancel implied by Property Law Act 2007**: leases which were entered into on or after 1 January 2008 have implied into them, unless expressly excluded, a right for a tenant to terminate the lease if they can no longer use the premises for the specified business use. On the face of it, this could arguably give a tenant a right to terminate the lease if, due to an earthquake or other event, they cannot use the premises for the specified use. However, such argument would need to be advanced with caution: there is not yet any case law supporting such argument and the purpose behind the drafting of the right of termination contemplated the inability to use premises *lawfully* for the permitted use (such as due to town planning changes) rather than in the physical sense.

Summary

From a tenant’s perspective, the Christchurch experience highlights the following:

"It can be very tempting for a tenant with a neglectful landlord to withhold rent until the landlord does what it is required to do …"

- Landlords are often given greater discretion in the ability to cancel, or insist that the lease is kept on foot, than is ideal for tenants. Tenants should seek greater control over the decision as to whether the lease is to terminate or be kept alive.

- Tenants should not be left in limbo, while the landlord seeks to obtain building consents and reinstate, for an indefinite period. Tenants should seek to impose some certainty, for example, by way of a sunset date.

- A tenant should seek an ability to terminate in the broadest situations possible. For example, they should seek a right to terminate (or, at least, have a rent abatement) if the premises can no longer be accessed (for example if they are in a cordoned off area).

From the landlord's perspective, there are two main issues:

- Landlords should seek to have the greatest discretion possible in deciding what to do with their property and the lease. Ideally this would include the option of keeping the lease alive, or terminating it, even upon total destruction.

- In addition to an ability to keep the lease alive (at its discretion) for as long as possible (thus maintaining the rent roll or, at least, an entitlement to it) the landlord may want to ensure that the lease allows it to take out loss of rent cover for a sufficiently long period (say 24 months), with the premium for this recoverable from the tenant as an outgoing.

Christchurch landlords and tenants will no doubt be adopting a pragmatic approach to dealing with their issues at hand. However, as discussed above, the written lease itself will dictate the strict rights and obligations of the parties. Whether those parties wish to rely on those strict rights and obligations is another matter.

Tenants' right to withhold rent or opex

It can be very tempting for a tenant with a neglectful landlord to withhold rent until the landlord does what it is required to do under the lease. In the High Court case *Grant v Hannay* the tenant did just this; because its landlord had failed to attend to necessary maintenance and repairs to the premises.

In the lease, however, the rent was required to be paid "without any deductions or set-off". This is standard wording in commercial leases. It means that the tenant must pay the rent notwithstanding they consider the landlord owes them anything (either a known sum or the performance of any landlord obligation).

The judge accordingly, and not surprisingly, held that the tenant was in the wrong.

However, the "no set-off" regime usually only expressly applies to the payment of rent – and not other money payable by a tenant under the lease. Accordingly, it is arguable that a tenant could

withhold other payments, such as opex, if they can claim a breach by the landlord. Landlords should accordingly ensure their leases contain no right for the tenant to set off against *any* payment when due; and tenants may want to explore exploiting this loophole while they can!

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This paper gives a general overview of the topics covered and is not intended to be relied upon as legal advice.