

CLIENT ALERT

COVID-19 Lease Issues: What You Need to Consider

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The current COVID-19 pandemic has created myriad lease issues for commercial tenants who have closed stores, and are analyzing whether to abate rent during the closure.

Top Level Conclusions:

- Arguments depend on individual lease language, the law of the applicable jurisdiction, and facts relevant to the specific location.
- The tenant argument is basic—the tenant is not getting what it bargained for, which is a tenant space where it can operate its business. A straightforward analogy provides insight: where a supplier contracts to provide ten widgets a month, and can't provide the widgets for one month, even if it is not the supplier's fault, the purchaser does not pay for the ten widgets that were not supplied.
- This argument is consistent with the language of many leases through language that explicitly or implicitly places an obligation on landlord to provide a space in which the tenant can "operate" its business. If a landlord fails to provide such a space, then there is a breach and the tenant is entitled to a variety of remedies. Similar obligations may be placed on the landlord to operate a shopping center or an office building.
- In retail leases, co-tenancy provisions may also provide a basis for at least partial abatement of rent. Some leases provide for an immediate right to pay substitute/co-tenancy rent in the event that co-tenancy occupancy thresholds are not satisfied.
- Many leases have force majeure provisions that need to be examined. Questions to consider are whether the current COVID-19 crisis is within the definition of a force majeure event, and how the force majeure language might impact payment obligations. If there is language limiting the impact of force majeure on the ability to pay, tenants will need to be clear that the impact of the force majeure event is on the failure to provide a space in which tenants can operate their businesses.
- Lease provisions regarding landlord default, condemnation and hazardous materials, among others, also need to be considered.
- Commercial tenants may also have arguments regarding impossibility/frustration of purpose in that tenants are unable to operate their business.

The Key Questions for Tenants:

1. Are landlords in breach of leases?

- Tenants will want to argue there is an obligation on landlords to make space available for tenant to operate its business as described in the leases. The leases should be reviewed for specific language and for an implied obligation.

- Many leases have requirements regarding a landlord's obligation to operate a shopping center or office building more generally (and may require that the building be operated in a first-class manner).
- If the tenant can no longer operate its business consistent with the purpose set out in the lease, tenant can assert that is a material breach of the contract.
 - Facts supporting the tenant might include government orders and the decision of the landlord to close the building.
 - Where tenants are not receiving the benefit of the bargain, they may have rights not to pay rent.
- Other provisions to consider are:
 - Representations and warranties regarding the continuing operation and conditions in the shopping centers and office buildings.
 - Landlord's obligations regarding the common areas.
 - Condemnation provisions.

2. How are retail co-tenancy provisions affected?

- Given the increasing number of store closures, it is likely that co-tenancy thresholds will not be met. This could be an effective argument for rent abatement.
- If substitute rent provisions are based on gross sales, tenant may be able to claim it owes no rent under a co-tenancy provision.
- Tenants should consider:
 - Is the tenant required to be operating to rely on a co-tenancy provision?
 - What is substitute rent? Does the substitute rent replace all forms of rent or just minimum rent?
 - Is the substitute rent immediate, or does it only begin after the co-tenancy threshold has not been met for an extended period?
 - Are there exclusions for closures as a result of force majeure events?

3. How do force majeure clauses come into play?

- Whether the epidemic qualifies as a force majeure event:
 - Dependent on lease language.
 - Force majeure events are typically construed narrowly.
 - Unprecedented nature and governmental actions may weigh in favor.
- Some provisions state that force majeure events do not impact payment obligations.
- Landlords will argue that such language means that tenant cannot use the current situation as a basis not to pay rent.
- Tenants will argue that such language was intended to deal with force majeure events that impact the ability to pay, not situations impacting the physical ability of tenant to operate its business. Tenants will argue that it is the inability to operate its business that is the basis not to pay rent, not the force majeure event.

4. Do the doctrines of impossibility and frustration of purpose excuse rent payments?

- Leases typically identify the use intended for the premises (*i.e.*, retail store).

- Tenants will argue that:
 - With regard to operating a store, performance is impossible (especially in light of government restrictions).
 - With regard to frustration of purpose, the purpose of the lease – to operate a retail store – has been wholly frustrated on a temporary basis.
- There is legal authority that suggests these doctrines may be invoked on a temporary basis.
- These doctrines may be applied narrowly by the courts.

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