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Coronavirus: Impact on Office, Retail and Industrial Leases

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The intensity with which the COVID-19 outbreak and the response to it has escalated continues to impact both landlords and tenants under commercial leases. It is safe to say that landlords and tenants will be viewing certain routine boilerplate language in leases differently in the future. Right now though, the COVID-19 pandemic's impact on businesses and business operations is raising uncertainty under commercial leases about issues best addressed with proactive assessment from tenants and landlords regarding their lease obligations, with a particular eye toward the following lease provisions:

- **Force Majeure:** Force majeure provisions in commercial leases provide for the postponement or suspension of performance of certain landlord and tenant duties because an unforeseeable circumstance beyond the control of a party prevents or delays that party's performance. Typically, landlords and tenants look to force majeure protection if they are unable to perform material or time-sensitive obligations, such as the obligation of a landlord to timely complete construction and deliver possession of space to a tenant, or the obligation of a tenant to continuously operate its business from its premises. Force majeure provisions rarely extend to purely monetary obligations, even if time sensitive, such as a tenant's obligation to timely pay rent or a landlord's obligation to timely fund a tenant improvement allowance. While commercial lease forms differ substantially, force majeure clauses typically offer protection from a litany of events like acts of God (i.e., tornadoes, floods and hurricanes), unavailability of utility service, action by governmental bodies, riots, war, labor strikes and embargos resulting in the stoppage of delivery of goods and services. Although commercial leases might not expressly reference pandemics, epidemics or widespread impacts from communicable diseases as force majeure events, unless a lease tightly restricts the categories of events that may constitute force majeure, COVID-19 related events could still trigger a force majeure claim. Because of the COVID-19 outbreak, an increasing number of factors are unquestionably blocking and disrupting commerce, including, notably, governmental action, disruptions in labor forces and interruptions in supply chains, resulting in significant downstream effects. Further, it seems reasonable that force majeure provisions that mention "unforeseeable events" or "events or circumstances beyond either party's control" should cover disruption in performance arising out of, if not directly caused by, the COVID-19 outbreak. Tenants and landlords should review force majeure provision of their leases very carefully to determine whether events related to the COVID-19 pandemic are covered under the force majeure provisions of their leases.
- **Operating Hours, Cessation of Business, Abandonment or Vacation of a Leased Space:** Commercial leases in the retail sector often require tenants to operate for minimum "retail" business hours and/or to operate "fully staffed." Commercial leases may also include a tenant obligation to continuously operate (mainly in the retail setting) or state that "abandonment" of the premises is a default. Because many businesses are now allowing, if not requiring, employees to work remotely or are otherwise facing the realistic need (or, perhaps, requirement) to adjust business operating hours, tenants may be unwilling or unable to fully comply with operating requirements in their leases. Landlords may recognize that short-term tenant adjustments in operational practices are prudent and necessary; however, long-term or permanent change may not be so well received, particularly if those

changes negatively impact a landlord's property or if they are misconstrued or misunderstood. For example, how is an office landlord to know if a tenant's decision to lock its doors is a temporary step to mitigate risk until the COVID-19 outbreak abates or the tenant's election to abandon its premises? Planning and regular communication are key to mitigating conflict between landlords and tenants. Lease parties should first review their leases to understand what amount of detail is devoted to operating requirements. Second, landlords and tenants should actively engage with one another to understand, plan for and document appropriate modifications of lease requirements regarding operations. Even if a lease is silent on operating requirements, prudent tenants planning on closing offices for indefinite or extended periods should communicate with landlord about their intentions. Landlords, for their part, should make reasonable accommodations to tenants. Landlords and tenants should be particularly clear with one another about whether adjustments in operating practices will excuse or modify other obligations under a lease, such as tenant obligations to pay rent and utilities or landlord obligations to provide services. Both tenants and landlords should continue to maintain insurance in place.

- **Common Areas:** To aid in "social distancing" efforts, many landlords are considering closing or imposing restrictions upon the use of common areas at their properties. In office properties, those closures may impact common breakrooms, workout facilities or similar building amenities. At retail properties, access to food courts, play areas and other gathering spaces may be limited. While sophisticated landlord lease forms may give landlords virtually unfettered rights to control (including eliminating or restricting access in many cases) common areas, heavily negotiated leases or leases on tenant forms may more severely limit landlord control over common areas. It is unlikely that a limitation or restriction on use of common areas would rise to the level of an actual or constructive eviction unless a tenant is prevented from reasonably accessing its leased space. Regardless, negotiated lease provisions may contemplate that closures of common areas constitute a landlord default and/or entitle a tenant to specific remedies, such as the right to abate rent, the right to adjustment in common area maintenance, or operating expense reimbursement payments or the right to assess daily penalties. Any landlord assessing common area changes should carefully review its leases to understand its obligations to tenants. Landlords should also be communicating with tenants on their plans so that tenants may make appropriate plans for change to the status quo. Landlords should avoid, if possible, common area restrictions that will deprive tenants of meaningful access to or use of their premises or critical components of the landlord's property. In the rare circumstance where severe limitations are required, landlords should be prepared to make reasonable and appropriate accommodations to impacted tenants. If a landlord's steps go so far as to deny access to the tenant's premises completely and appropriate accommodations are not forthcoming to the tenant by the landlord, an impacted tenant should consider whether under the lease or state law such deprivation rises to the level of constructive eviction or entitles the tenant to abate rent or exercise other remedies.
- **Alterations:** Tenants, particularly in office properties, are now considering whether and how best to de-densify work space to mitigate the risk of social spread of COVID-19. Tenants may desire to make physical changes to their space in order to assist in those efforts. It is probably unlikely that leases requiring a landlord's prior consent for alterations would excuse those consent requirements under these circumstances. It is likely in the interest of landlords to grant reasonable leeway to tenants taking prudent and reasonable steps to minimize the spread of COVID-19 throughout the properties they occupy. Landlords should be available to their tenants to expedite and reasonably consider emergency alterations or other steps proposed by their tenants to mitigate COVID-19 impact. Tenants, for their part, need to look at their leases regarding alterations and approach alteration requests in good faith with their landlords, where necessary, based on what the tenant has in mind for the space. In the coming weeks, landlords and tenants should work together to implement steps

taken by tenants to minimize the risk as a whole.

- **Insurance Considerations:** For obvious reasons, tenant revenue is equally important to landlords, and tenants' financial health can have a direct impact on the financial health of a landlord's property. If one or more tenants at a property are forced to curtail business activities or, worse, to close their businesses for some period to mitigate spread of the COVID-19, what will the financial impact be on the tenants and their landlord? Will those tenants be able to meet their rent obligations? Will they survive in the long run? Tenants and landlords often carry (and may be contractually obligated under their leases to maintain) business interruption insurance to help provide a financial backstop intended to protect against substantial interruptions in business activities. However, because business interruption coverage is "property" coverage, business interruption insurance generally only protects against interruptions in business activities resulting from physical damage to property. If a workforce in a leased space is infected, or faced with the threat of infection, such that the property is uninhabitable (or unhealthy) for some period, do such circumstances constitute "property damage" within the requirements of a business interruption policy? From the landlord's perspective, the landlord may wonder whether it may have a claim under its rent loss insurance. The answer is probably no unless a tenant has the corresponding right to abate rent under the relevant lease due to the outbreak. Tenants and landlords should be engaged in coverage reviews now with their risk management experts to fully understand whether, and to what extent, they may have insurance protection available for COVID-19 issues.
- **Communicate:** Landlords and tenants should be proactively and openly communicating with each other and, where possible, coordinating efforts to mitigate against potential impact from the COVID-19 pandemic. This is not a time for landlords and tenants to engage in gamesmanship to try to gain advantage over one another at a time when they are both subject to material and adverse impact affected in ways no one ever anticipated. **If a landlord or tenant is in doubt over its position or what the other side to its lease contract may or may not do or be able to do, communicate.**

If you have questions on planning for the impact of the COVID-19 pandemic on your property, please contact any member of [Baker Donelson's Real Estate Team](#). Also, please visit the [Coronavirus \(COVID-19\): What You Need to Know](#) information page on our website.