

## ***From the Desk of Andrew Baraff***

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### **Leasing in a Covid-19 World: Thoughts From the Tenant's Perspective**

As we all know, the Covid-19 virus is affecting every aspect of our lives.

Lawyers are being inundated by their clients with questions about their rights in this novel situation.

In particular, my clients are asking me what rights they have, and in general what they should do, under their leases if they need to, or are legally required to, close their business.

1. **Bottom Line (and Force Majeure)**. The general consensus among New York City leasing lawyers on the tenant side seems to be that unless the tenant doesn't care about losing its space and the effects of the landlord coming after any assets its business might have, as well as any assets a guarantor of the lease might have, then tenants should continue to pay rent if they can. (Because it is always the first question asked, "*force majeure*" clauses are unlikely to permit the abatement of rent or termination of a lease. *Force majeure* is discussed in more detail below.)

But tenants should also use the possibility (or reality) of not being able to pay rent to renegotiate their rent or obtain an abatement of rent, since landlords will generally prefer some rent to no rent at all, or worse, that the tenant closes its doors for good, leaving the landlord with empty space for an unknown period of time while the landlord tries to re-rent it in this market – which could easily last 6 to 9 months or longer – at which point who knows how low rents might be?

Ultimately, though, the outcome of any negotiation will depend on the specific facts of the situation and the terms of the particular lease.

The following is a summary of some of the practical questions and legal principles that I think a business owner in New York should be aware of as it considers whether or not to stop paying rent and (trying) to walk away from its lease.

2. **Continuing Liability**. Under pre- Covid-19 law in New York, just because you temporarily close your doors, or even shut down permanently, you are not relieved from your liability under your lease – even if you are required to close by law. The landlord still has the right to exercise all of its remedies under the lease, including using security deposits and drawing on letters of credit to cover unpaid rent and other charges. And the landlord can still sue the tenant to collect all past due and future rent under the lease. If the business has assets, the landlord can also go to court to seize those assets and sell them to cover all unpaid rent.

However, in past week, Governor Cuomo has suspended all evictions, residential and commercial, in New York for 90 days, and the New York State courts have suspended evictions, and practically all court filings, until further notice. (Both orders also apply to mortgage foreclosures.) At this time, it is not clear which mandate governs, or if landlords (and lenders) can begin and pursue proceedings to some extent short of a court filing. We also do not know how long these moratoriums will remain in effect (if the Governor's order is applicable, the 90 days could easily be extended at that time) or what will happen when the moratoriums end. But for now, they provide some breathing room for landlords and tenants to calmly consider how to address the current challenge and to try to work out mutually beneficial arrangements without having to go to court.

3. **Guarantors**. If your lease has a guarantor, remember that even if your business closes and has no assets for the landlord to pursue, your guarantor will remain fully liable under its guaranty. This means that guarantors should be consulted before any action is taken, since they might bear some or all of the costs of a default under the lease. (Although the closure of the courts will delay enforcement of any guarantee for at least 90 days.)

4. **Rent Abatements and Lease Terminations**. Depending on the terms of their lease, tenants might be entitled to terminate their lease or receive a full or partial rent abatement. There are also several legal principles that might permit these results despite the actual wording of the lease. (See Section 9 below – For Tenants' Lawyers.) Since a pandemic is a novel situation, though, that few (if any) leases specifically contemplated, no one can predict how the courts will rule on the application of these principles in a Covid-19 world. But if the stakes are high enough, or if there is little to lose, invoking them now and litigating them later might be a realistic option.

5. **Rent Defaults.** Even though evictions have been temporarily stayed, ignoring action by a landlord and assuming that you will be protected because of the extraordinary situation would be a serious mistake. If a tenant ultimately decides to, or has to, stop paying rent, and cannot reach an arrangement with its landlord, at some point the landlord might deliver a formal notice terminating the lease and demanding that the tenant surrender the space and pay all damages provided in the lease. If this occurs, the tenant should immediately notify its counsel, who should ask the courts if it is permitted to file for something called a “Yellowstone injunction”, which might allow the tenant to cure the default after everything is sorted out. (If the filing of Yellowstone injunctions falls within the mandate of prohibited court filings, I would assume that when the restrictions end, courts will deem the filings to have been made, but that is only my assumption. Again, no one knows what will actually happen.)

6. **Business Interruption Insurance.** Insurance experts are advising that business interruption insurance is not likely to provide relief, since most policies disclaim liability for loss of business due to public health situations and almost all policies require that the cause of the lost income is directly attributable to physical loss or damage. In a very new development, however, New Jersey is apparently considering legislation that would add loss of income due to Covid-19 as a covered loss under certain insurance policies, regardless of the terms of the policy. Whether the law will be passed, and whether courts would uphold it, are questions no one can answer. But if it works in one state, it is possible that other states may follow suit. Personally, I believe that this will ultimately not provide relief to business owners, but since this is all uncharted territory, anything is possible. And successful or not, I applaud New Jersey’s creative thinking.

7. **Governmental Relief.** A number of Federal, State and local relief programs are available to small and mid-sized businesses, ranging from low- to no-interest loans and outright grants, and more are likely to become available over the coming weeks and months. Businesses should not hesitate to take advantage of them.

8. **Bankruptcy.** As a very last resort, businesses and their owners might consider filing for bankruptcy. Since this is a draconian measure with very complicated and serious long-term repercussions, no one should ever take such a step without consulting highly experienced and specialized bankruptcy counsel.

9. **For Tenants’ Lawyers.** I have seen many articles and posts advocate the use of the doctrine of “*force majeure*” to support an argument for rent abatement or closure. (An event of “*force majeure*” is basically an act of God or other event that is beyond either party’s control – think hurricanes and earthquakes). In my view, this approach ignores the reality that the *force majeure* clause in any well-drafted lease provides that if an event of *force majeure* occurs (which is drafted to include the typical events, as well as “any other event that is beyond the landlord’s control”), the landlord has no liability to the tenant and the tenant is not excused from performance of the lease, including its obligation to pay rent. Unless courts rule that Covid-19 is so far beyond the pale of what anyone could have contemplated, regardless of any catch-all language, I don’t believe that *force majeure* is going to be of much help.

Instead, in the absence of language in the lease, I think untenability clauses (which might give tenants rights when the space becomes unusable) and the doctrines of impossibility of performance, impracticability of performance and frustration of purpose, certainly for the period when the tenant’s business is required to close by law, and perhaps when a business shuts its doors because the factual nature of the situation makes performance (particularly the payment of rent) effectively impossible even if they can legally remain open, will turn out to be the best avenues for relief. And many of us are researching other potential theories. However, the situation is changing daily, and the only thing that is certain anymore is uncertainty.

If you have questions call us: we’d like to help.

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*This is a difficult time. It is my personal hope that during this global crisis not only landlords and tenants, but all of us, will put aside our differences and work together to find solutions that will benefit everyone. Stay safe.*

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