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Commercial Landlord-Tenant Issues During the Pandemic



By
**Peter E.
Fisch**



And
**Salvatore
Gogliormella**

After several weeks of restrictive measures implemented to mitigate the effects of the coronavirus (COVID-19) pandemic—including the closure of non-essential businesses and orders to “shelter in place”—business owners are increasingly being required to make difficult decisions in the face of significant liquidity shortfalls. In particular, commercial tenants are weighing the decision to abandon premises they lease or to withhold rent due to their landlords, which decisions raise a number of legal issues. Tenants have considered various legal theories to support rent abatement and lease termination claims, though at this point in the process, many tenants have come to agreement with their landlords on interim relief.

Negotiated Settlements

As a consequence of the substantial, in some cases complete, loss of revenues for many tenants, commercial landlords have generally taken a pragmatic approach, which is also driven by limited access to the courts and a perception that courts will not be sympathetic to any attempt to evict

tenants based on pandemic-related defaults. Another factor for landlords is the belief that it will be quite difficult to replace an existing tenant in this environment.

Many commercial landlords and tenants have agreed to modify the terms of their leases in order to provide short-term relief to tenants, especially those in the retail sector. Among other things, parties have agreed to (i) short-term (e.g., 30-90 day) rent deferrals, with deferred rent to be repaid either in lump sums or in installments with vary-

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ing repayment terms, (ii) short-term rent reductions, (iii) lease extensions coupled with free rent to commence now (so called “blend and extends”), (iv) negotiated lease terminations (often for stipulated sums), and (v) some combination of the foregoing. Landlords typically prefer to defer rent (even if forgiven at a later date) rather than grant an abatement to preserve the landlord’s claim in a bankruptcy of the tenant.

Legal Theories for Lease Terminations and Rent Abatements

In the absence of a negotiated agreement, commercial landlords and tenants should carefully review their leases to determine whether a tenant has the explicit contractual right to terminate its lease or withhold rent. If none exists and the tenant is unable to – or for strategic reasons elects not to – abide by the terms of the lease, the tenant may try to assert a common law defense to non-payment or abandonment.

Cotenancy Provisions. Retail leases (in particular, for shopping centers) may contain cotenancy provisions that, if triggered, permit the tenant to pay a lower rent and in some cases to terminate the lease. A cotenancy clause will usually be triggered by a failure of the overall building or center to meet an agreed occupancy threshold for a specified duration, such as fewer than a designated number of anchor tenants open and operating and/or less than a designated percentage of gross leasable area then open and operating. In many cases the cotenancy trigger allows the tenant to convert to paying percentage rent (i.e., a stated percentage of gross sales) in lieu of the stated base rent in the lease for the duration of the trigger condition. Cotenancy provisions also often permit termination of the lease if

PETER E. FISCH and SALVATORE GOGLIORMELLA are partners at Paul, Weiss, Riffkind, Wharton & Garrison LLP. PETER S. BOROCK, an associate at the firm, assisted in the preparation of this article.

the trigger condition continues for an extended period of time (typically 6-18 months).

Force Majeure Clauses. If a contract contains a force majeure clause, such clause may excuse a party's nonperformance under the contract when extraordinary events prevent such party from fulfilling its contractual obligations. Tenants may try to avail themselves of such clauses, which are commonly included in commercial leases, as a means of excusing non-payment of rent under current circumstances. There are two major caveats to tenants invoking force majeure clauses to abate rent. First, and most importantly, force majeure clauses typically apply only to performance obligations and not to payment obligations. In fact, force majeure clauses in leases often expressly provide that they do not apply to monetary covenants, such as a covenant to pay rent. Second, while the force majeure landscape may be significantly altered as a result of the COVID-19 pandemic, there is generally a high bar for a party to invoke such clauses, which are typically narrowly construed. Courts are reticent to expand the list of covered events that constitute a force majeure beyond those specifically enumerated in a lease. Thus, where a lease's definition of force majeure does not explicitly include epidemics or pandemics, governmental restrictions, or other pertinent circumstances, the tenant may be unsuccessful in invoking a force majeure clause under the current circumstances.

Clauses Concerning Casualty or Condemnation. Commercial leases may permit a tenant to terminate its lease, or provide for an abatement of rent for a period of time, if all or a material portion of the demised premises is damaged in a casualty or is condemned by the government.

While tenants may try to argue that the actual or potential presence of COVID-19

within the demised premises constitutes damage from a casualty, this would represent a significant departure from the typical application of a standard casualty clause. Broader lease provisions that refer to "untenantability" of – rather than physical "damage" to – the leased premises could potentially support a different outcome, but it is far from certain that a tenant would be entitled to terminate its lease under such a provision. In interpreting statutes that allow a tenant (usually in the absence of a casualty provision in the applicable lease) to terminate its lease because a casualty has rendered the premises unfit for occupancy, courts have resisted claims that the presence of an epidemic constitutes adequate grounds for such a termination.¹

Tenants and landlords alike should consider the availability of alternative sources of relief, including insurance policies, potential claims of just compensation for regulatory takings, and federal, state and local programs designed to assist ailing businesses during these trying times.

If a government takes possession of private property in order to use it as (for example) a hospital, a testing site or a distribution center, a displaced tenant may well be permitted under its lease to terminate or to obtain an abatement for the duration of its displacement. In contrast, it is far less clear that a tenant would succeed in arguing that a forced closure or similar action (without acquisition of title or possession) for a public use constitutes a temporary taking of the demised premises for purposes of a condemnation provision. If it were to represent a taking for such purposes,

then the tenant may be entitled to termination or an abatement in this case as well.

Constructive Eviction or Breach of Covenant of Quiet Enjoyment. Tenants may attempt to invoke the common law doctrine of constructive eviction and claim breach of the covenant of quiet enjoyment. In order to avail itself of one of these theories, the tenant must typically show fault on the part of the landlord. The presence of a contagious disease and the imposition of governmental restrictions to combat it are unlikely to be sufficient.

However, a landlord's negligence in addressing the risk of contagion during this pandemic may support a tenant's claim under one of these doctrines. At least one court has expressed a willingness to consider a tenant's right to terminate a lease on the basis that the landlord affirmatively introduced a disease or negligently omitted to take precautions to prevent its spread.² Landlords should thus be mindful of the potential legal implications of failing to take appropriate action to protect the health of tenants during a pandemic.

Unless the applicable lease provides otherwise, a tenant's continuing to operate its business at the premises (although not necessarily its keeping items at the premises) will typically preclude the tenant from claiming constructive eviction or at least create a presumption of tenantability.³ Although it may be possible in some jurisdictions to assert a breach of the covenant of quiet enjoyment while a tenant remains in possession of the premises,⁴ continued operation may well serve to weaken a tenant's case.

Frustration of Purpose. Tenants may also try to invoke the common law doctrine of frustration of purpose in seeking to terminate their leases. If a lease limits the tenant to a particular use (or, in some jurisdictions, if the parties spe-

¹ See 61 A.L.R.2d 1445 (originally published in 1958) (outlining cases in which courts dismissed arguments that scarlet fever epidemics permitted tenants to terminate their leases).

² See *Majestic Hotel Co. v. Eyre*, 65 N.Y.S. 745 (N.Y. App. Div. 1st Dep't 1900).

³ See 2 N.Y. Landlord & Tenant Incl. Summary Proc. §25:28 (5th ed.); 74 N.Y. Jur. 2d Landlord and Tenant § 409.

⁴ See Alexander G. Tselos, *Breach of Quiet Enjoyment Can Constitute Constructive Eviction*, THE LEGAL J. FOR RETAIL REAL ESTATE (Spring 2017)).

cifically contemplated a particular use when they executed the lease), and a subsequent prohibition precludes such use, the tenant may be able to show that the purpose of the lease has been so frustrated that the lease is void or voidable⁵.

Typically, however, a tenant cannot avail itself of this doctrine if the lease permits the tenant to use the demised space for one or more purposes that remain lawful⁶. A tenant will generally be required to show that it would be unreasonable to continue to bind the tenant⁷. In assessing the severity of the hardship that a given restriction would inflict on a tenant, courts have examined, among other things, the anticipated duration of the restriction, any exemptions available to the tenant, and whether the restriction was foreseeable at the time the parties entered into the lease⁸.

Even if some commercial tenants can terminate their leases under this doctrine, it would be a novel application to use this concept to allow tenants to abate rent for the duration of a forced closure without terminating their leases. While crises of this magnitude can lead to changing legal interpretations, tenants should not stop making rental payments on the assumption that this doctrine will permit them to do so without terminating their leases.

Remedies Available To Landlords

In the absence of a negotiated arrangement, some tenants are electing to abandon the leased premises or withhold

rent, either of which typically constitutes a breach of the applicable lease. Depending on the terms of the lease, the tenant may have a cure period, although any cure periods for such breaches are generally short. If a tenant has no notice or cure right or remains in breach beyond the applicable notice or cure period, the landlord may begin to draw down on any security posted with the landlord (usually in the form of a cash security deposit or letter of credit), sue the tenant and/or any guarantor for damages, and/or initiate eviction proceedings.

Limitations on the Exercise of Remedies

As a practical matter, landlords wishing to recover damages or evict tenants may be precluded from doing so under current conditions. Courts across the country have significantly curtailed “non-essential” judicial proceedings⁹. For example, an indefinite suspension of filing new eviction proceedings in New York remains in place¹⁰, and Governor Andrew Cuomo issued an executive order prohibiting the enforcement of residential and commercial evictions and foreclosures at least through June 15, 2020¹¹.

Even in the absence of such policies, the courts’ capacity to hear and process cases brought by landlords may be compromised by shortages of personnel and other resources. The inability of landlords to exercise remedies for a period of time, however, does not affect tenants’ underlying obligations to pay

rent and otherwise comply with their leases, and landlords will at some point be able to enforce their leases through the courts and, in many cases, charge default interest on delinquent payments.

Alternative Sources of Relief

In all events, tenants and landlords alike should consider the availability of alternative sources of relief, including insurance policies, potential claims of just compensation for regulatory takings, and federal, state and local programs designed to assist ailing businesses during these trying times. In particular, eligible tenants should consider seeking loans from the Small Business Administration’s “Paycheck Protection Program,” which permits a portion of funds to be used for rent. (It is anticipated that no more than 25% of loan proceeds may be used for non-payroll purposes, including rent¹²).

Some landlords have conditioned rent relief on the tenant applying for assistance under the relief programs. In any negotiated agreement, landlords should consider making sure that tenants do not “double dip” by obtaining a rent abatement or deferral from the landlord along with governmental relief intended to enable the tenant to make the landlord whole.

There may well be limitations on parties’ ability to recover insurance proceeds based on the existence of a pandemic and/or governmental actions to combat it. For example, policies of business interruption insurance may provide coverage only in the case of physical damage to property by casualty and/or contain specific exclusions for epidemics. Consistent with the advice of the Real Estate Board of New York, however, parties should review their insurance policies to determine what claims might be available to them and promptly notify their insurers of those claims.

⁵ See Restatement (Second) of Property: Landlord & Tenant §§ 9.2, 9.3 (1977, Oct. 2019 update); 74 N.Y. Jur. 2d Landlord & Tenant § 49 (Feb. 2020 update); 1 N.Y. Landlord & Tenant Incl. Summary Proc. § 2:15 (5th ed.).

⁶ See Restatement (Second) of Property: Landlord & Tenant § 9.3; 74 N.Y. Jur. 2d Landlord & Tenant § 49 (Feb. 2020 update).

⁷ See Restatement (Second) of Property: Landlord & Tenant § 9.3.

⁸ See, e.g., *Gardiner Properties v. Samuel Leider & Son*, 111 N.Y.S.2d 88 (N.Y. App. Div. 1st Dep’t 1952); see also 30 Williston on Contracts § 77:96 (4th ed.) (addressing foreseeability).

⁹ See Ryan Tarinelli, New York Court System Plans to Relax Coronavirus Restrictions, Law.com (April 9, 2020 3:22 PM) <https://www.law.com/newyorklawjournal/2020/04/09/new-york-court-system-plans-to-relax-coronavirus-restrictions/>; Chava Gourarie, New York State Halts Evictions and Foreclosures Indefinitely, COMMERCIAL OBSERVER (March 16, 2020), <https://commercialobserver.com/2020/03/new-york-state-halts-evictions-and-foreclosures-indefinitely/>.

¹⁰ (Id.)

¹¹ Executive Order No. 202.8, State of New York Executive Chamber (https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/EO_202.8.pdf).

¹² It is anticipated that no more than 25% of loan proceeds may be used for non-payroll purposes, including rent. See <https://home.treasury.gov/system/files/136/PPP--Fact-Sheet.pdf>.