Real Estate Lessons Learned from Covid-19: A Review of Recent Precedent on Lease Clauses

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As every commercial landlord or tenant is doubtless aware, the Covid-19 pandemic and resulting business closures wreaked havoc on the commercial leasing realm, impacting just about every tenant's ability to conduct business, generate revenue, and pay rent. Amidst the wreckage, a coast-to-coast legal battle has raged from the beginning of the economic shutdown and continuing through this day and beyond, as to one central question: Should the landlord or the tenant absorb the costs of a global pandemic that nobody anticipated? Everyday lease provisions contemplate and manage certain common *risks* – the risk of fire, utility outage, even that a government entity condemns a portion of the property. Nobody anticipated Covid-19, and few built the risk of a virtual economic standstill into their leases.

The Reality of Force Majeure

Grasping for any lease guidance on this question, landlords, tenants and counsel headed straight for the *force majeure* clause. This clause contemplates remote risks such as war, rebellion, an act of God, and yes, even pandemic. Still, virtually every incarnation of such language provides that no such drastic event would forgive the payment of rent by the tenant to a landlord. So, in trying to provide clarity and comfort going forward, landlords, tenants, and counsel could make sure that "pandemic" and "government-ordered shutdown" are included in every *force majeure* clause from this day on, but no landlord is likely to agree to excuse rent for these causes, any more than they were previously willing to excuse rent for a nuclear calamity. However, several issues emerging from the pandemic provide insight that review and careful negotiation of other standard lease provisions—provisions that should have required close attention all along—can help manage lingering Covid-19 and future pandemic risks.

Lease Guaranty Provisions

A recent case in New York highlights the importance of lease guaranty provisions. Many business owners may not want to give a personal guaranty of their entity's lease. Yet, many landlords will require a guaranty because a tenant LLC or corporation could close operations and leave rent obligations unpaid. In 135 E. 57th St., LLC v. Saks Inc., a case involving Saks Fifth Avenue, the retailer argued that not only should its tenant affiliate be excused from performance under government shutdown conditions, but the Saks corporate parent, as guarantor, should also be off the hook. The Court disagreed as to the guarantor, ruling that any eviction moratorium applied only to the tenant and not the enforcement of a corporate guaranty. The lesson learned is that it may always be best to negotiate a guaranty to control where the guarantor's liability may be different or deeper than that of the tenant. For example, a lease could include a "good-guy" clause where the guarantor is released from liability as long as the tenant surrenders the space with the rent paid to date.

Continuous Operations Clause

Another common lease clause that carries implications for a pandemic or government-shutdown conditions is the continuous operation clause. This language, most common in the retail setting, requires that the tenant open for business and remain open on a steady basis, without, for example, closing a store or restaurant for a vacation period. Clearly, this

lease requirement was front and center where the conduct of many retail businesses became difficult or impossible amid government shutdowns, but courts in the Covid-19 era have not been unanimous as to what is required to constitute the legal defenses of "frustration of purpose" or "impossibility." While the continuous operation requirement, unlike the payment of rent, would arguably be excused under *force majeure* conditions, careful lease drafting should specify what extraordinary conditions would excuse the tenant from continuous operation.

Permitted Use Clause

Finally, the Covid-19 emergency has highlighted the need to carefully review the permitted use clause in every lease. In most cases, the tenant's counsel should be working to expand the definition of permitted use of the space. The expansion of the definition of permitted use could help protect the tenant from a claim of lease violation. For example, a clause that only provides "office use" could leave the tenant susceptible for hosting a conference that is not a specifically enumerated use. However, as mentioned, courts have not been uniform in determining the impact of government shutdown orders on tenant operations, with some holding a restaurant's ability to conduct curbside or take-out business meant that the tenant's "use" of the restaurant premises was not impossible. Alternatively, a Massachusetts court held that the inability to host patrons for sit-down service made a "café" use substantially impossible. In Newbury v. Caffe Nero Americas Inc. the tenant and its counsel may be happy that they did not go further in expanding the definition of "permitted use."

The Covid-19 pandemic illustrates that it is crucial for landlords, tenants, and counsel to craft a permitted use clause, and other routine lease clauses, with as much precision as possible.