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Rights, Remedies and Responsibilities: Navigating COVID's Impact on Landlords and Tenants

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October 13, 2020

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Lease Formation

- Original Lease
 - Final negotiated version properly signed
 - Signed in correct corporate capacities
 - Dated/commencement date is clear
 - Guaranty signed/dated
 - Retain original in file
- Modifications/Assignments
 - Fully executed-same parties, same capacities
 - Guarantors sign Modification
 - Retain original in file
- COVID Concerns



Lease Defaults/Force Majeure/COVID Issues

- Monetary v. Non-Monetary – in general, Courts treat differently
- Lease will define Defaults
- Provide proper notice of Default (strict compliance); review force majeure provision
 - Proper notice address
 - Identify the default
 - Provide proper time to cure
 - Delivery of notice - method
 - Who gets notice
 - Guarantors
 - Lenders



Force Majeure (French, For “Superior Force”) Provisions

- Intended to protect parties from having continuing obligations after the occurrence and during the continuance of certain described events that were unforeseeable and beyond such party’s control.
- Triggering events can include strikes or labor troubles, unforeseen governmental restrictions and limitations, war and acts of God.
- A vast majority of states construe the language included within force majeure provisions according to their plain meaning.
- Some states narrowly construe force majeure provisions and exclude certain situations from applicability if they are not specifically included as an event that prevents a party’s performance (such as language as to epidemics, pandemics and COVID-19).



Force Majeure (Cont'd)

- If a force majeure provision does not contain “catchall” language (i.e., “...other events beyond a party’s reasonable control”), NY and CA courts limit force majeure application to what is specifically set forth in the provision.
- Non-performing parties must prove that the specific event was (a) unforeseeable; (b) a direct cause of the party’s inability to perform; and (c) there are no alternative methods to complete performance under the contract.
- Texas courts, unlike NY and CA courts, do not require the demonstration of “reasonable diligence” to avoid disruption unless it is specifically detailed in the lease and do not require the event to be unforeseeable. “Reasonable diligence” is defined by the Texas Supreme Court as “such diligence that an ordinarily prudent and diligent person would exercise with similar circumstances.”



Force Majeure (Cont'd)

- While force majeure may excuse performance in certain crises, they often provide that a party's financial obligations (i.e., payment of rent) are not excused.
- Further, because inability to make payments (such as rent) is not an unforeseeable event at the time of construction of the contract and is within the control of the contracting parties, a party's inability to pay alone does not constitute force majeure.
- If force majeure does apply, however, a tenant wishing to use the force majeure provision to their benefit must be aware of any required notice to be provided to landlord.



Force Majeure (Cont'd)

- If a lease force majeure provision contemplates governmental orders excusing tenant's obligation to perform its duty to repair upon request from landlord within a certain time frame, tenant's performance will generally be excused until the orders have been lifted.
- To successfully argue application of a force majeure provision to the excused performance of the obligation to pay rent in court, reference must be made to the specific negotiated language within the document.



What if There Is No Force Majeure Clause?

- Force majeure clauses supersede common law doctrines of impossibility, impracticability and frustration of purpose, which are defenses to the performance of the covenants under a contract; some tenants using as affirmative argument to excuse performance.
- The subtle differences between each doctrine hinge on the ability of the performing party to continue with performance, given the circumstances at the time of execution of the contract.
- In each situation, the performance of the contract is no longer possible, the performance is still possible but significantly more difficult, or the reason for entering into the contract has become moot due to factors outside of the control of the contracting parties.



Impossibility of Performance

- Limited to the occurrence of an act of God, or by a limitation by law that could not have been anticipated or protected against when creating the contract
- Inability to perform is **objective** – must consist in the nature of the thing to be done and not in the inability of the particular obligor to do it
- Must prove it was **objectively impossible**, not just more difficult
- Unforeseen interferences in the supply chain or demand for products typically fall short



Impracticability & Frustration of Purpose

- Impracticability is the theory that a contract is created with specific circumstances in mind, and that basic assumptions of the world in which the contract was to be performed were thereafter upset by a contingency, the nonexistence of which was a basic assumption of the contract.
- Similarly, frustration of purpose is based upon the theory that there was a basic assumption of the absence of the frustrating event at the time of entering into the contract.
- Will depend on the state, and the particular lease provisions.
- California courts have held that performance of a contract is excused when an 1) unforeseeable event 2) outside of the parties' control 3) renders performance impossible or impracticable.”
- Frustration of purpose is an effective alternative to impracticability or impossibility as the business purpose of the agreement may have been voided during a mandated governmental shutdown.
- If term of lease is very short, and term of lease is disrupted, chance of prevailing on these defenses is increased.



Constructive Eviction (Due to Breach of Covenant of Quiet Enjoyment)

- Majority of courts find that constructive eviction is a landlord's act or failure to act that substantially interferes with or permanently deprives a tenant from using its leased premises.
- Requires that the landlord cause the interference with tenant's right to use and quiet enjoyment of the leased premises.
- Tenant should utilize if landlord voluntarily shuts down their building, no matter if for benevolent or malicious reason.
- Tenant must provide notice to landlord, and must abandon and vacate within a reasonable time after landlord fails to remedy.



Remedies for Default

- Protect Claim to Property at Premises
 - Landlord's Lien
 - Contractual lien – Lease
 - Statutory – Texas Property Code §54.021
 - Temporary Restraining Order – prevents removal of property
 - Distress Warrant – Texas Property Code §54.025



Possession

- Terminate lease/terminate possession without terminating lease
- Make demand for possession
- Lock Out §93.002 Texas Property Code
 - Rental default – post notice
 - Abandonment – post notice (make sure clear abandonment)
 - If Tenant pays, re-entry
 - Lease controls*



Eviction Proceedings

- Justice of the Peace case
- 3 day/11 day notice to vacate - §24 Texas Property Code (“D”
- Quick trial in Justice Court – either side has automatic right to appeal de Novo
- Tenant must post bond to appeal
- Writ of possession if Tenant fails to vacate
- Appeal de Novo to County Court – (2 month process or longer if tenant pushes)



Discussion of Recent COVID-19 Litigation Decisions: Contractual Defenses

- *In re: Hitz Restaurant Group* – Ch. 11 U.S. Bankruptcy Court – Northern District of Illinois Eastern Division (Case 20-05012)
- *Future Street Limited v. Big Belly Solar, LLC* – US District Court for the District of Massachusetts
- *Palm Springs Mile Assoc., Ltd. v. Kirkland's Stores, Inc.* - US District Court for the Southern District of Florida
- *Latino v. Clay, LLC* - US District Court for the Southern District of New York
- *Backal Hospitality Group LLC v. 627 West 42nd Retail LLC* – New York Sup. Court
- *Federal Trade Commission v. A.S. Research, LLC* - US District Court for the District of Colorado
 - What do these decisions say about future case law and positions?



Landlord's Issues

- Tenant Bankruptcy
 - Stays all collection efforts
 - Gives Tenant right to assume or reject Lease (possible reason for proactive termination of Lease)
 - Careful with application of security deposits during bankruptcy



Effects on Leasing

- Relationships become more important: tenants must be able to trust their landlords and property managers in a crisis.
- Landlords expected to deliver operational and management excellence; may institute new protocols (expect higher OpEx!).
- New demands for HVAC systems to ventilate clean air.
 - Who pays may depend on factors such as: age of existing system, whether facility is single tenant or multi-tenant, and relative negotiating strength of the parties and risk tolerances.
- New cleaning specifications on both sides of the table.
- Flexibility: shorter lease terms, broader assignment and subletting rights, and termination rights.
- Rent relief provisions for interruption of services and building closures.
- Alternate rent provisions for tenants? Perhaps tied to a closure period of certain length due to gov't orders, a reduction in sales or revenue by certain %, no tenant default, and tenant required to apply for PPP, then % deferral of rent until some time (1 month?) after orders are lifted.
- Force majeure negotiations: landlords will still insist that rent payments are never excused due to force majeure, and tenants will want rent relief for certain force majeure events, such as pandemic-related causes.
- Carve out COVID delays from “time is of the essence” provisions relating to performance of covenants.



Effects on Acquisitions/Dispositions

- Force Majeure and Delay Clauses in PSAs!
- More often than not, force majeure and other permissible delays were not addressed in purchase and sale agreements.
- Due diligence and inspections are being delayed by:
 - Governmental orders
 - Travel restrictions (affects buyers and their contractors)
 - Quarantine requirements
 - Delays and closures at governmental agencies and city departments
 - Heightened sensitivity and requirements during physical property inspections



Effects on Acquisitions/Dispositions (Cont'd)

Recent examples of PSA provisions: **All contract deadlines extended but only COVID-19 delays.**

- **COVID-19 Delays.** The obligations of Seller and Purchaser and the Applicable Dates (as defined below) shall be extended for a reasonable period of time, for each applicable extension, to the extent delays with respect thereto are directly caused by, from or in connection with the virus commonly known as COVID-19 (e.g., lack of availability of flights, delays of third parties in delivering reports including title updates and survey, inability to inspect the Property including walk through of apartment units, public lockdowns, closure of governmental or recording offices and/or the failure of financial institutions to process wire transfers). **“Applicable Dates”** means the Inspection Deadline, time period to deliver the Additional Earnest Money, Title Review Period, Closing Date, and the Extension Fee payment delivery period. Notwithstanding the foregoing, (a) in the event that the Inspection Deadline does not occur by the date that is 90 days after the Effective Date, other than due to a default by the prospective terminating party, then either party may terminate this Agreement upon written notice to the other party and Purchaser shall be entitled to the prompt return of the Earnest Money, and (b) in the event that the Inspection Deadline occurs and Purchaser has delivered its Notice to Proceed, and Closing does not occur by the date that is 90 days after the Inspection Deadline, other than due to a default by the prospective terminating party, then Seller may terminate this Agreement and Purchaser shall be entitled to the prompt disbursement of the Earnest Money.



Effects on Acquisitions/Dispositions (Cont'd)

Recent examples of PSA provisions: Closing extended for all types of force majeure if seller not able to vacate at scheduled closing. Payment is not excused.

- **CLOSING DELAY.** Closing under the PSA shall take place on the date that is the latest of (a) fifteen (15) days following expiration of the Inspection Period, and (b) _____, 2020, or such earlier date mutually agreed upon by the parties; provided, however, if Seller is delayed from being able to timely depart the Property by the then-scheduled Closing Date because of an inability to complete its departure obligations or move to its new premises due to Force Majeure, then the Closing Date shall be extended on a day-for-day basis. “Force Majeure” shall be defined as Act of God, strike, lockout, shortage of material or labor, restriction by any governmental authority, civil riot, flood, or any other cause not within the reasonable control of such party including, but not limited to, acts of war, emergency, terrorism, bioterrorism, governmental preemption in connection with a National Emergency, epidemic or pandemic disease (including, without limitation, delays arising out of the spread of COVID-19, such as, without limitation, delays in the responsiveness of, or the unavailability of, governmental authorities to grant permit applications or signoffs or to perform inspections, and the unavailability of contractors or laborers due to executive and/or municipal or governmental orders (including, without limitation, “stay at home” and/or quarantine orders)), or by reason of any rule, order or regulation of any department or subdivision thereof of any government agency or by reason of the conditions of supply and demand which have been or are affected by war or other emergency (collectively and as applicable, “Force Majeure”). Under no circumstances shall the non-payment of money by either party or a failure attributable to a lack of funds on the part of either party be deemed to be (or to have caused) an event of Force Majeure.



Effects on Acquisitions/Dispositions (Cont'd)

Recent examples of PSA provisions: **Only Closing Date Extended and Only if Recording or Title Policy not available due to COVID-19 Delays.**

- Closing Date. The closing of the transactions contemplated hereby (the “Closing”) shall take place at or prior to 3:00 P.M. Pacific time on the later of (i) July __ 2020, and (b) in the event that Purchaser has elected to consummate the Loan Modification and Assumption, subject to Section 12.6, the date that is the first Business Day that is at least ten (10) days after the Initial Consent (as hereinafter defined) has been delivered by Existing Lender and reaffirmed by Purchaser in writing (the “Scheduled Closing Date”), subject to extension as set forth in Section 4.2(ii) (in respect of Unpermitted Exceptions) or this Section 5.1 (in respect of a COVID-19 Closing Limitation), or modification as set forth in Section 12.6 (in respect of the Loan Modification and Assumption, including subsequent to the occurrence of the Initial Consent Deadline). The Closing shall occur through an escrow with Escrow Agent and pursuant to escrow instructions consistent with the terms of this Agreement and otherwise reasonably satisfactory to Seller and Purchaser (the date on which the Closing shall occur being herein referred to as the “Closing Date”). If either Seller or Purchaser determines, in its reasonable discretion, that, due to circumstances related to COVID-19 concerning the inability of the Recorder’s Office of _____ County to record the Deed, or the inability of the Title Company to issue the Owner’s Policy as set forth herein (a “COVID-19 Closing Limitation”), either Seller or Purchaser may elect to extend, one or more times, the Scheduled Closing Date (not to exceed sixty (60) days in the aggregate) by delivering to the other party written notice of the exercise of such extension right (which notice shall set forth the extended Scheduled Closing Date).



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Effects on Acquisitions/Dispositions (Cont'd)

Recent examples of PSA provisions: **All Deadlines extended for all force majeure events; payment is not excused.**

- **Force Majeure.** Except as otherwise set forth in this Agreement, this Agreement and the obligations of the parties hereunder shall toll if such party is prevented or delayed from performance by reason of any cause beyond the reasonable control of such party including, but not limited to, acts of war, emergency, terrorism, bioterrorism, governmental preemption in connection with a National Emergency, disease (including, without limitation, delays arising out of the spread of COVID-19, such as, without limitation, delays in the responsiveness of, or the unavailability of, governmental authorities to grant permit applications or signoffs or to perform inspections, or the unavailability of required meetings of governmental agencies necessary to act to grant any Approvals) or by reason of any rule, order or regulation of any department or subdivision thereof of any government agency or by reason of the conditions of supply and demand which have been or are affected by war or other emergency (collectively, "Force Majeure"). Under no circumstances shall the non-payment of money by either party or a failure attributable to a lack of funds on the part of either party be deemed to be (or to have caused) an event of Force Majeure.



Changing Space Demands

- In general, e-commerce demand is increasing greatly, driving need for industrial real estate – corresponding impact on manufacturing demand in certain sectors.
 - Increased competition for prime warehouse locations
 - Need to act quickly to sign LOIs and leases or miss the opportunity
 - Smaller tenants may need to make concessions
- In dense urban areas, build-to-suit warehouse also increasingly competitive due to scarcity of useful vacant land.



Security Deposits

- Obligation to refund §93.005 Texas Property Code
- Retention - §93.006 Texas Property Code
- Written accounting of offsets/credits
- Penalties for wrongful retention §93.011 Texas Property Code



Premises Liability Claims (Negligence)

- Injury claims – immediately tender to insurance upon first notice/belief
- Inadequate security claims – tender
 - Police logs
 - Patrol/lighting/safety
 - Reasonable security measures
 - Responsive to requests/repairs/maintenance
 - Be proactive



Vendor Agreements

- Indemnity
- Indemnity for Landlord's negligence (Conspicuous)
- Property Management Agreements/Indemnity Defense Issues



Disposal of Property

- Follow Lease
- Notify senior lenders, if any
- Store for 60 days (Lease Controls)
- Disposal in a commercially reasonable manner



Thank You for Joining Us

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