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Applying lease terms during the pandemic

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Retail landlords and tenants are scouring their lease documents for potential remedies to their COVID-19 ills. Given the unprecedented and global nature of the crisis, these legal documents provide few clear answers to the questions troubling store operators, property managers, investors, lenders and others with stakes in the retail property market.

SCT contributing editor Matt Hudgins asked two expert lease negotiators, an attorney and a real estate broker, to identify common lease language that may apply to coronavirus-related events. Ryan Rivera, a partner in Hartman Simons in Atlanta, and Brad Umansky, president of Progressive Real Estate Partners in Rancho Cucamonga, California, also suggested points to consider before invoking or responding to the use of those provisions.



What standard lease terms could be interpreted to address a pandemic or government-ordered closure? We are hearing a lot about citing force majeure provisions in order to limit liability because of extraordinary and unforeseeable events.

Rivera: As legal counsel for landlords, we've seen a number of letters from tenants describing COVID-19 as a force majeure event. Some are going a step further, contending the purpose of the lease has been frustrated and that performance under the lease has become impracticable. That touches on a number of legal doctrines — frustration of purpose, commercial impracticability and impossibility — in which a party claims its duties and obligations have become exceptionally and unforeseeably more difficult or impossible to perform as a result of the force majeure.

Umansky: Force majeure is likely the most relevant part of the lease that could apply. However, it's very complicated, and depending on interpretation, it's not clear it's a viable remedy. Ironically, this is a provision that many landlords and tenants ignore when negotiating a lease, as I think many consider it the "legalese" at the back of the lease that will never come into effect.

Rivera: For a lot of local mom-and-pop retailers, that is a fair assessment. They may just accept the boilerplate force majeure language in a lease without looking closely at that provision. On more of a national level, though, both landlords and tenants have generally looked closely at the force majeure clause.

So not every version of that provision will work the same, you mean? How are people attempting to use it?

Rivera: We've seen both landlords and tenants generally describe this pandemic as a force majeure event that relieves operating covenants [and] certain other obligations and extends deadlines for performance. For example, a landlord might have a construction delivery date coming up that it can't meet because the work can't continue during a government closure. The landlord might say the target delivery date should be extended on a day-for-day basis for every day work is delayed as a result of the pandemic. The distinction [between landlord and tenant perspectives] has been the interpretation of force majeure provisions relative to the payment of rent. And there's not a lot of case law out there on force majeure. Even some of the letters that tenants are preparing are just generally referencing these legal doctrines, and they are noting they intend to either abate rent and/or suspend performance under the lease for a period of time. Often, landlords will acknowledge that yes, COVID-19 is a force majeure event that may relieve certain obligations under the lease, such as a continuous operations covenant, so a tenant doesn't have to continuously operate under a landlord- or government-initiated closure. However, many of those landlords are disputing frustration of purpose and commercial impracticability arguments, directing tenants to a common clause in force majeure provisions that provides force majeure doesn't excuse a tenant from the prompt payment of rent or any other payments required under the lease. I can see the arguments from both sides. Force majeure provisions will be ripe for litigation, as tenants interpret the clause one way that may permit suspension of all obligations for a period of time, while a landlord interprets it to permit suspension of certain obligations but not the payment of rent.

What other lease provisions are coming up in relation to COVID-19?

Rivera: We have seen tenants describe this pandemic as a casualty event or a temporary taking by a governing authority. Usually under casualty or condemnation, you'll see an abatement of rent during a period of restoration from casualty or during a period in which the tenant is closed as a result of a temporary taking. I think of casualty as being damaged by fire or another casualty event followed by a period of restoration, though. There's no restoration and no damage to the premises here, so the casualty argument may be a steep hill to climb for tenants. On condemnation, it will depend on how it is worded in the particular lease.

Umansky: Some leases have provisions to address rent, parking fees and other costs in the event of an action that a landlord takes which causes damage to a tenant – for example, causing the tenant to lose electricity due to construction on the site. However, I don't think anything in the vast majority of leases would address the situation we are facing.

Can a tenant terminate its lease or demand a rent reduction in response to a government-mandated store closure?

Umansky: Some might argue that the government's actions could be considered a taking, as if the property is being condemned for public use, but I think a tenant would have a really hard time making this argument. By the time a landlord wins the argument, it would likely be a lose/lose situation. That being said, I do think that if the tenant is insincere or refuses to communicate with a landlord, they could very easily be putting themselves at risk for a future judgment against them.

“This is a case where being right from a legal perspective may just be wrong”



Did we miss other lease provisions people should consider?

Rivera: Tenants will be taking a close look at ongoing co-tenancy requirements in their leases. For tenants whose leases contain ongoing co-tenancy clauses that require a minimum occupancy in the shopping center or named operators that must be open for business and the shopping center has closed down or other tenants closed, tenants may be able to pay [discounted] co-tenancy rent, particularly if the landlord hasn't cured the situation in the time allowed.

Umansky: I believe tenants and owners will likely be wasting a lot of their time and possibly wasting a lot of their money if they are looking to the lease to address this unprecedented situation. The reality is that if one has to rely on the courts to dictate how to remedy this issue, it will be a long time before getting a judgement against the tenant, and recovering the judgement is likely going to be virtually impossible in most cases. I think the best action a landlord or tenant can take in the situation we are facing is to be transparent with each other, be empathetic with the other party, ask for what you really need, compromise and look forward to better times. This is a case where being right from a legal perspective may just be wrong.

Rivera: That's good advice. While some national tenants may have strong arguments to abate or reduce rent, we have found that most landlords have been willing to work with tenants to find a compromise when the tenant has been transparent and acknowledged the landlord is facing its own challenges during this crisis. Some major landlords have proposed 90-day deferrals of rent that tenants would pay next year. They are saying, "Let's cooperate rather than dig into lease provisions and make arguments about responsibility." A lot will come back to whether the landlords' lenders are onboard with it and will permit a deferral of rent payments at this time.

How can landlords and tenants help each other arrive at workable solutions?

Rivera: Landlords that want to get in front of this are telling tenants, “We disagree with your interpretation of the force majeure clause, and we believe you are obligated to pay full rent.” However, recognizing that landlords and tenants are in a partnership, those landlords have been proposing various ways to help retailers survive these next few months. We've seen several landlords agree to defer rent for April and May and in some cases June, with the deferred rent due and payable either at the end of this year or in some cases over the course of 2021, without interest. Particularly for the local tenants, it's that type of relief they are going to need, to be able to survive the next few months while their stores are closed.

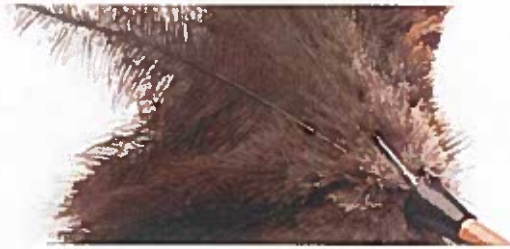
When tenant requests for relief come in, we have clients that immediately respond with a rent relief application that requires the tenant to submit, among other things, evidence showing the tenant has pursued all governmental assistance that might be available, along with details on any assistance received, gross sales and financial statements for the last two years and steps the tenant has taken to adjust its business operations during this pandemic. They are also noting that any sort of financial assistance, rent relief or otherwise, will be contingent on the tenant's disclosure to the landlord of any payment or benefit the tenant receives that is earmarked to defray its rental obligations under the lease.

Loan documents will often require the lender's approval to defer or abate rent, so we're advising landlord clients that plan to provide any type of rent relief to be sure the lender has approved those terms before signing any agreement to modify the monetary obligations under the lease or, alternatively, to incorporate a lender approval contingency into the agreement.

Umansky: I agree that making a mutually beneficial deal is the best path forward. There are a variety of creative ways these agreements can be structured that benefit both the tenant and the landlord. Tenants should be prepared to provide some concessions in return for rent deferral or abatement, such as fulfilling the balance of their lease term without default or waiving certain rights they might have relative to exclusives or

rights of first refusal. Also, if a landlord is dealing with a franchisee, I'd recommend asking what the franchisor is doing to help and that the franchisor is in the loop relative to any assistance provided by the landlord. Furthermore, I'd suggest that both tenants and landlords look carefully at any options to seek relief from the federal programs being set up to address the pandemic as a way of diversifying the pain the country is facing, versus putting it all on individuals or businesses.

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