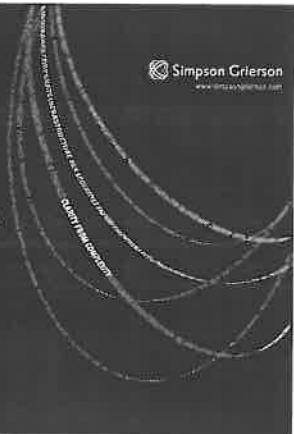
  
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## Termination of Leases on Damage/Destruction and Issues raised by Canterbury Earthquakes

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LAPA Conference 3 November 2011



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## Overview

1. Lease Provisions
  - Total destruction
  - Partial destruction
  - Reinstatement
  - What do you need to do?
2. Claim of Frustration
3. Property Law Act 2007
  - Lessee's right to terminate
  - Insurance Implications
4. Additional Clauses



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## Lease Provisions

### 1. What are your rights under your lease?

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## Extent of Damage

- First Step – Are premises totally or partially damaged / destroyed?
  - Obtain expert assessment



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## Total Destruction - ADLS

- ADLS Lease - Total Destruction - definition of "untenantable" (clause 26.1(a))

*"IF the premises ... shall be destroyed or so damaged*

*(a) as to render the premises untenatable then the term shall at once terminate; or*

*(b) in reasonable opinion of the landlord as to require demolition or reconstruction, then the landlord may within 3 months ... give ... notice to terminate and a fair proportion of the rent and outgoings ... [shall abate]."*

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## Total Destruction - Property Council (BOMA) Lease

- Property Council or BOMA Lease - Clause 7.1 – "unfit for use"

*"IF Premises are destroyed or damaged to such an extent as to be unfit for use or the Building is totally destroyed... this Lease will terminate as from the date of such destruction or damage..."*

- "Unfit for Use" is untested in Courts. Probably same meaning as "untenantable"

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## Total Destruction (cont'd)



- Nature of test applied – objective, not subjective – factors such as:

1. Purpose of Lease
2. Duration of Lease (including renewal terms)
3. Extent of Damage
4. Estimated time of repairs

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## Total Destruction (Case Law)



- *DFC New Zealand Limited v Samson Corporation Limited* (1994) ANZ ConvR 216

*Untenantability* = "Nothing more nor less than [is] able to be used and enjoyed by a tenant. Within that general catalogue of clause 26, subclause (a) involves some degree of permanence. In other words, something which is merely transitory or temporary will not make a building untenable. However, where there is a substantial interference with the tenant's ability to enjoy, use and operate, particularly when one is talking about commercial premises, then you have 'untenantability'."

Fire "guttled" shop. Repairs estimated by assessor to take 3 weeks. In context of a 6 year lease term this is "merely transitory or temporary..."

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## Total Destruction (Case Law)



- *Russell v Robinson* [2011] 2 NZLR 424

- Affirmed definition of *Untenantability* in *DFC New Zealand Limited v Samson Corporation*.

- It is an "objective state to be determined on the specific relevant facts".

- In this case, a fire on the first day of the lease. Extensive Structural damage. Tenant wanted lease to remain on foot. Landlord did not.

- Court found that a 10 month reinstatement period in context of a 4 year lease term (with one right of renewal) was considerably more than "merely transitory or temporary" and did amount to untenability.

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## Total Destruction (Case Law)



- *GP 96 Ltd v FM Custodians Ltd* [CIV-2011-409-627]

- An interim injunction application by tenant preventing mortgagee of Landlord from terminating lease and demolishing building.
- Premises were in red zone. No significant structural damage. With "a minimum amount of cosmetic repair work" the building could be occupied [save for the Red Zone restrictions].
- Renewal terms should not be ignored.
- Uncertainty about length of Red Zone restriction but even if this lasted 7 months in a 16.5 year term, this would not be enough permanence.
- Judge avoided 'commercial chaos' in ruling that the Red Zone issues would result in Untenantability – "very significant implications". Much more comprehensive evidence needed especially as an interim injunction only.

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## Total Destruction (cont'd)



- Denial of use/access (not by the landlord) is insufficient
- Lack of utilities is insufficient
- Degree of permanence required



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## Partial Destruction



- Partial destruction (clause 27 ADLS)

27.1 *"IF* the premises or any portion of the building... shall be damaged but not... to render... untenable and

a) Landlord's policy... not invalidated... and

b) all... necessary permits and consents... obtainable

... Landlord with all reasonable speed expend all... insurance moneys... towards repairing such damage... landlord shall not be liable to expend any sum... greater than the amount... received."

27.3 "Until the completion of... the repairs or reinstatement a fair proportion of... rent and outgoings... cease to be payable... from date of damage."

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## Partial Destruction (cont'd)



### Key outtakes of Clause 27 ADLS

- Landlord to repair provided insurance proceeds sufficient and building / resource consents obtained
- Abatement of rent and outgoings
- Requirement to bring whole building up to code?
- Area / degree of damage / significance

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## Partial Destruction (BOMA)



### BOMA Clause 7

7.2 *"IF the Premises are damaged but not...to be unfit for use...then (subject to the rights of any mortgagees and to the granting of all necessary third party consents)...Landlord will expeditiously expend all insurance money...reinstating the Premises and...carparks...*

*In...event that insurance moneys...insufficient...or third party consents are not available the Term will immediately cease.*

7.4 *After damage or destruction...then a fair proportion of the annual rent...operating expenses and other moneys payable... will be suspended until the completion of the repairs / reinstatement..."*

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## Reinstatement consequences



- Rent Improvements Percentage (clause 21.2)
  - Further ability for the landlord to cancel
    - if unreasonable amount to upgrade
  - Recovery of costs to upgrade building to meet code
- Type of reinstatement to be undertaken (clause 27.2)
  - Materials and form of construction as Landlord thinks fit, sufficient so long as reasonably adequate for Tenant's occupation and use.

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## What do you need to do?

### • Effective date of termination?

- If untenable = date of damage/destruction (ie. it is immediate) (clause 26.1)
- If landlord cannot reinstate due to lack of consents or insufficient insurance = date that situation is ascertained (clause 27.4)

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## What do you need to do?

When deciding if Lease is on foot:

- Act in haste, repent in leisure – possibility of wrongfully repudiating the lease
- Wait and see approach vs certainty
- "Sound out" the other party (without prejudice!) but need to bear in mind the interests of insurers and mortgagees

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## Frustration

### 2. Claim of Frustration



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## Doctrine of Frustration – will it apply?

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### *Steele v Sorepiso* [2007] 1 NZLR 1

Where through no fault of either party, an unforeseen supervening event makes performance of contract impossible or so different from what was intended that contract simply cannot apply to the changed circumstances

- Courts traditionally reluctant to apply it to leases
- Exceptional circumstances only
- Inclusion of "force majeure" clause

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## Property Law Act 2007 (PLA)

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### 3. Implied Lease terms & Insurance Implications



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## Lessee's right to terminate

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- PLA, Clause 10, Schedule 3

#### **Premises unable to be used for particular purpose**

(1) The lessee may terminate the lease, on reasonable notice to the lessor,

if—

(a) it is an express or implied term of the lease that the leased premises may be used for 1 or more specified purposes; and

(b) at any time during the currency of the lease, those premises cannot, or can no longer be, lawfully used for 1 or more of those specified purposes. [underlining added]

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## Implied lease terms in PLA

- Applies to lease entered into after 1 January 2008 - unless contracted out
- More applicable if there is a specific narrow use (eg. cell phone repeater site)
- Perhaps stretches "practically used" into "lawfully used" but if access is lawfully denied this may be possible

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## Insurance Implications

- Effects of sections 268 – 271, Property Law Act 2007
- s269 – lessee indemnified from making good damage to insured premises if insured
- Tenant's liability to landlord for damage caused by tenant's fitout not being properly secured – may have liability
- Need to adequately record insurance liability if seeking to depart from the "norm" under the PLA

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## Moving forward

### 4. Additional Clauses to Consider



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## Moving forward

- Further issues to provide for in lease:
  - Force Majeure
  - No make good on lease expiry
  - No unit title development
  - Minimum delivery of services

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## Any questions?

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