COVID-19 Is Unlikely To Remove Commercial Rent Obligations

Law360, (May 13, 2020)

Elizabeth Bhappu Kudla

The worldwide COVID-19 pandemic has raised tensions surrounding commercial leases as federal, state and local regulations are forcing tenants to temporarily shutter their business or change the way they operate. This landscape is leading toward a growing trend in tenants asking their landlords for concessions on their lease terms including rent and operating covenants.

Some tenants are mistakenly of the belief that this pandemic is a legal excuse to stop paying their rent or even to validly terminate their leases. In the vast majority of cases, this argument is unlikely to succeed and ultimately could cost the tenant unnecessary litigation fees and landlord goodwill.

Tal Diamant

This article aims to help tenants understand why this COVID-19 pandemic is more than likely not going to serve as an allowable out from rent payments or a lease altogether and, also, will discuss better options for both the landlord and the tenant to navigate this unprecedented situation.

The COVID-19 pandemic and the governmental actions that are being taken as a result are generally not a valid reason to terminate a lease unless there is an express tenant termination right based on a non-landlord-caused prolonged closure event like the current one. The provisions that tenants are most often citing to bolster their termination argument are frustration of purpose/impossibility of performance, casualty, condemnation and constructive eviction.

For a valid claim of impossibility of performance to be brought by the tenant under the lease, the performance under the lease must be objectively impossible and not just financially unfavorable. In most cases, the short duration and scope of these governmental orders make it such that performance under the lease is not objectively impossible.

Certain establishments providing essential services are still able to operate. For the majority of the stores that are required to close, such closure is only temporary and, thus, the tenant will still be able to operate for the majority of the term.

The only potentially valid argument for impossibility is where the lease was signed right before the COVID-19 pandemic and the tenant will have a difficult time building out their space and ramping up business operations when reopening occurs and for a substantial period thereafter. In that specific and limited circumstance, a tenant may have a strong economic reason to terminate the lease.

Some tenants are also stating that governmental closure orders resulting from this

pandemic trigger their termination rights pursuant to the casualty and condemnation provisions under their lease. In the instance of a casualty argument, a COVID-19 temporary closure does not meet the standard definition of casualty.

Traditionally, courts have treated an event as a casualty only if caused by an accident or natural disaster resulting in physical damage without an intervening cause.[1] Most experts agree that the pandemic was not simply caused by accident or natural disaster, but rather by human action.

There are two main issues to consider when determining whether or not lease condemnation provisions would apply.

The first is whether a governmental order actually falls within the government's eminent domain powers. Constitutional scholars have determined that COVID-19-related orders are typically not tantamount to constitutional takings.[2]

Second, pursuant to case law, constitutional takings require that the "regulation permanently deprive [the] property of all value."[3] Thus, a tenant's attempt to exercise a termination right tied to a temporary COVID-19 closure will likely fail.

A constructive eviction claim usually requires the leased premises to be made so unbearable by the landlord that a tenant cannot use the premises for its intended use under the lease. For example, it has been held that a constructive eviction exists where there is no working HVAC and the building temperature reaches almost 90 degrees routinely.[4]

In the context of the COVID-19 pandemic, the argument that the government's temporary actions would give rise to a constructive eviction claim is likely to fail because those actions are not landlord-caused and in most cases last for a small portion of the lease term.

Tenants are also utilizing the COVID-19 pandemic as an excuse to avoid paying rent citing the familiar force majeure, casualty or condemnation provisions as the underlying reason for not paying rent. This analysis is also unlikely to be met with any success.

Force majeure typically excuses the performance of a party's obligation due to acts of God, governmental actions or orders and those events caused beyond the reasonable control of each party, but rarely the obligation to pay rent. The vast majority of leases we have negotiated have an express carveout requiring payment of all rent despite cases of force majeure.

In fact, force majeure may not even be triggered if it was not drafted in such a way so as to include a pandemic or a national emergency. Courts have routinely held that force majeure clauses are to be construed narrowly and have defined an "act of God" as an

"overwhelming, unpreventable event caused exclusively by forces of nature, such as an earthquake, flood, or tornado."[5]

Given these holdings, the COVID-19 pandemic is probably not an act of God as it is not a force of nature like an earthquake, flood or tornado. Depending on how specific the force majeure clause is drafted, if force majeure applies at all, it may excuse the tenant's nonfinancial lease obligations such as a covenant to remain open or engaging in maintenance or other work. It would be difficult for a tenant to successfully cease rent payments based on the force majeure provision.

A tenant would similarly struggle to make a valid argument that they could stop paying rent due to casualty, condemnation or constructive eviction. Based on the above discussion regarding termination claims, since it is unlikely for a tenant to meet the first threshold of proving the elements of casualty, condemnation or constructive eviction succeeding in a rent reduction remedy is as improbable as obtaining a termination remedy.

The tenants' best option is to discuss the issues that they are facing candidly with their landlords with the recognition that landlords want to see their tenants succeed. The more concrete financial background and other related data that tenants can provide to their landlords to explain the tenants' current economic situation, the easier they can reach a mutually workable solution. Many landlords have been willing to offer tenants reasonable options such as rent deferral, reduced rent and waiver of covenants (such as opening requirements) to the extent allowable by landlords' lenders.

Tenants should also utilize the government assistance programs being offered, including without limitation under the CARES Act, during the COVID-19 pandemic to help with payroll, rent and other business-related expenses. The ability of the landlord to offer concessions may ultimately be constrained by the type of assistance the landlord can obtain.

Landlords should also utilize assistance programs including loan assistance from lenders under the Coronavirus Aid, Relief, and Economic Security Act. Section 1110 of the CARES Act greatly expands the Small Business Administration's Economic Injury Disaster Loan program, which allows the SBA to provide loans to small businesses of up to $2 million at a statutorily capped interest rate of 3.75% and a term of up to 30 years.[6]

Further, while no such legislation is in place to date, there has been some discussion of government-mandated rent relief. Some states have already put state-mandated moratoriums on evictions and states could require rent relief for tenants as the COVID-19 situation broadens. As such, landlords and tenants alike should pay attention to the constantly evolving changes the U.S. and state governments are making through executive orders and legislation and seek professional guidance from their attorneys and advisors.

Ultimately, the best choice for both the landlord and the tenant is to proactively work together through the challenges the COVID-19 pandemic is presenting without pursuing costly litigation. Such a unified approach will result in both tenants and landlords emerging from this pandemic with the least disruption and harm possible.

Elizabeth Bhappu Kudla is an associate and Tal Diamant is a shareholder at Brownstein Hyatt Farber Schreck LLP.

[1] See, e.g., Barrow v. Lenox Terrace Dev. Assocs., 79 A.D.3d 457 (1st Dep't 2010); Ji-Jae Corp. v. Agyeman-Duah, 189 Misc. 2d 595 (App. Term 2d Dep't 2001).

[2] https://reason-com.cdn.ampproject.org/c/s/reason.com/2020/03/20/does-the-takings-clause-require-compensation-for-coronavirus-shutdowns/?amp.

[3] Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 535 U.S. 302, 332 (2002); see also id. at 341–42 (nearly three-year moratorium on development imposed to conduct an impact study did not constitute a categorical taking).

[4] Weissbard & Fields, P.C. v. Phenix-Georgetown, Inc., 477 A.2d 215 (1984).

[5] Elavon, Inc. v. Wachovia Bank, Nat. Ass'n, 841 F. Supp. 2d 1298, 1306 (N.D. Ga. 2011) (quoting Black's Law Dictionary (9th ed. 2009). See also, Kel Kim Corp. v. Cent. Mkts., Inc., 70 N.Y.2d 900, 902 (1987) (holding that force majeure defense is narrow and excuses nonperformance "only if the force majeure clause specifically includes the event that actually prevents a party's performance").

[6] See 15 U.S.C. Sec. 636(b).