

March 24, 2020

## **Abandonment of Leases and Abatement of Rent During the Coronavirus Pandemic**

The coronavirus (COVID-19) pandemic has significantly affected the ability of businesses across the United States to continue to operate in the ordinary course. In recent days, state and local governments across the United States have instituted increasingly restrictive measures, including the closure of non-essential businesses and even orders to “shelter in place,” in an effort to limit the disease’s spread.<sup>1</sup> The existence of these restrictions and a host of changing market conditions pose a real threat to the liquidity and profitability of many businesses, and are forcing business owners to make difficult decisions. Retailers across the country have begun trimming their hours of operation or closing their stores entirely.<sup>2</sup> We have seen companies lay off large portions of their work force in order to cut costs.<sup>3</sup> Tenants are also weighing the decision to abandon premises they lease or to withhold rent due to their landlords. This memorandum highlights certain actions that commercial tenants suffering hardship as a result of the COVID-19 pandemic should consider taking, as well as certain factors they should take into account in doing so.

### **Practical Courses of Action**

Commercial tenants affected by the pandemic should closely review the terms of their leases – and consider the applicability of remedies that may be available to them under statutory provisions and common law doctrines – in order to determine whether they can terminate their leases (if it makes sense to do so) or seek rent abatements.

After analyzing their rights, tenants should strongly consider reaching out to their landlords and attempting to negotiate appropriate arrangements in light of the circumstances. Especially in instances in which the landlord is predisposed to keep the lease in place and the tenant is experiencing or at risk of severe economic distress, the landlord may well be receptive to such discussions. Many tenants have already begun exploring

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<sup>1</sup> See, e.g., Coronavirus Live Updates: One After Another, States Are Ordering Residents to Mostly Stay Indoors, N.Y. TIMES (March 20, 2020 5:47 PM), <https://www.nytimes.com/2020/03/20/world/coronavirus-news-usa-world.html>; Alexei Koseff, Coronavirus Order: Gov. Gavin Newsom Tells Californians To Stay at Home, SAN FRANCISCO CHRONICLE (March 19, 2020 7:08PM), <https://www.sfchronicle.com/politics/article/Coronavirus-order-Gov-Gavin-Newsom-tells-15144649.php>.

<sup>2</sup> See Kyle Tyko, Coronavirus Store Closures, Changes: See Which Retailers Are Closed or Changing Hours, USA TODAY (March 19, 2020 3:58AM), <https://www.usatoday.com/story/money/2020/03/17/coronavirus-store-closings-hours-changes-list/5068211002/>.

<sup>3</sup> See, e.g., <https://www.businessinsider.com/hospitality-layoffs-danny-meyer-ushg-lays-off-80-percent-workforce-2020-3>.

options with their landlords. Among other things, parties have discussed reductions in the rent owed by tenants (often for a specified period of time or on an indefinite basis until operations resume), deferrals of tenants' obligations to pay their rent (again, for specified periods or indefinitely pending the resumption of operations), and termination of the leases (often for a stipulated sum).

In the absence of a negotiated arrangement, tenants intending to assert – based on one or more of the theories outlined below – that they are entitled to terminate their leases, or receive abatements of their rent, should promptly notify their landlords of those claims. They may want to continue to pay in full the rent provided for in their leases, and then seek refunds of rent based on those claims. Tenants that are unable to – or elect for strategic purposes not to – pay rent on a current basis may be able to escape remedial action by landlords in the short term (to the extent landlords are disinclined to enforce remedies or courts are unavailable or unwilling to grant relief). Tenant should understand, however, that they may fail in any future attempt to terminate their leases or secure abatements and may be liable (along with their guarantors) for delinquent rent and interest thereon.

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. 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.<sup>4</sup>

### **Remedies Available to Landlords**

The abandonment of leased premises or the failure to pay rent would typically constitute 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

<sup>4</sup> The Real Estate Board of New York has advised its members to notify all of their insurers (including insurers under property, business interruption, environmental and pollution, general liability, and directors and officers insurance policies) of any business interruption losses related to COVID-19, and has suggested using language like the following for these purposes: "As a result of the March 12, 2020 Declaration of a State of Emergency issued by the Mayor of the City of New York and subsequent Declarations of Emergency by the Governor of New York State and President of the United States, the cumulative restrictions and prohibitions resulting from these Declarations, the presence of the COVID-19 virus, and other potential impairment to persons and property, your insured, \_\_\_\_\_, has sustained a covered loss. Please kindly accept this communication as notice under the above-referenced policy issued to \_\_\_\_\_ and any other policies in place that might provide coverage."

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 temporarily or indefinitely suspended judicial proceedings that are not deemed essential.<sup>5</sup> For example, an indefinite suspension of all eviction proceedings and pending eviction orders in New York State became effective on Monday, March 16, 2020, and Governor Andrew Cuomo announced at a press conference days later that a moratorium on all evictions in New York State would remain in effect for 90 days.<sup>6</sup> 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.

### **Legal Theories for Lease Terminations and Rent Abatements**

Commercial tenants may seek termination of their leases, or abatements of their rent, in connection with the pandemic, based on a number of potential legal theories, including (i) decreases in the operations of co-tenants; (ii) force majeure; (iii) casualty, condemnation or deprivation of services; (iv) constructive eviction or breach of the covenant of quiet enjoyment; and (v) frustration of purpose.

### **The Language of the Lease Governs**

As an initial step, commercial tenants and landlords should carefully review their leases to determine whether a tenant has the explicit contractual right to terminate its lease or withhold rent as a result of a forced closure or other relevant circumstances. Most leases provide that rent is to be paid without setoff,

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<sup>5</sup> See Jacob Gershman & Byron Tau, Coronavirus Disrupts U.S. Court System, WALL ST. J. (March 17, 2020 7:40 AM), <https://www.wsj.com/articles/coronavirus-disrupts-u-s-court-system-11584445222>; 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/>.

<sup>6</sup> See Memorandum from Judge Lawrence K. Marks, Chief Administrative Judge, dated March 15, 2020; Rebecca Baird-Remba, Cuomo Orders Nonessential Workers To Stay Home, Suspends Evictions, COMMERCIAL OBSERVER (March 20, 2020), <https://commercialobserver.com/2020/03/cuomo-coronavirus-measures-workers-stay-home-evictions-suspended/>.

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counterclaim or defense. Leases sometimes provide for termination or abatement under very limited circumstances, such as a casualty or condemnation or a landlord's failure to provide bargained-for services.

### **Cotenancy Provisions**

Retail leases (in particular, for shopping centers and regional malls) may contain cotenancy provisions that are premised on the notion that the value of the leasehold is dependent on retail traffic to the center, and retail traffic is often driven by the level and nature of occupancy of the center. These cotenancy provisions, 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 the failure to meet an agreed occupancy threshold, 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. Some of these clauses will have further conditions (such as the tenant in question continuing to operate, and the absence of a tenant default) and will typically have some requirement that the trigger condition has continued for an agreed duration before the tenant has any remedy. 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. The cotenancy provisions also often permit termination of the lease if the trigger condition continues for an extended period of time (typically 6-18 months).

### **Force Majeure Clauses**

As outlined in our March 16 Memorandum,<sup>7</sup> if a contract contains a force majeure clause, such clause can 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 the current circumstances. There are two major caveats to tenants invoking force majeure clauses to abate rent, however. First, and most importantly, force majeure clauses typically apply only to performance obligations which are expressly stated to be subject to force majeure, and not to lease obligations generally. In fact, force majeure clauses 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 based on them.

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<sup>7</sup> <https://www.paulweiss.com/practices/litigation/litigation/publications/update-force-majeure-under-the-coronavirus-covid-19-pandemic?id=30881>.

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### **Clauses Concerning Casualty, Condemnation or Deprivation of Services**

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 or if the landlord fails to provide specified services to the tenant.

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.<sup>8</sup>

If a government takes possession of private property in order to use it as (say) 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) by a governmental authority 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.

While many leases require landlords to provide certain services, those leases vary widely in addressing landlords’ failures to provide them. Tenants often waive any right to terminate or any claim of abatement if the landlords’ failures result from causes beyond the landlords’ control. Other leases specifically provide for abatements, regardless of the cause of the landlords’ failures.

### **Constructive Eviction or Breach of Covenant of Quiet Enjoyment**

Especially in instances in which leases are silent with respect to the topics discussed above, tenants may try to look outside the four corners of their leases and invoke the common law doctrine of constructive eviction or claim breach of the implied 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.<sup>9</sup> The presence of a contagious disease and

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<sup>8</sup> 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).

<sup>9</sup> See Milton R. Friedman, *Friedman on Leases* §§ 29.201 at 1468l; 29.301 at 1479, 1489 (3rd ed.).

the imposition of governmental restrictions to combat it are unlikely to be sufficient in themselves.<sup>10</sup> 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.<sup>11</sup> 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.<sup>12</sup> 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,<sup>13</sup> 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 specifically 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 voidable.<sup>14</sup> Typically, however, a tenant cannot avail itself of this doctrine (even though certain uses become unlawful during the term) if the lease permits the tenant to use the demised space for one or more purposes that remain lawful.<sup>15</sup> For example, restaurants in New York City (which, as of the date of this memorandum, are permitted to deliver food or sell takeout but not to have customers dine on the premises)

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<sup>10</sup> *Id.*

<sup>11</sup> See *Majestic Hotel Co. v. Eyre*, 65 N.Y.S. 745 (N.Y. App. Div. 1<sup>st</sup> Dep't 1900) ("We doubt not that if the landlord was guilty of affirmative negligence, or negligently suffered acts to be done by which a contagious disease was introduced into a thickly populated hotel or tenement house, or upon the breaking out of a contagious disease upon the premises, he, retaining and exercising a general control over the public parts of the house, should negligently omit to take precautions to prevent the spread of the epidemic, or otherwise to protect the tenants from contagion when the means lay within his power so to do, a case might be made which would avail as a justification for the surrender of the premises.").

<sup>12</sup> See 2 N.Y. Landlord & Tenant Incl. Summary Proc. § 25:28 (5th ed.); 74 N.Y. Jur. 2d Landlord and Tenant § 409.

<sup>13</sup> See Alexander G. Tselos, Breach of Quiet Enjoyment Can Constitute Constructive Eviction, THE LEGAL J. FOR RETAIL REAL ESTATE (Spring 2017).

<sup>14</sup> 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.).

<sup>15</sup> See Restatement (Second) of Property: Landlord & Tenant § 9.3; 74 N.Y. Jur. 2d Landlord & Tenant § 49 (Feb. 2020 update).

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will likely be unable to terminate their leases under this theory. A tenant will generally be required to show that it would be unreasonable to continue to bind the tenant.<sup>16</sup> 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 lease.<sup>17</sup>

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.

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<sup>16</sup> See Restatement (Second) of Property: Landlord & Tenant § 9.3.

<sup>17</sup> See, e.g., *Gardiner Properties v. Samuel Leider & Son*, 111 N.Y.S.2d 88 (N.Y. App. Div. 1<sup>st</sup> Dep't 1952) (holding that an indefinite prohibition imposed an emergency presidential order would frustrate the purpose of a 99-year lease so long as the tenant sought and was denied an exemption); see also 30 Williston on Contracts § 77:96 (4th ed.) (addressing foreseeability).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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