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Alert Level 3 - Implications for Commercial Contracts and Leases

By Andrew Skinner - 17 Apr 2020

The Government has announced that most, but not all, businesses can start to open when we shift to Alert Level 3. The businesses that do open must take health measures to keep their workers safe and workers must work from home if they can. Retail and hospitality businesses can only open for delivery and contactless pre-ordered pick up. Businesses cannot offer services which involve face to face contact or sustained close contact (e.g. hair-dressing).

As the Government starts providing further details on Alert Level 3 and the measures businesses will need to take, there will be fresh scrutiny on business contracts and leases to determine the impact the transition will have. The complete shutdown mandated by Alert Level 4 most likely prevented many non-essential businesses from performing certain obligations under contracts and also triggered the "No Access" clause in the 6th edition of the Auckland District Law Society lease. As we contemplate a move to Alert Level 3, the same business contracts and leases will need to be reviewed again to consider whether the Alert Level 3 restrictions impact a party's ability to perform a contract and whether the No Access clause continues to apply.

The Doctrine of Frustration

A business is sometimes tempted to claim frustration of contract when a contract becomes more difficult or expensive to perform than first envisaged. The reality is that the doctrine of frustration is not often available. Broadly speaking, the doctrine of frustration may apply to release the parties from a contract where the contract is incapable of being performed or performance is impossible as a result of an intervening event not caused by either party. It is not enough that the contract has become more difficult or less beneficial for a party. The Courts have set a high threshold for the doctrine to apply and many factors need to be taken into account, including the

duration of the frustrating event and the length of the contract. The doctrine also does not apply if the contract addresses the risk of the event that has occurred.

The transition from Alert Level 4 to Alert Level 3 may remove some of the restrictions that made performance of a contract impossible making it less likely the doctrine will apply. Some contracts in certain industries may continue to be unable to be performed but businesses need to be very cautious in claiming frustration and must seek legal advice before claiming a contract is at an end.

Force Majeure

It is reasonably common in commercial contracts for the parties to have agreed a force majeure provision, which usually provides that a party's obligations are suspended during any period when an event has occurred that prevents the party from being able to fulfil their obligations (and often a non-exhaustive list of examples of events is outlined).

It is important to understand that the suspension of obligations due to force majeure events is governed by the specific clause in your contract, which means that a careful analysis needs to be undertaken of the types of events covered by the clause and the consequences of those events. The onus will be on the party claiming the force majeure event to prove that the event is covered. If the event is a force majeure event, the party claiming the event of force majeure will normally need to notify the other party and the contract may contain strict notification requirements that need to be met. It is best not to assume that force majeure is obvious or assumed and it is always best to clarify the position with the other party.

If your contract has a force majeure mechanism which applied during Alert Level 4, then you will need to review the clause again to consider whether the mechanism operates during Alert Level 3. There may be much greater scope for differing views between parties as to whether a business is prevented from performing an obligation or whether performing that obligation has just become more difficult.

No Access Clause 27.5 in the 6th Edition of the ADLS Lease

There has been plenty of discussion and analysis on the "No Access" clause but in many respects the application of the clause will only become more difficult as we head towards Alert Level 3. To summarise, the clause is triggered if there is an emergency and the Tenant is unable to gain access to the premises to fully conduct the Tenant's business from the premises because of the emergency, including, amongst other things, any restriction on occupation of the premises by a competent authority.

The difficulty in applying the clause is because it mixes the concepts of access, use and occupation. Whilst under Alert Level 3 many businesses will be able to obtain access to the premises, the restrictions may impact the tenant's ability to fully conduct the business from the

premises. For example, a restaurant with a large seating area may open to provide a delivery or takeaway service, but will not be able to use the seating area. The tenant may argue that as the business cannot be fully conducted due to the Alert Level 3 restrictions, then a fair proportion of the rent and outgoings for the seated area should cease to be payable. Conversely, the landlord may argue that the clause does not apply as the tenant has access to the premises.

Many tenants and landlords had hoped for some assistance from the Government on this issue as we have seen in Australia. However, aside from the proposed changes to the Property Law Act extending the timeframes before landlords can cancel leases, it seems the Government is now largely leaving this matter up to landlords and tenants to agree.

This article is of a general nature and is not intended to be relied upon as legal advice. Please contact Andrew Skinner at Martelli McKegg if you wish to discuss (09 300 7622).

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