

ALERTS

Commercial Leasing — Financial Issues Facing Landlords and Tenants Related to COVID-19

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The COVID-19 pandemic has severely disrupted the daily lives of individuals and businesses across the United States as the federal and local governments continue to enact restrictions and preventative measures to stem the tide of infection.

This *Alert* focuses on some of the financial issues facing landlords and tenants in the commercial lease context related to COVID-19, particularly as tenants begin seeking rent abatements and other concessions from landlords as a result of the inability to properly occupy, utilize and enjoy their business premises. Below are some of the approaches that tenants may explore as they look to landlords for rent relief.

Express Contractual Rights

Landlords and tenants should review their lease documents to determine their rights and obligations in light of the specific circumstances leading to the complete or partial discontinuation of business operations and use of the demised space. For example, “force majeure” clauses in commercial leases address improbable events beyond a party’s control, such as the outbreak of war, natural disasters or “acts of God,” that prevent a party from performing its obligations under an agreement. Generally speaking, courts have historically interpreted force majeure provisions narrowly on a case-by case basis and are more apt to excuse a party’s performance if the force majeure clause expressly lists the event that prevents a party’s performance. Therefore, leases should be

reviewed to identify specific terms that would apply to the COVID-19 pandemic such as “epidemic,” “pandemic,” “contagious disease” or “public health emergency.” It is also important to note that even if a force majeure clause contemplates a pandemic or similar event, most force majeure clauses in commercial leases expressly exclude relief from rent payment obligations.

Force majeure provisions may have specific application in particular types of contracts. For more information on some of these specific applications please see the following *SRZ Alerts*: Force Majeure Under New York and Delaware Law (March 19, 2020) (discussing force majeure and other aspects of contract law applying during the COVID-19 global pandemic); Real Estate Deals and Leases — COVID-19 Considerations (March 17, 2020) (discussing “go-dark” and material adverse effect provisions in leases and other real estate agreements); Trading Agreements — Buy-Side Considerations (COVID-19) (March 17, 2020) (discussing force majeure and related provisions in trading agreements, including ISDA master agreements, prime brokerage agreements, master repurchase agreements, futures agreements and FX master agreements); and Business Interruption and Related Insurance for Losses from COVID-19 (March 17, 2020) (outlining business interruption insurance and other insurance related to loss).

Common Law Doctrine

Tenants may seek to rely on the common law doctrine known as “frustration” as a way to gain financial relief. Frustration occurs when an unforeseen event either renders contractual obligations impossible or substantially frustrates a party’s principal purpose for entering into the contract. Given the rarity of pandemics in the United States, there is little legal precedent in connection with pandemic-related lease disputes so, in addition to potential lengthy and costly legal action, it is uncertain whether the COVID-19 outbreak and its adverse impacts would be enough to reach the threshold necessary for a successful frustration claim. However, if government officials take more stringent steps to prevent further spread of the COVID-19 virus (such as prolonged periods of mandated lockdown of citizens or building shutdowns), it is conceivable that courts could grant this unusual relief to tenants.

Landlord Assistance

As losses continue to mount for commercial tenants worldwide as a result of the COVID-19 outbreak, there has been some societal and governmental pressure on landlords to step in and offer financial assistance. Over the past several weeks, some of the largest landlords across Singapore, Hong Kong and Malaysia have responded by offering their retail tenants partial rent abatements of up to 50% for the next several months or, in some cases, for the period affected by COVID-19 government measures. As cities around the United States continue to grapple with potential enactments of further preventative measures that may continue to hinder tenants and their businesses, it remains to be seen whether some of the larger U.S. landlords will follow their international counterparts and proactively step in to offer their tenants some form of rent relief.

Settlement Discussions

While tenants may have limited contractual remedies in seeking rent relief under their leases, it would be prudent for landlords, including for the reasons discussed below, to maintain an open dialogue with their tenants in order to explore an acceptable outcome for each of the parties:

- *Legislation.* Several U.S. cities are in the process of contemplating or passing legislation that would suspend the ability of landlords to evict commercial tenants for up to 12 months. While it remains to be seen whether additional tenant-friendly measures are considered by legislators, landlords would be wise to work with their tenants and come up with creative solutions that would provide some level of financial relief and at the same time allow their tenants to stay in possession on a long-term basis.
- *Replacement Tenants.* Given the current impact of COVID-19 and the uncertainty of when businesses across many cities in the United States will be able to resume normal, healthy operations, even if a landlord were successful in evicting its tenant for failure to pay rent, the costs and potential difficulty for a landlord to procure a replacement tenant will likely prove to be quite challenging.

While the ultimate adverse impact of COVID-19 on the U.S. real estate market remains to be seen, it is likely to be material in the short term and the current legal restrictions and CDC guidelines have created a challenging environment for both landlords and tenants. Parties should

look to avoid lengthy and costly legal action by searching for creative alternative solutions that can benefit both parties in the long term.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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