OUR ANSWERS TO COMMONLY ASKED QUESTIONS FROM COMMERCIAL TENANTS DURING THIS UNPRECEDENTED TIME

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INTRODUCTION

As advisors to numerous companies with offices, stores and operations in the greater Seattle area – the original epicenter of the novel coronavirus (COVID-19) in the U.S. – we are hearing similar questions and concerns during this unprecedented time of business and school closures, shelter-in-place orders, and social distancing.

Most people in the region, including many of our clients, have either voluntarily or involuntarily reduced their hours of operation and many have temporarily ceased operations at their premises.

Unlike the dotcom bubble and financial recession of 2008, this situation came upon so quickly and many businesses are not able to physically occupy their spaces, leading not only to significant business disruption but also uncertainty, as it relates to these contractual obligations.

We have received, and continue to receive, several questions from our clients regarding their commercial lease obligations during this unprecedented time.

1. Am I entitled to rent relief?
2. Will my business interruption insurance policy apply to this loss? What about government forced shutdowns from communicable disease?
3. Are there insurance policies that address business interruption from communicable disease coverage?
4. Are there other concerns in the property insurance language that building owners and tenants should know about during this time?
5. Can I be evicted if I can’t pay April rent?
6. We haven’t moved into our new offices yet. Can I delay the commencement date?
7. My building was shut down by the landlord. Am I entitled to rent abatement?
8. Can I keep my premises closed and would that be a default under my lease?
9. What can I do during this time of hardship?

We hope these answers provide some clarity.
1. AM I ENTITLED TO RENT RELIEF?

Perhaps the most common question from our clients revolves around whether companies are entitled to any rent relief.

Most commercial leases include a force majeure provision that excuses a party’s performance for any period when performance is delayed due to strikes, lockouts, labor disputes, acts of god, acts of war, terrorist acts, civil commotions, fire or other casualty, and other causes beyond a party’s reasonable control. In some cases, the force majeure provision also covers governmental actions and/or an inability to obtain services, labor, or materials.

In most cases, however, there is an exception in the force majeure provision for the payment of rent or other amounts owed under the lease; in other words, most commercial tenants do not have the right to delay paying rent even when their business is shutdown or severely restricted due to factors outside of their control.

Tenants could also try to invoke other legal theories to support their request, such as “frustration of purpose,” “impracticality,” and “impossibility,” but the applicability of these provisions, in most cases, does not excuse a tenant from a payment obligation. For example, the legal doctrine of impossibility does not excuse performance where the performance is merely made more difficult or expensive. So, while impossibility could potentially excuse a tenant’s breach of its continuous operation covenant as noted below, it would not typically excuse the tenant’s failure to pay rent.

As the conditions that have created these recent closures are so unique, some tenants are requesting rent relief on a theory that there has been a “casualty” or even a “condemnation” of their premises. While a plausible argument could be made that the spread of COVID-19 is akin to a natural disaster, or that the forced closures of businesses amounts to a governmental “taking,” it is unusual for any commercial lease to provide tenants with rent relief in these scenarios unless there is also a partial lease termination applicable to the premises.

Businesses should review their leases carefully at this time to understand their rights and obligations and to determine whether there may be an early termination option that may be available to them or to their landlords.
2. WILL MY BUSINESS INTERRUPTION INSURANCE POLICY APPLY TO THIS LOSS? WHAT ABOUT GOVERNMENT FORCED SHUT DOWNS FROM COMMUNICABLE DISEASE?

Business Interruption insurance can be found in many different types of policies with different coverage triggers (i.e. cyber vs. property vs. pollution, etc.), with the most commonly purchased area of Business Interruption insurance being in the Commercial Property Policy. Based on standard industry policy forms, it is most likely that an insured’s business interruption coverage in their property policy will not respond to COVID-19 or other communicable disease outbreaks. There may be some instances of sub limited coverage depending on the policy forms and each loss will need to be evaluated on a case-by-case basis regarding the exact cause of the loss (i.e. direct onsite contamination vs. only government shutdown and threat of contamination).

Most insureds, as mentioned, have their sole business interruption insurance in a property policy, which pays for the loss of net income plus extra expense (including payroll if opted to cover) due to “direct physical loss or damage” to the property insured (buildings, contents, etc.). Likewise, the Civil Authority coverage (read: Government Shutdown), generally applies to restricted access to your premise due to “direct physical damage” done to another location caused by, or resulting from, any “Covered Cause of Loss”. An example being a fire in a shared building, whereby the fire department and other government authorities prevent access to your location that is not on fire. Some Civil Authority policy languages also go so far as to put a mileage radius around your location where such an event could occur and trigger coverage.

As the trigger for both of these coverages to apply requires “direct physical damage,” it will be a likely argument with the various insurance carriers whether or not a virus outbreak like COVID-19 constitutes as “direct physical damage”, as well as whether or not the cause of loss was specifically excluded or not. It is important to note that some policies have further bacteria, virus and communicable disease exclusions in their policy wordings or contain broad pollution exclusions. For civil and government authority coverage, much of that will also depend on court interpretations of “direct physical damage” and whether any mileage impact limitation is in play at time of loss.

For these reasons above, it is most likely that the business interruption coverage in a property policy will not respond to a COVID-19 loss. AHT’s recommendations have been for clients that have suffered an interruption or extra expense loss to proceed with filing a claim with their carrier to allow them to make the determination of applicable coverage. It is also important for insureds to start tracking their income and expense losses now as it relates to COVID-19. We recommend careful review of your policies with your brokers to determine guidance and strategy around any potential claims.
Keep in mind, the reason the insurance carriers are not covering these carte blanc is due to the potential for bankrupting the insurance marketplace and that a majority of the property carriers do not have a way to rate for this (as they would say a fire based on building construction, fire systems, and location), and the carriers have also not rated for this type of exposure either.

The Insurance Service Office (ISO), that provides much of the base policy forms used across the industry did, in mid-February, release two optional business interruption forms to address communicable disease after COVID-19 broke out in the U.S. — the first is to address the operational shut down of your location by civil authority due to communicable disease (vs. a more natural disaster), and the second being for operational shut down due to public transportations shut down by a civil authority. At this current time, we have not seen any carrier take these newly released forms up and likely won’t while this outbreak is ongoing (as they have no guidance about what to charge for these endorsements and would need to file the form and rate with each state’s regulatory body for approval). These should be reviewed for future renewals by all insureds, where possible, and once filed/approved for each carrier — a process that can take years.
3. ARE THERE INSURANCE POLICIES THAT ADDRESS BUSINESS INTERRUPTION FROM COMMUNICABLE DISEASE COVERAGE?

Just as there may be specific exclusions for communicable disease or viruses, the property policy may also contain carrier enhancement endorsements that could potentially apply some small sublimits from a “contamination” or “covered crisis event”. Likewise, there may be some other potential avenues of coverage hidden in various policy forms for small sublimits — all of which are dependent on the language and circumstance of the individual loss (i.e. direct onsite outbreak vs. government mandate).

There are pandemic insurance policies available in the London marketplace that could be looked at; however, all of them now exclude COVID-19, so it would be for future unknown pandemics — these started back after the SARS, MERS and H1N1 outbreaks occurred. Each of these policy types differ in their wordings from carrier to carrier — with some limiting to respond to direct communicable disease contamination and subsequent shut down when occurring just at your location, while others contain broader language that could apply to government shutdowns due to communicable disease outbreaks elsewhere resulting in loss of attendance, etc. Minimum premiums start around $250K and require certain local death thresholds and disease outbreak parameters to be met for coverage to apply. These were largely purchased by some of those in the hospitality and entertainment industry.

For real estate owners who have purchased pollution insurance, there could be potential of coverage there for decontamination expenses onsite as long as “communicable disease” and “virus” aren’t excluded and the event occurs on site. These communicable disease exclusions have become more common after H1N1. Additionally, it should be noted that the cleanup trigger may require a government organization to order such cleanup for coverage to apply and other time limitations on reporting and addressing. A careful review of these policies would be warranted for those that have them to see if coverage may respond.

For those event halls and conferences that have been cancelled, previous Event Insurance policies may have been purchased with a Communicable Disease rider that would likely respond to COVID-19; however, these policies are currently unavailable for COVID-19 due to the ongoing outbreak.

For restaurant owners, many may think to look at their food contamination insurance policies as a potential recourse of coverage, if there was direct contamination on site and potentially the food, to deem it unsafe to consume. While this is a possibility, this would be a higher hurdle to have accepted since currently no evidence suggests that COVID-19 can spread over food at this time. Should that scientific data change, there would then be a potential of coverage that could apply.
4. ARE THERE OTHER CONCERNS IN THE PROPERTY INSURANCE LANGUAGE THAT BUILDING OWNERS AND TENANTS SHOULD KNOW ABOUT DURING THIS TIME?

It should be noted, for many building owners who are familiar with their property policies, that they include a vacancy clause that normally would limit coverage to a defined set of perils if a property remains vacant for over 30 days, such as a lack of vandalism or theft coverage or a removal of water damage coverage. In today’s current COVID-19 world, it will likely be harder for insurance carriers to enforce such limitation in the policy language, as doing so may go against public policy (i.e. violating a government mandate to maintain coverage), and also many locations would still be leased out without ability to sublease during this temporary closure. For any landlords, it would be worth confirming with the carriers that such clauses would not apply during this time. Regardless, it should be noted that property owners and tenants should take careful steps in mitigating their losses still, such as turning off non-essential water connections and properly securing valuables for concern over theft.

Tenants and those who are working from home should make sure to check with their brokers for any limitations to off-premise property coverage.
5. CAN I BE EVICTED IF I CAN’T PAY APRIL RENT?

Until recently, there was no prohibition on landlords proceeding with unlawful detainer actions against commercial tenants who are behind on rent, but on March 17, 2020, Seattle instituted a new Emergency Order restricting evictions of small businesses and nonprofits located within the city of Seattle. Small businesses are defined as any business entity that is independently owned and has 50 or fewer employees per establishment or premises.

The Emergency Order prohibits any landlord from enforcing a lease provision that would remove a small business or nonprofit tenant from its premises. The prohibited remedies include terminating the lease or the tenant’s right to possession. The Emergency Order also obligates property owners to “endeavor to enter into a payment plan or other workout agreement to assist a distressed small business or nonprofit in rent relief…” It also prohibits a landlord from charging late fees, interest or other charges due to late payment rent during the moratorium, which will continue until May 17, 2020 (and could potentially be extended).

Besides its very limited application to small businesses and nonprofits, the Emergency Order is silent about what may happen to non-paying tenants after the moratorium is lifted. Since the stated purpose of the Emergency Order is to prevent evictions during this time, it can be presumed that after the moratorium is lifted, landlords will be able to institute unlawful detainer actions and reinstitute late fees and interest as permitted under their leases.
6. WE HAVEN’T MOVED INTO OUR NEW OFFICES YET. CAN I DELAY THE COMMENCEMENT DATE?

In a situation where the tenant is building out its tenant improvements, the tenant’s ability to complete its tenant improvements in the premises may be delayed as many local governmental offices have temporarily closed their permit offices and, importantly, Washington State has instituted a Stay Home, Stay Healthy Proclamation, effective at midnight on March 25, 2020, that narrowly limits the type of construction work that is permitted to take place to construction (a) related to essential activities (as that term is described in the Proclamation); (b) to further a public purpose related to a public entity or governmental function or facility, or (c) to prevent spoliation and avoid damage or unsafe conditions or to address emergency repairs. In most cases, the construction of tenant improvement buildouts for “non-essential” businesses is not permitted until the statewide order is lifted in two weeks, which could be extended.

Whether the tenant can delay the commencement date or rent commencement date is highly dependent on the specific lease terms and the work letter agreement and what, if anything, the lease says about tenant delays. Even after the Proclamation is lifted, the timing of a buildout may be further delayed due to the unavailability of general contractors or subcontractor or materials or supplies. In most leases, the tenant’s obligation to pay rent commences a certain number of days after the delivery of possession of the premises, or a certain number of days after the tenant obtains all permits for the buildout, whichever occurs first, so even if the tenant is delayed in obtaining required permits for a buildout or is unable to proceed with construction work due to a statewide order, there is a date certain after which the tenant’s obligation to pay rent kicks in.

Businesses that are encountering issues with tenant improvements, delivery dates, and move-out dates should be reaching out to their advisors to assess the impact of these delays and should also be communicating with their landlords, tenants, or service providers, as the case may be.

As a general matter, businesses should be incorporating into their pending contracts a force majeure provision that expressly includes as a force majeure event any actions taken by governments in response to a pandemic and, depending on the nature of the contract, delays relating to obtaining supplies, parts, and materials.
If the landlord elects to temporarily shut down a building or a shopping center in response to the coronavirus outbreak, then it is most likely to be the case that the affected tenants will be excused from paying rent during the period of the shutdown. The reason that tenants are entitled to rent relief in this scenario (but typically not in other cases) is that the landlord’s action has directly forced the tenant to not operate within their leased premises, so the tenant’s obligation to pay rent is excused under a legal doctrine of “constructive eviction” for the period when the building or shopping center is closed.
8. CAN I KEEP MY PREMISES CLOSED AND WOULD THAT BE A DEFAULT UNDER MY LEASE?

Some tenants have closed their businesses temporarily, either due to a governmental mandate or because it does not make economic sense to continue to operate during this time.

Are tenants allowed to “go dark”? The answer depends on whether the lease includes vacating or abandoning the premises as a tenant event of default and how that provision is defined under the lease.

Retail leases typically have “continuous operation” covenants and specifically state that any closure for more than a specified number of days is a tenant default, while some leases only consider the tenant’s closure an abandonment if the business is closed and the tenant fails to pay rent on time.

Even if the lease prohibits closures for a certain period of time, if a government order requires the tenant’s business to be closed (for example, because it is a theater, nightclub or gym), then the tenant may rightfully have a defense of impossibility or impracticality to excuse its failure to comply with a continuous operation covenant.

The tenant could either cite a force majeure provision that excuses performance in the case of governmental action, or they could also argue that performance is either impossible or impractical due to the government order.
Chances are good that it will be up to the landlord whether it will be willing to accept less rent or provide any rent abatement during this time. The continuing, and often long-term, nature of the tenant–landlord relationship can be viewed more comparably as a partnership rather than a single and isolated business transaction. Ongoing cash flow is crucial for a landlord to continue to make mortgage payments, maintain the operation of the building, etc. In turn, the tenant’s financial stability should be looked at as of equal importance as rent payments are the leading source of the landlord’s cash flow.

We are advising our clients to communicate with their landlords now about what they need from the landlord to get through this closure period. Some clients are requesting 50% rent abatement for the next few months, while others are requesting a deferral on minimum rent – or even minimum rent and additional rent – until the end of the year. In most cases, our clients are agreeing to extend their lease terms by the length of the deferment or rent abatement period.

In many cases, a landlord would prefer to give some temporary relief in the form of some rent abatement or deferment, knowing that the severity of the current situation is a temporary one that could not have been predicted by anyone and knowing that the tenant’s ability to pay rent will likely be restored as soon as the tenant is back to business as usual.

If a landlord elects to abate or defer rent, or waive any provision of the lease (such as the continuous operation covenant), it is important for the tenant and landlord to be very specific about the terms of the abatement or deferment and it is important to have the arrangement confirmed in writing. The writing should clearly state whether only the minimum rent is deferred or abated, or if the tenant is also permitted to defer taxes, insurance, and common area maintenance charges; the length of deferment; whether the length of the lease term is extended or not; and the agreement should be signed by both parties.

Tenants and landlords will need to prepare for the COVID-19 outbreak to increase its spread and damage before it stabilizes. As the situation evolves, businesses should seek advice from their advisors with greater frequency to continue to operate and conduct their businesses with minimal disruption.

If you have any questions about the topics presented in this article, please feel free to contact Brian at Brian.Biege@cbre.com, Susan at skim@alcourt.com, or Brian at bking@ahtins.com.

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