TENANT COVID-19 DEFENSES. WHERE DO WE STAND?

Author(s): John D. Fairbrook

For most of 2020, the COVID-19 pandemic has caused shutdowns across the country and the world, dramatically affecting most businesses. And, although vaccines are now being distributed, all predictions are that the financial stress on both landlords and tenants will continue throughout 2021 until the economy can fully recover. There are, of course, predictions that the move to online purchasing will cause many retailers to close permanently. In our firm last year, tenant bankruptcy matters have increased 150% year-over-year, and lease dispute matters have increased 60% in the same time period, and we expect those numbers to increase more in 2021. The reason that tenant lease dispute matters have not been significantly greater is due to the slowdown of the courts and local bans on commercial tenant evictions.

While landlords and struggling tenants are regularly negotiating lease amendments to get through the pandemic, many tenants and guarantors, large and small, including national tenants like The Gap, Starbucks, Victoria's Secret and Hugo Boss, with the ability to pay are refusing to meet their obligations and using the pandemic as an excuse. Attorneys for the tenants and the guarantors are using three traditional defenses to attempt to avoid their obligations, force majeure, impossibility of performance, and frustration of purpose, all of which are legitimate defenses, but none of which have ever been analyzed before in light of a pandemic. Now that there have been hundreds of cases filed, here is a brief summary of how those defenses are being asserted and used in landlord-tenant/guarantor litigation.

Force Majeure

Most commercial leases contain what is known as a "force majeure" clause. In simple terms, a force majeure clause allocates the risks of events which are beyond the parties' control, usually

excluding the inability to pay rent as a force majeure event. Force majeure provisions in commercial leases can vary dramatically from lease to lease, and may excuse or delay the performance of contractual obligations by either the landlord or the tenant. By way of example, typical force majeure events can include labor strikes, lack of materials, delays by governmental agencies, natural disasters and "acts of God." In rare cases (we've only heard of a few), some force majeure clauses may even identify pandemics as a force majeure event. Whether the COVID-19 pandemic and associated public health orders constitute a force majeure event will depend largely on the specific language in the force majeure provision. No California court has yet to rule on the applicability of a force majeure provision to the COVID-19 pandemic and the associated public health orders. Depending on the language of the lease, even the existence of a force majeure event may not operate as a defense. Importantly, force majeure provisions often exclude certain performance obligations of a tenant from the application of a force majeure provision. For instance, commercial leases typically provide that a force majeure event will not excuse or otherwise abate the tenant's obligation to pay rent under the lease.

For a tenant to successfully use a force majeure clause as a defense to performance, the event must fall within the category of events specifically enumerated in the clause or in fact be unforeseeable at the time that the parties entered into the contract. In addition to establishing that a particular event falls within the force majeure provisions of the lease, a tenant must also prove that the force majeure event was the cause of the tenant's inability to perform. In most cases, the fact that a tenant's business has suffered an economic hardship will not, in and of itself, support a force majeure defense.

Impossibility of Performance

One commonly argued defense is that performance was impossible. The defense of impossibility has its roots in the common law but is also codified in California Civil Code Section 1511, which provides that performance of an obligation may be excused in whole, or in part, if the performance "is prevented or delayed by an irresistible, superhuman cause, or by the act of public enemies of this state or of the United States, unless the parties have expressly agreed to the contrary;..." Importantly, however, the mere fact that a tenant's performance has become more difficult, more expensive or less profitable will generally not support the defense of impossibility. The impossibility of performance must relate to the contractual obligation to be performed and not a tenant's ability or inability to perform. One California court observed that "the impossibility must be in the nature of the thing to be done, and not in the inability of the

promisor to do it." By way of example, a tenant's obligation to pay rent would likely not be found to be impossible as the result of the COVID-19 pandemic. However, a tenant forced to close its doors due to a government order might be excused from the obligation to keep its business open due to the impossibility of performance. Where the impossibility is only temporary, the contractual obligation may be suspended during the duration of the impossibility.

Frustration of Purpose

Another common law defense is "frustration of purpose." This defense may be asserted when the performance of a contract may be technically possible, but the object or purpose of the contract has been destroyed. Significantly, to avoid continuing lease obligations on the basis of frustration of purpose, a tenant would have to establish that the value of the lease has been completely destroyed. This might occur if the premises are destroyed or rendered unfit for any purpose. Although each situation must be evaluated on a case by case basis, it may be difficult for a tenant to argue that public health orders stemming from the COVID-19 pandemic destroyed the entire value of the lease. Many businesses were only temporarily closed, and many were able to operate with certain restrictions. The fact that the tenants' revenues and/or profits were reduced generally will not support the defense of frustration of purpose. The California Supreme Court noted "… laws or other governmental acts that make performance unprofitable or more difficult or expensive do not excuse the duty to perform a contractual obligation…" Even where a business is required to close, many commercial leases give a tenant the right to sublease the premises to another tenant. A tenant who has the right to sublease the premises may find it difficult to argue that the complete economic value of the lease has been destroyed.

It has now been ten months since the onset of the pandemic and its economic impacts and associated government regulations continue to severely effect commercial landlords and their tenants. While that seems like a long time for some of the questions surrounding all of these defenses to be determined, the fact is that the courts have been greatly slowed by the pandemic and, realistically in "court time," we probably won't have definitive answers (appellate court decisions) whether any of the foregoing defenses will work until the pandemic is over. In the meantime, landlords and tenants will be negotiating the "pandemic clause" in all new leases drafted hereafter as a standard provision.

Trainor Fairbrook's leasing and property management attorneys are available to assist landlords in responding to COVID-19 disputes and other lease issues.

[1] *Lloyd v. Murphy* (1944) 25 Cal.2d 48.