

COVID-19: Issues Impacting Commercial Leases

The COVID-19 pandemic has impacted all aspects of life, restricting mobility and forcing federal, state and local governments to implement increasingly aggressive measures to curtail the spread of the virus. We have set forth below just some of the pertinent issues to consider. Although we have focused on New York law, these issues apply to leases generally. All companies' needs are different and we are committed to helping you address the legal and operational challenges affecting your business.

Force Majeure, Frustration of Purpose, and Impossibility of Performance

- Under present New York case law, *force majeure* clauses are construed narrowly, such that, unless the *force majeure* provision includes a specific reference to "epidemics," "disease," or comparably specific terms, a party relying on a presumed *force majeure* exception will face an uphill battle, which will depend in large part on the language of the lease.
- Moreover, while *force majeure* clauses may excuse certain tenant obligations, typically such clauses do not apply to a tenant's obligation to pay rent.
- Tenants may attempt to assert two common law defenses: "frustration of purpose" and "impossibility of performance." However, these concepts, which sound so promising, are judicially construed even more narrowly than *force majeure* claims (particularly impossibility of performance) and rarely come to trial as a result. But the unique economic disruption caused by the pandemic may present opportunities to revisit these doctrines.

Landlord's/Tenant's Work

- Where a landlord has not yet permitted or completed tenant improvement work or landlord work, relevant issues include:
 - Whether the lease provides for tenant remedies if the landlord has not completed its work by an outside date, including additional free rent or a tenant's right to terminate.
 - Whether such outside date is subject to extension and whether there are limits to such extension.
- Similarly, where tenants negotiated for free rent with the expectation that they would be able to complete their own fit-out and open for business by a particular date, we expect to see comparable claims as well as requests for rent forbearance.

Insurance

- Insurance policies should be carefully reviewed to determine whether any applicable coverage may exist.
- However, some business interruption insurance policies contain an "Exclusion for Loss Due to Virus Or Bacteria," which limits coverage for "loss or damage caused by or resulting from any virus . . . that induces or is capable of

inducing physical distress, illness or disease.”

- In response to these kinds of exclusions and unprecedented losses, federal and state insurance regulators may attempt to apportion such losses more broadly via new regulations and insurance and reinsurance programs (as was also the case in the post-9/11 era).
- For example, the State of New Jersey has moved to compel state-licensed insurance carriers to drop all exclusions relating to “virus” or related business interruption exceptions.

Rent Abatement Rights

- Leases should be reviewed to determine whether any rent abatement rights exist because of (1) the inability of a tenant to access or use its premises, or any common or amenity areas, (2) the landlord’s failure to perform services, and (3) the inability of a tenant to timely complete any planned tenant’s work (as discussed above).

Default

- If a tenant is considering or threatening a default, its lease should be reviewed to confirm notice and cure periods, and assess the parties’ respective rights, remedies, and defenses.
- It should be ascertained whether any guaranties of lease obligations exist, and whether or not there exist any security deposits.
- Eviction proceedings and orders in New York State have been suspended indefinitely; it is unclear whether landlords may file new eviction cases.

Condemnation/Eminent Domain

- Leases should be reviewed to determine whether there is any applicability of condemnation and eminent domain provisions to the COVID-19 pandemic and resulting governmental closures and restrictions on civilian movement.
- Casualty clauses typically address physical damage to a building, rather than the inability to access or use space (whether or not as a result of express governmental order).
- Regulatory takings claims could be asserted by either party but eminent domain provisions typically address a taking of all or a portion of the physical real estate, as opposed to takings based on governmental restrictions on access and use.
- Such claims may be difficult to value and allocate between the parties as a result.

Operational Issues

- Both landlords and tenants must deal with potentially affected employees in a humane and legally permissible manner.
- Providing additional cleaning and upgrading building systems (e.g., HVAC) will result in increased costs, which

may or may not be recoverable through operating expense or capital expenditure pass-throughs.

- Alleged non-compliance with cleaning standards issued by applicable governmental authorities, whether by Landlord or Tenant, may become a point of contention.

Many landlords and tenants may seek to be proactive in voluntarily negotiating modifications of their leases to address the impact of COVID-19. Our firm has substantial experience in negotiating lease work-outs for both landlords and tenants during many prior market downturns and crises. We are available to assist you through these challenging times. Each day, new developments and governmental actions change the issues to be discussed or reviewed. As facts change during the coming weeks and months, we hope to provide additional guidance.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

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