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Covid-19 – update on commercial legal issues

By Sean Lynch, 17 April 2020

Below are some brief comments on the following topics: Commercial Leases; Employees; Director Duties (conditional relief); Commercial Contracts; Insurance; NZ Courts.

Commercial Leases

- Whether a commercial tenant is entitled to relief from rent and outgoings will depend on the terms of the lease. Each lease needs to be assessed on a case by case basis.
- If the lease is the ADLS 6th edition version, then clause 27.5 (No Access in Emergencies) will assist the tenant – but again each lease needs to be assessed on a case by case basis. This is because even though clause 27.5 is the same clause in each lease version (unless amended by agreement), the clause specifically relates to **the tenant's** ability **to gain access to the premises** to **fully** conduct **its specific business** from **the specific premises** during the applicable emergency period. Different businesses will be different, and different premises and related uses will be different too.
- For example, a café or restaurant business (with no online sales etc) has 100% non-access and non-use during the level 4 alert and the same or very close to that at level 3, whereas a lease to store equipment in an open yard would still be continuing a large portion of the intended use through any level of alert, even though access may be restricted. Also, if a business is an "essential business" but only for a small portion of its services, then if access to the premises is legally restricted for the balance, then that split suggests a workable basis from which a "fair proportion" can be agreed.
- Clause 27.5 does not mandate a 'one size fits all' approach, nor does it mandate a 50/50 sharing of rent or outgoings, nor does it state that landlord costs must be included (the clause solely and specifically relates to 'relief from rent and outgoings'). Many people at present are not actually reading the wording of the clause itself, and instead are deciding to form a view based on what *they think* the words "fair proportion" mean, taken in isolation.
- The words "fair proportion" are clearly intended to work with the words in line one of clause 27.5 which state "*unable to gain access to the premises to fully conduct the tenant's business from the premises*". So, if the particular tenant is able to gain access to the premises to conduct some of the tenants business from the premises, then "fair proportion" should be approached on that basis. However, if the particular tenant is completely unable to gain access to the premises at all to conduct any of the tenant's business from the premises, then "fair proportion" could well be 100% relief in many business tenancy cases. Clause 27.5 does not state that the percentage relief cannot be 100% in that case. Also,

the word “proportion” when read with the words “fully conduct” suggest a split *where there is some right of access for the tenant to use of the premises to conduct the tenant’s business* – but if there is none, then 100% relief is completely possible and in many cases fully justifiable.

- I have read articles from some claiming that the storage of equipment items in itself would provide grounds for the relief portion to be reduced. However, that does not make sense for say a restaurant, or a gym or an entertainment business where ‘access by people’ is <u>everything</u> that drives the revenue of that business and is the core intent of the lease, and the ‘storage of equipment’ is merely incidental in order to achieve that and is a useless component on its own, and was never intended to operate on its own.
- I have read other articles from some claiming that a whole “range of factors need to be assessed” under clause 27.5 (e.g. landlord costs; Government subsidies etc) – when in fact none of that is actually mentioned at all in clause 27.5, and the starting point for contractual interpretation is always *the actual written words agreed to*.
- I have read other articles from some claiming that if a business is able to operate ‘remotely’ then the percentage relief should be far lower, but again, this fails to take into account the key words in clause 27.5 “from the premises” – as well as my next bullet point below. However, a tenant with an “on premise” server may be a slightly different scenario from a tenant without that (i.e. fully in *the Cloud*).
- Many people have also missed the key point being that the two fundamental components of any lease for a tenant are exclusive possession of the premises for the intended use, and quiet enjoyment. The payment of rent is obviously very closely aligned to those two key components. Clause 27.5 is intended to provide the appropriate level of relief where those two core components are affected on an adverse basis for the tenant due to an emergency. If there is 100% no access, no possession and no enjoyment, then the fair proportion seems to fairly align to that.
- The other factor with clause 27.5 is ‘time’. Some landlords are currently trying to ‘force deal terms’ on tenants now but before the rules applying to lockdown-lift become fully known, and before the full impact of that is assessed. Also, if say level 4 endured for only 75% of a given rental period and a tenant’s ‘no access’ and ‘no business’ was 100% during that time, then 25% for that rental period may still be payable depending on the circumstances. So, relief can be 100% for the applicable emergency period whilst a different percentage relief level may apply outside of that.
- Other commercial leases without clause 27.5 would need to be reviewed for possible relief options.
- Parties should approach the issue of rent and outgoings relief on a fair, reasonable and ‘common sense’ basis, and also bear in mind that proceeding to mediation or arbitration would involve further cost, and so the wider economics of the situation need to be considered.
- Any final agreement should be reached in writing, preferably drafted formally by a lawyer to minimise the risk of any related dispute later.
- For many commercial tenants, a bigger issue will be what happens to rent and outgoings payment liability <u>after</u> all alert levels are removed and it’s “business as usual”. In our view, both parties should start a conversation sooner rather than later regarding the various relief options available such as payment deferral schemes linked to either an extended term or ability to repay the deferred component (or a part of it) over time. It will generally be in the

interests of landlords to try to retain tenants and so exploring a lease variation model along these or other lines appears to be a prudent step. Careful legal drafting is required though in order to avoid disputes arising later.

- Temporary changes to the Property Law Act 2007 in terms of lease cancellation times (from 10 working days to 30) has also been suggested as likely coming into effect.
- Note that *force majeure* or contractual frustration arguments are not likely to assist tenants in these current circumstances, but again, each case needs to be assessed on its own facts and applicable lease terms.

Employees

- As widely noted, money derived from the Government's wage subsidy scheme must be applied for the benefit of employees, on a gross basis (before tax), for the required duration, and subject to the other scheme terms which employer recipients agreed to on application.
- Covid-19 has not altered employment law (yet at least). This means that any change to an employee's employment terms needs to be agreed. It also means that businesses may be permitted to undertake business restructuring for forward planning purposes. That could mean redundancies for one or more employees provided that the correct employment law rules and processes are followed, as well as the terms of the Government's wage subsidy scheme (if accepted by an employer).

Director Duties (conditional relief) **& Insolvency Law Changes**

- The Government has announced intended changes to New Zealand's corporate insolvency laws, most significantly to provide directors with a 'safe harbour' from claims against certain insolvency-related directors' duties and allowing companies to "hibernate" debts for up to seven months. However, these relief measures will be subject to certain conditions being fulfilled on a case by case basis by those seeking the relief.
- The '**safe harbour**' relief will likely apply to sections 135 (Reckless Trading) and 136 (Duty in relation to incurring obligations to ensure those obligations can be fulfilled). These sections do not require directors to immediately cease trading when solvency issue arise, but they do require directors to act more cautiously and to place creditor interests at the forefront of their decision making process. If directors fail to act correctly, they can become personally liable.
- Without some specific Covid-19 relief measures, some directors may feel forced to decide to commence more formal insolvency measures sooner (such as liquidation) even though the business may have longer term viability. The Government has stated that it is keen to ensure that businesses with longer term viability survive the Covid-19 crisis and so is trying to strike an appropriate balance with these proposed relief measures, but which will not be permitted to be abused.
- The details of the exact relief are yet to be made public, but we understand that directors' decisions to continue trading or to incur new obligations will not breach the above specific duties / sections if:
    - in the good faith opinion of the directors, the company is facing or is likely to face significant liquidity problems in the next six months as a result of the impact of the Covid-19 pandemic;

- the company was able to pay its debts as they fell due on 31 December 2019; and
- the directors consider in good faith that it is more likely than not that the company will be able to pay its debts as they fall due within 18 months (for example, because trading conditions are likely to improve or they are likely to able to reach some form of arrangement with their creditors).

- In addition to the 'safe harbour' relief, a new temporary business survival scheme, known as the "**Business Debt Hibernation**" scheme, will be available to businesses facing liquidity issues. The scheme will enable qualifying businesses affected by Covid-19 to place existing debts into hibernation for up to seven months, by way of a moratorium on the enforcement of those debts.
- Once again, the details of the exact relief are yet to be made public, but we understand that the key features of the Business Debt Hibernation scheme will be that:
  - it will only be available to businesses that fulfil the required qualifying criteria, likely to be similar to the 'safe harbour' relief;
  - where the required qualifying criteria is fulfilled, businesses may provide notice to their creditors proposing entry into the scheme;
  - once notice is provided, a one-month long moratorium on claims against the business will commence and creditors will have one month to vote on the proposal;
  - if a majority of the creditors (by number and value) vote in favour of the proposal, then the proposal will be approved and a further six month moratorium will be binding on all creditors other than the entity's employees (subject to any conditions agreed with creditors);
  - where a proposal is not approved, businesses will have the range of existing options available (including such as more formal creditor compromises, voluntary administration and, if necessary, liquidation); and
  - to give all parties the required comfort to continue to deal with the debtor company, all payments made by the company to third parties will be exempt from the voidable transactions regime provided the transaction was entered into in good faith by both parties, on arm's length terms and without the intent to deprive the existing creditors of the company.
- We understand that the intent is for the Business Debt Hibernation scheme to be simple, flexible and cost-effective. This provides all parties with certainty, and gives companies and their directors some "breathing room". The debts will remain owing though and so a plan around repayment will be needed to be arrived at reasonably quickly by the debtor company.

Commercial Contracts – continued performance, *force majeure* & contractual frustration

- You may be a buyer, seller, supplier, distributor, agent, licensor, licensee or some other type of party to a contract.
- Whether Covid-19 will affect the terms of your contract can only be assessed on a case by case basis by reviewing all of the contract terms, and by assessing the commercial and legal context, and by assessing whether any form of release of performance liability for any party is legally probable or possible.

- *Force majeure* (French for 'superior strength') in general terms relates to full or partial release from performance liability due to unforeseen circumstances, usually described in a reasonably long list of different types of events (often including 'Acts of God') . *Force majeure* needs to be an express term of the contract, but it could be couched in language not easily detectable. Each contract would need to be assessed. Once found, the issue would then become - how the express words relate to the specific Covid-19 factual and legal issues applicable to that contractual arrangement.
- The doctrine of contractual frustration may apply if factual or legal circumstances arising from Covid-19:
    - make it impossible for one or more parties to perform their obligations under the contract; or
    - make performance of the contract radically different from what the parties originally intended.
- The threshold for 'making out' contractual frustration is high, otherwise parties to contracts would be invoking the doctrine often in an attempt to avoid the obligations they had agreed to. Generally speaking, just because "things have got much harder" under the contract will not be enough – but each case needs to be assessed on its own merits.
- Case law associated with *force majeure* or contractual frustration may need to be researched too. Similar past factual or legal scenarios may give strength to a client's current claim.
- Relief from liability can be total or partial or temporary depending on whether *force majeure* or contractual frustration applies, and depending on the specific circumstances of the case.
- Another contractual point for consideration is the status of contracts which were agreed to before say alert level 3, but which were conditional in some way at that point. If a party purports to cancel the agreement due to one or more of those conditions, then the issue may become whether that party purported to cancel on the correct legal basis, or simply just because of Covid-19 'general uncertainty'. The latter may not be a permitted ground for cancellation in the circumstances. Each case would have to be assessed on its own though.

Insurance

- If your business has business interruption insurance you should notify the insurer right away. It may be though that one or more epidemic type exclusions apply, but that would need to be assessed on a case by case basis. Notification should be made through regardless.

NZ Courts

- Under alert level 4, the Courts process is severely restricted. Virtually all civil claims processes are suspended, and only "necessary' criminal or other cases are being heard. The same applies to the various Tribunals.

If you require any commercial legal assistance, please contact Sean Lynch at sean@lynchandco.co.nz. The above article is not intended as legal advice because each set of circumstances will differ. Specific legal advice is required for any particular case.

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