

PRACTICAL MATTERS FOR CONSIDERATION DURING COVID-19

During these unprecedented times when we are all working from home, businesses will be looking to save costs where possible. This in turn means that business owners are reviewing their contracts and, in particular, leases and franchise agreements.

What are your options if you are unable to perform your obligations under the lease or franchise agreement?

Force Majeure

Many agreements contain a force majeure clause. By force majeure we mean an event happening beyond your control like an act of God or pandemic. Each force majeure clause may be different, but the effect is the same – it relieves the party that is unable to perform, or is delayed from performing, their obligations under an agreement. In order to be successful in using a force majeure clause you must:

1. Have a triggering event occur. Each clause will detail a variety of triggering events. Some examples include an act of God, a natural event or epidemic or pandemic as mentioned above.
2. The required effect of the triggering event is that you are unable to legally or physically perform your obligations under the agreement.

Both of the above elements must be proven in order to successfully use the force majeure clause to get out of your obligations. What will count as a triggering event will depend on the exact wording of the clause in the document.

Doctrine of Frustration

If there is no force majeure clause in the agreement then the common law doctrine of frustration may assist you.

For the doctrine to apply, you must argue that due to an unforeseen event, it is physically impossible for you to perform your obligations. Accordingly, the agreement is frustrated and automatically terminated.

It is important to note that there is a high burden of proof to apply a force majeure clause or argue that the agreement has been frustrated. You are admitting that there has been a breach of the agreement, but you should not be held responsible for the breach. If successful, you will not be liable for costs (although this once again depends on the particular wording of the clause of the agreement). However, if you are not successful, you will be liable for costs for both yourself and the other party that opposed the application of the clause.

What if you do not have a force majeure clause, or frustration does not apply to you? If it is a lease, you will need to review the terms of your particular lease.

Leases

The Auckland District Law Society (ADLS) lease is used for the majority of premises. The sixth edition contains a no access clause which is clause 27.5. This clause reads as follows:

- “27.5 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 reasons of safety of the public or property or the need to prevent reduce or overcome any hazard, harm or loss that may be associated with the emergency including:*
- (a) a prohibited or restricted access cordon applying to the premises; or*
 - (b) prohibition on the use of the premises pending the completion of structural engineering or other reports and appropriate certifications required by any competent authority that the premises are fit for use; or*
 - (c) restriction on occupation of the premises by any competent authority,*
- then a fair proportion of the rent and outgoings shall cease to be payable for the period commencing on the date when the Tenant became unable to gain access to the premises to fully conduct the Tenant’s business from the premises until the inability ceases.”*

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Clause 27.5 above was included after the Christchurch earthquake occurred in 2011 as tenants of many businesses were physically unable to access their premises.

This clause allows for abatement of rent and outgoings if the tenant is legally or physically unable to access their premises due to safety of public or property or to prevent, reduce or overcome any hazard or harm. The period of rent abatement will start from the time that you cannot access the premises. There is also a non-access period which will be defined in the First Schedule.

Other forms of leases limit the suspension of rent and outgoings to an amount that the landlord is able to recover under its own insurance. Some shopping centre leases penalise tenants for not keeping the premises open during usual centre trading hours. However, given that the centre itself is closed, then the tenant should not be penalised as it is obeying both the directions of the centre management and the New Zealand government.

The tenant's main obligation under the lease is to pay rent and outgoings. Before you decide to stop paying rent, it is advisable to talk to your landlord. Landlords are aware that this is an unprecedented situation, and may be willing to compromise on payments.

Franchise Agreements

Generally, all franchise agreements contain a force majeure clause and can be applied if both elements discussed above are proven. However, if you are a franchisor or franchisee, you must also consider other agreements and issues, and not just the franchise agreement.

Franchisors should do the following:

- Review your franchise agreements, including the force majeure clauses.
- Review and monitor your supplier agreements, employee agreements, insurance policies and other third-party agreements.
- Ascertain if franchisees have adequate stock to operate the business (if applicable). If the stock has to be thrown out, or given away in the case of perishable items, then assist the franchisee in the best way to dispose of these items – for instance donating to a food bank.
- Monitor your employees and franchisees mental health and welfare, and direct employees and franchisees to appropriate sources if necessary.
- Make a plan on how to communicate with franchisees, including keeping franchisees up to date on how the management is handling issues such as royalty payments, negotiating lease rental abatements (if necessary) and other costs associated with the business. You must be open and honest with franchisees.
- Look at government schemes to assist you and advise your franchisees to do the same.

Franchisees should also look at the following issues:

- Review your franchise agreement, including the force majeure clause, employee agreements, insurance policies and other third party agreements.
- Monitor your employees' health and keep them up to date on payments and wages.
- Look at your stock and ensure that you have sufficient stock to run your business (if applicable).
- If you have any financial concerns you should talk to your franchisor without delay, and you should make contingency plans, speak to your bank and apply for government schemes if applicable.

As a part of the good faith obligations in franchise agreements, both parties should keep their lines of communication open and we strongly recommend that both parties speak to each other before trying to enforce any of the provisions of their agreements.

Should you have any further queries please contact either Stewart Germann or Khushbu Sundarji at Stewart Germann Law Office.