Commercial Lease Considerations for Small Business Owners (COVID-19)

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COVID-19
Remote Small Business Legal Clinic

NELP has expanded its services in the wake of the COVID-19 pandemic to adapt to the emerging needs of small business owners, working with Lawyers for Good Government and several NYC law firms to provide free, remote legal consultations to small business owners.

The purpose of the clinic is to help small business owners understand and act upon options available under the federal government’s COVID-19 stimulus package and other opportunities available through federal, state and local programs as well as navigate any additional remedies available to small businesses related to COVID-19.

Fill out our brief intake form to request an appointment.
Key Issues Affecting Real Estate Tenants

Global economies are confronting unprecedented circumstances in the face of the COVID-19 pandemic, presenting a number of challenges and issues of first impression to the real estate industry and commercial leases in particular.

COVID-19 related business interruptions have negatively impacted many small businesses in NY (and across the nation). A significant number of small businesses have had their operations impaired or may have closed during this crisis.

Our observations are intended to help you with risk identification, rent relief, and management strategies. The content of this presentation is current as of June 11, 2020; however, the fast-moving, dynamic nature of the situation and fact-specific nature of many key issues means that some of the advice given today may not be true in the immediate future. We recommend staying on top of all national and local updates that may impact your lease.
General Observations

Identify, Assess, Strategize

► There is no one-size fits all approach.

► Identify and assemble your leases and other critical contracts.
  
  - Many customary contractual provisions will not clearly address current circumstances. You are not alone if your lease does not clearly cover the current situation.
  
  - Ongoing governmental action creates additional ambiguity regarding customary contractual rights and remedies (and this is changing on an almost daily basis).

► Assess your business impact within the contractual framework and evolving COVID-19 landscape.
  
  - Traditional enforcement mechanisms unlikely to provide parties with timely or effective redress (e.g., eviction moratoriums, closure of courts).
  
  - Your legal and contractual rights may depend on particular facts and circumstances (mandated closure of non-essential business vs. voluntary closures by landlord or tenant).

► Formulate a communication strategy with your landlord.
  
  - Specifics of real estate type and your relationship with your landlord should influence your approach.
    
    - For example, landlords of retail tenants are likely to be more cooperative than other landlords since most retail businesses cannot operate without their stores being open (and it is typically harder for retail businesses to operate remotely).
  
  - Engage in open dialogue early through written notice and direct discussions with your landlord.
  
  - To the extent possible, we recommend reserving potential rights and defenses. Specific lease provisions and legal arguments can be addressed in negotiated agreements.

► Negotiated solutions are likely given scope of COVID-related disruption.
  
  - Rent deferral and restructuring (rather than waiver or abatement) is most likely but exact solutions will vary depending on facts and circumstances of each lease.
  
  - Don’t forget – this is largely unprecedented territory!
Tenant Considerations

**Business Management and Workout Strategy**

- Small businesses should undertake a cash flow analysis and consider liability management actions with landlords and other vendors.
  - Determine the priority of rent vs. other company liabilities (e.g., payroll, taxes, credit facilities), and any potential personal recourse.
  - Assess what your total liability will be if an event of default occurs under your lease.
- Consider the specifics of real estate use.
  - Have operations ceased in your building?
    - Reason may become important (forced closure vs. tenant’s decision to close).
  - Is the landlord providing services that are necessary for your continued operations?
  - Is the rent below market? What is the remaining term?
- Review your insurance policies to determine whether COVID-19 losses may be covered.
  - Business interruption coverage may be unavailable in typical policies (but it is still worth pursuing).
  - Assess your landlord’s access to rent-interruption insurance.
  - When in doubt, contact your insurance broker or insurance provider.
- Manage potential health and safety liabilities at the premises.
  - Consult CDC, federal, local and industry guidelines for notification and enhanced cleaning requirements relating to COVID-19 infections.
  - Assess whether the continued operation of your business will be profitable while implementing required/suggested safety measures (including capacity restrictions).
- Review your lease to assess the merit of any claims for abatement, deferral or termination, and risks of non-payment.
  - Remember to also read any riders or amendments to your lease carefully for changes to the standard lease forms.
Landlord Considerations

Know Your Landlord’s Position

► Landlords will consider similar factors in responding to defaults and workout requests.
   - What is the viability of the tenant’s business following the crisis? Has the tenant had a history of defaults or disputes? Does the landlord and tenant have a good working relationship?
   - How likely is landlord to find a replacement tenant in the current environment?
   - Is the tenant or landlord likely to receive government relief from any legislative stimulus?
   - Does landlord have obligations to tenant under lease (e.g., delivery of improvements, provision of utilities and services)?
   - Does landlord have a mortgage on the property?

► Assessment of potential remedies by landlord.
   - Practical and legal limitations on landlord’s ability to respond, negotiate, and enforce.
     - The timing and volume of requests is likely to overwhelm some landlords (especially smaller/less sophisticated landlords). Be aware that landlords are likely facing their own issues during the COVID-19 pandemic.
     - Consent from your landlord’s lender may be required to agree to any material modification to your lease.
     - Emergency orders are temporarily restricting evictions and other remedies in many jurisdictions.
       - NY: moratorium on residential or commercial evictions (this will be discussed in more detail on a later slide).
     - Some remedies may be available in short-term.
       - Security deposits, letters of credit, parent guaranties, late fees / default interest, etc.
       - Potential lockout and self-help remedies for commercial leases (availability and process varies by jurisdiction).
       - Notice and cure rights may apply under your lease.

► Landlords will also focus on potential health and safety liabilities and compliance with governmental mandates.
   - Closure of a building by a landlord may provide stronger arguments for a tenant to abate rent or terminate lease.
Communication Strategy

Communication with Landlords

- Early, direct and ongoing communication with landlord is important.
  - Suggested tone of preserving the relationship and seeking a cooperative solution that allows both landlord and tenant to weather the storm and return to being a viable long-term tenant with accommodations for unforeseen crisis.
  - It may be more productive to start out with a general appeal to your landlord prior to relying on pure legal arguments, particularly if such legal arguments are questionable.
  - Simply withholding rent and not communicating may set a negative tone for negotiations. This may prompt landlords to take a more aggressive approach in response, especially when conditions improve down the road.
  - Written letters to landlord may be preceded or followed by telephone calls to establish less formal dialogue.
  - Comply with notice provisions contained in your lease if at all possible.

- Advise landlords that operations have been / will be halted or impaired and thus your business will be substantially impacted.

- Avoid a direct admission of an inability to pay your debts, which may trigger defaults in other agreements. If you must refer to obligations, make sure to refer to "the tenant's obligations" as opposed to "my obligations" if you are not personally the tenant.

- Reserve rights and defenses with respect to potential legal arguments and implications of government actions.
  - Facts and circumstances are rapidly changing (almost on a daily basis) which may impact available theories for relief and negotiating leverage.
  - Non-payment of rent may be asserted by landlords as a defense to tenant claims.
  - Consult your attorney or the City Bar for the best methods to reserve your specific rights and defenses.

- If possible, pre-negotiation agreements should be used to protect you before engaging in substantive workout discussions or providing confidential business information.

- Be prepared to specify your requested relief and what you are doing to get relief through other avenues (i.e., the stimulus package, insurance, suppliers, staff, furloughs, etc.).

- Sophisticated landlords may request a lot of due diligence materials from a tenant prior to making a decision on how to proceed.
Lease Obligations and Issues

Tenant Obligations

- Understand your applicable lease provisions re: amount and timing of rent obligations, including base and any additional rents.
  - Identify any express provisions permitting abatement or deferral of rent, together with any notice and cure rights for failure to pay.
  - The standard REBNY form lease is unlikely to have a provision to specifically help a tenant in this situation (absent a negotiated rider or amendment, which would also be unusual).

- Abandonment of premises or failure to continuously operate may also constitute a default by tenant.
  - Lease may permit temporary closure or require notice and cure period.

Force Majeure

- Not typically available with respect to a tenant’s obligation to pay rent (most provisions specifically exclude nonpayment of rent as an excusable obligation as a result of force majeure).
- May excuse or extend other non-monetary obligations of parties (e.g., tenant’s covenant to continuously operate, landlord’s delivery of improvements or provision of services, etc.)
- The specific definition of “Force Majeure” under your lease will govern whether a pandemic like COVID-19 is included.
  - Historically these provisions have been strictly construed as to events covered and application to lease obligations.
- There may be a time limit on notice to claim force majeure within a specified time after occurrence of the event.
Lease Obligations and Issues (cont’d)

Alternative Lease Provisions or Common Law Relief

- Novel arguments may exist depending on facts, circumstances and applicable lease provisions.
- Voluntary Closures
  - Closure by Tenant: A tenant electing to cease operations, including as a result of decreased revenues from “suggested” social distancing, work-from-home, etc., is unlikely to have claims for abatement, deferral or termination under lease or common law theories.
    - Presence of infections and level of landlord response could raise issues of frustration of purpose, tenantability and quiet enjoyment. Is the landlord taking steps to mitigate the chances of infection in the building or your premises?
  - Closure by Landlord: If a landlord closes the building and/or denies access and services of the premises, tenant may be entitled to abatement or other relief under the terms of the lease or the legal theory of constructive eviction.
- Mandatory Closures (e.g., governmental order)
  - The specific details of “New York on Pause” orders and closures of non-essential businesses plays an important role in relief under your lease.
    - Facts are important and subject to change – is your landlord required to close the entire building, or is your business required to close or substantially reduce operations (e.g. dine-in restaurants restricted to take-out and delivery).
  - Facts may not fit express definition or traditional use of “casualty” or “condemnation”, absent physical taking of space by authorities (e.g. for use as a temporary triage center, testing site, etc.)
Lease Obligations and Issues (cont’d)

Landlord Remedies and Workout Considerations

► New York has a temporary moratorium on commercial and residential evictions, but this generally does not relieve rent or other obligations under the lease (it just temporarily restricts enforcement of eviction and other related remedies) (this will be further discussed in more detail on a later slide).

► Assess practical implications of court closures and impairment of customary adjudicative process on enforcement of remedies.

► Tenants generally are not entitled to “self-help” by withholding or offsetting abatement or damage claims against current rent obligations.

► Security deposit or guaranties may be available to landlord for unexcused failure to pay rent (this will be further discussed in more detail on a later slide).

► Late fees and/or default interest may be triggered and deemed to accrue pending resolution of workout (this will be further discussed in more detail on a later slide).

► Lease modifications to be negotiated may include rent holiday and restructuring of payment schedule to recover deferred rents after operations resume.
  – Negotiated lease modifications should include a waiver of all tenant defaults during period covered by the modification.
  – Parties should consider potential proceeds to tenant from CARES Act and any other federal, state or local government COVID-19 response package.
  – There may be timing issues related to either party’s lender or other required third party consents.
  – Note that your landlords will be engaging in similar forbearance and workout negotiations with their own lenders.
  – Some landlords are seeking lease extensions in exchange for modifications to existing obligations. It’s important to understand the liability you are undertaking in the future in exchange for short term relief.
Summary of Tenant Considerations

What should tenants be thinking about?

- Did you pay rent on June 1st (or the applicable date your rent is due), or are you already in default?
- If you are in default, do you have any defenses against paying rent?
  - Look at your lease, including riders and amendments carefully.
    - Interruption of services language
    - Force majeure clauses
    - Temporary taking provisions
    - Quiet enjoyment, access rights
- Are you still operating in the premises? If not, why not?
  - Are you closed because of government order or because of the cash flow of your business? Did your landlord order the building closed?
- What, specifically, are you requesting from your landlord?
  - Not to pay base rent? Additional rent? For how long? Rent deferment or forgiveness?
  - Waiver of any defaults.
  - Remember that your landlord may have pressure from their own lender to make timely mortgage payments.
Current New York State COVID-19 Relief and Regulations

Evictions & Foreclosures (State of New York Executive Order No. 202.28)

- Evictions and foreclosures are not permitted from March 16, 2020 through August 20, 2020 if a tenant or landlord is eligible for unemployment insurance or otherwise facing hardship due to COVID-19. Because of this, there is a general feeling in the marketplace that, to be effective, default letters from a landlord sent between March 16, 2020 through August 20, 2020 will need to be resent once the applicable Executive Order has expired and the courts have reopened, though that has not been definitively determined.

Late Fees (State of New York Executive Order No. 202.28)

- Landlords are not permitted to demand any payment, fee or charge for late payment of rent from March 20, 2020 through August 20, 2020.

CDC Recommendations

- At a minimum, tenants should review and comply with the recommendations listed on the CDC website: https://www.cdc.gov/coronavirus/2019-ncov/community/office-buildings.html
Personal Liability (NYC-Specific) (City of New York Int. No. 1932-A)

- New York City enacted a regulation that prevents commercial landlords from enforcing personal liability provisions in leases or rental agreements with certain business tenants "impacted by COVID-19" (tenants should review City of New York Int. No. 1932-A to determine if they satisfy one of the enumerated criteria comprising the definition of "impacted by COVID-19"). Importantly, the regulation applies only to guarantors who are natural persons (it does not impact commercial lease guarantors who are business entities). This regulation is limited to defaults occurring between March 7, 2020 and September 30, 2020.

- Note that the NYC regulations listed on the prior slide are vague in some aspects and a number of issues still need to be sorted out, including, but not limited to:
  1. What happens if a default commences before September 30, 2020 but continues thereafter?
  2. What amounts are landlords excluded from suing for? Are legal fees or other non-recurring costs or reimbursement items included?
  3. What if the guarantor is also the tenant under a lease?
  4. What if the guarantor executed a stand-alone guaranty instead of the lease itself?
  5. Are all businesses included or just some? Does this only relate to springing guarantees or all guarantees?
Conclusion/Commercial Leasing Basics Summary

► Attorney input is invaluable.
► Don’t be frustrated if you do not immediately receive relief from your landlord.
► Start a dialogue with your landlord as soon as possible.
► When asking for amendments or relief, reflect on what terms you really need.
► Don’t assume the law provides any specific rights.
► Flexibility is always key.
► Stay current with all federal, state, and local updates regarding the COVID-19 pandemic.