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Commercial Leases Changing Day by Day During COVID-19 Crisis

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As state and local governments issue orders restricting business operations due to the COVID-19 outbreak, commercial landlords and tenants have many questions about the effects of these government restrictions on their leases. Although the situation is rapidly changing, this alert addresses common issues that are arising regarding commercial leases.

Is the COVID-19 outbreak considered a force majeure?

Whether the COVID-19 outbreak triggers a force majeure clause depends on the wording of the lease. Broadly worded provisions (such as "any event outside of the reasonable control of a party") may be too vague to be enforceable, as courts construe force majeure clauses narrowly.

What happens when the force majeure provision is triggered depends on the language of the lease. Generally, however, when such a clause is triggered in response to a government shutdown order, the landlord's obligation to grant access to and maintain the premises would likely be excused. Conversely, the tenant likely would not be considered to have abandoned the premises under the terms of the lease. Typically, the payment of rent is specifically addressed in force majeure clauses and is not suspended during the time of force majeure, though one of the effects of this pandemic may be that this aspect of the customary force majeure clause changes going forward. The allocation of risk in the force majeure clause may provide evidence of the parties' intentions and impact the application of common law principles, as the common law will always yield to the parties' agreement. For further analysis of how force majeure clauses impact contracts, please see these other articles on the Pepper Hamilton/Troutman Sanders COVID-19 Resource Center (available at: https://covid19.pepperlaw.com): "Your Contracts in a Coronavirus World" (available at: https://www.pepperlaw.com/publications/your-contracts-in-a-coronavirus-world-2020-03-16/) and "Is Coronavirus Infecting Your Commercial Contracts? Excusing and Enforcing Performance Amidst Worldwide Uncertainties." (available at: https://www.troutman.com/insights/is-coronavirus-infecting-your-commercial-contracts-excusing-and-enforcing-performance-amidst-worldwide-uncertainties.html)

In addition to force majeure, what arguments are tenants making to excuse their performance under commercial leases?

In the absence of a provision allocating risk of loss to the landlord or the tenant, tenants are asserting common law arguments based on impracticability (or impossibility) of contractual performance and frustration of contractual purpose. In addition, some tenants are asserting that the government restrictions act as a condemnation under the lease.

Impracticability and Frustration of Purpose

Generally, impracticability and frustration of purpose are construed narrowly and are highly fact-dependent. Impracticability excuses the performance of contractual duties when there is (1) an unexpected occurrence of an intervening act, (2) that was of such a character that its nonoccurrence was a basic assumption of the agreement of the parties, and (3) the occurrence of that intervening act made performance impossible, or at least commercially impracticable.

For example, the Pennsylvania Supreme Court has held, where a property was destroyed by fire, payment of rent by the tenant was excused under the theory of impossibility of performance. *Albert M. Greenfield & Co. v. Kolea*, 380 A.2d 758, 760 (Pa. 1977). Courts may use this type of holding as guidance for when the property is truly unavailable due to the COVID-19 pandemic or government-ordered shutdowns.

Relevant to government restrictions on business activities, impracticability can arise when the performance of a duty is made impracticable due to the requirements of a governmental order. *See* Restatement (Second) of Contracts § 264.

A similar doctrine, frustration of purpose, is also frequently being employed. It applies when a substantial purpose of the contract has been frustrated. Similar to impracticability, frustration of purpose applies when (1) the purpose was a substantial purpose of the contract, (2) the frustration is substantial, and (3) the nonoccurrence of the frustrating event must have been a basic assumption on which the contract was made. Issues regarding frustration of purpose are most applicable when there is a specific and identified permitted use in the lease or the intended use of the leased space is readily identifiable by the nature of the property that is being leased.

For both of these arguments, a party must act in good faith. Thus, if there are exemptions or other exceptions that would allow the business to continue operating, they must be pursued in good faith. Impracticability and frustration of purpose are not triggered by a change in market demand or financial condition, but rather the inability to conduct the activities or pursue the purpose that was the basic assumption of the landlord and the tenant.

If impracticability or frustration of purpose can be successfully applied, the next question is what is the appropriate remedy? Although termination is the often-cited remedy, abatement of rent may be more likely depending on the length of the impracticability or the frustrated purpose. When the impracticability of the contractual duty or the frustration of the contractual purpose is temporary, it is likely that these arguments would only serve to temporarily suspend the obligation to perform during the period of frustration (and afterward if the temporary issue makes performance afterward substantially more burdensome). *See* Restatement (Second) of Contracts § 269.

Condemnation Clauses

Tenants are also considering whether condemnation clauses in commercial leases may allow termination of the lease or rent abatement. Condemnation clauses generally provide that, if the leased premises is taken for any public or quasi-public purpose, the lease terminates or rent is abated for the portion of the leased premises that is condemned.

Although condemnation may seem like an attractive argument to terminate a lease when a government prohibits operations or restricts access to the property, it is unlikely to succeed because there is no transfer or acquisition of title (as there is under a traditional condemnation). Instead, in our situation with COVID-19, the state is temporarily exercising its police power to restrict activities for health and safety purposes. In addition, in a typical condemnation scenario, the landlord and sometimes a tenant receives compensation from the government for the acquisition of the property. If the condemnation clause is drafted broadly (which is rare), it could be argued that there is a temporary regulatory taking that triggers the remedies of the condemnation provision in the lease.

Can a landlord exercise self-help remedies (meaning evicting or locking out a tenant for failure to perform its lease obligations)?

The ability of a landlord to evict a tenant during the COVID-19 outbreak may be impacted by executive or judicial orders issued in response to the pandemic. Many courts have closed or otherwise limited operations. *See, e.g.*, New York Executive Order 202.8 (available at: https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/EO_202.8.pdf) (suspending residential and commercial evictions for 90 days); Delaware Justice of the Peace Standing Order (available at: https://courts.delaware.gov/forms/download.aspx?id=120318) Dated March 13, 2020 (suspending summary eviction proceedings); California Executive Order N-28-20 (available at: https://www.gov.ca.gov/wp-content/uploads/2020/03/3.16.20-Executive-Order.pdf) (authorizing local governments to suspend commercial and residential evictions for nonpayment of rent).

In the absence of eviction proceedings, many landlords may wonder if they can use self-help methods to evict or lock out tenants who fail to make rent payments. Generally, the law disfavors self-help. For example, in Pennsylvania, case law holds that, when the tenant is in possession of the premises, the landlord's self-help remedies are extremely limited, if not outright eliminated, and the landlord is required to pursue remedies under the Landlord and Tenant Act, 68 P.S. 250.101, *et. seq. See, e.g., Williams v. Kusnair's Bar & Tavern*, 288 Fed. App'x. 847, 850 (3d Cir. 2008) (citing cases for the proposition that self-help remedies by a landlord have been eliminated completely in Pennsylvania); *Spinks v. Equity Residential Briarwood Apartments*, 171 Cal. App. 4th 1004, 1038 (2009) ("Landlords thus may enforce their rights only by judicial process, not by self-help."); *1414 Holdings, LLC v. BMS-PSO, LLC,* 116 A.D.3d 641, 643 (App. Div. 1st Dept.) (self-help allowed for commercial leases only if expressly permitted under the lease). This applies equally to landlords for commercial tenants. *Lansaw v. Zokaites* (*In re Lansaw*), 2015 Bankr. LEXIS 106 (Bankr. W.D. PA. 2015) (citing *2401 Pennsylvania Ave. Corp. v. Southland Corp.*, 344 A.2d 582 (Pa. Super. 1975) (courts to apply Landlord and Tenant Act to a commercial lease)).

Thus, self-help measures, such as changing locks or removing tenant property, may expose a landlord to civil damages, and a landlord should carefully consider and seek legal advice before acting.

Demand for Cleaning and Quiet Enjoyment

Cleaning issues are likely to take center stage after the outbreak ends and business restrictions are lifted. Even if not expressly provided for in the lease or demanded by the tenant, landlords should take reasonable steps to maintain the property during and after the outbreak, following CDC guidelines (available at: https://www.cdc.gov/coronavirus/2019-ncov/community/organizations/cleaning-disinfection.html) for proper cleaning and disinfection.

Failing to maintain the property or failing to take appropriate steps to clean the property and prevent the spread of disease may be grounds for a breach of the common law right of quiet enjoyment or for constructive eviction. *See Sears, Roebuck & Co. v. 69th St. Retail Mall, L.P.*, 126 A.3d 959, 969 (Pa. Super. 2015) (upholding jury verdict for constructive eviction and breach of duty of quiet enjoyment when landlord allowed property to fall into severe disrepair, including rat infestation). Constructive eviction is a high bar, but issues related to the pandemic will provide opportunities for the development of case law applicable to our current circumstances.

As the length of business shutdowns grow, so will the scope and magnitude of issues that landlords and tenants need to navigate. The most effective method for dealing with the effects of the COVID-19 outbreak is for landlords and tenants to proactively communicate and avoid making rash decisions. Landlords may want to advise tenants of government loan programs, such as Economic Disaster Impact Loans (available at: https://www.pepperlaw.com/publications/eligibility-for-sbas-emergency-loan-program-for-businesses-impacted-by-covid-19-2020-03-20/) available from the U.S. Small Business Administration, which are available to many areas affected by the COVID-19 outbreak. Creating open channels of communication between landlords and tenants is important, especially under our current circumstances because this is a dynamic situation that may look very different (for better or worse) in a short period of time.