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# Commercial Lease Disputes, Litigation & Restructuring during the COVID-19 Pandemic

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# Welcome!

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## The next big problem for the economy: Businesses can't pay their rent

**The Washington Post**

PROPERTY REPORT

## Businesses Can't Pay Rent. That's a Threat to the \$3 Trillion Commercial Mortgage Market.

Delaying payments during coronavirus closings could ward off bankruptcies and layoffs, but hit landlords and their banks

**THE WALL STREET JOURNAL.**

**THE WALL STREET JOURNAL.**

## Landlords' New Credo for Late-Paying Retail Tenants: I'll See You in Court

Tensions between landlords and retail tenants over missed rent payments have been boiling over for weeks; now, they are spilling into the courtroom

## COVID-19 Related Governmental Shut Down Order Triggers Force Majeure Provision In Restaurant Leases

**LAW.COM**

## *Gallery Sues Landlord, Claiming Covid-19 Shutdown Voids Lease*

The lawsuit contends that since the Venus Over Manhattan gallery is closed by government orders during the pandemic, the lease should be terminated.

**The New York Times**

# Introduction: Current Situation & Trends



- Sharp rise of commercial lease disputes and litigation
- Highly variable, rarely applied lease terms suddenly relevant / controlling
- Evolving state and local pandemic related laws and orders
- Many companies' offices have been closed and some vandalized and looted during closures; landlords filed lawsuits
- The situation will only get worse when PPP loans dry out and more companies will end up in litigation
- Companies in distress consider lease restructuring vs bankruptcy options
- Landlord-tenant issues across many industries
- The trend to reduce footprint across industries evident



# Lease Litigation & Restructuring

- Comprehensive approach
  - Pre-litigation demand / litigation
  - Insurance considerations (business interruption coverage?)
  - Leveraged finance opportunities / solutions for distressed borrowers
  - Broader banking & finance considerations
  - Transactional solutions: lease agreement renegotiation
  - Tax implication of rent forgiveness/abatement
  - Real estate laws
  - Corporate restructuring for distressed companies
  - Employment considerations

In the wake of the healthcare crisis, a flurry of surveys were conducted.

**74%**

plan some increase  
to permanent remote work

- Gartner CFO Survey, 2020 (371 CFOs)

**40%**

want to work at home  
3+ days/week (+185%)

- IFMA Global Survey, 2020 (2,865 responses)

**70%**

want to work in office  
3+ days of the week

- Gensler Work From Home 2020 (2,300 workers)

**73%**

would feel positive about  
increasing work from home

- Gensler Work From Home 2020 (2,300 workers)

**70%**

of leaders say their teams  
perform the same or better

- IFMA Global Survey, 2020 (2,865 responses)



# Pre-litigation / Litigation

- Landlord / Tenant relationship can get ugly during the pandemic
  - It is a question of who bears the burden of the pandemic
- Rent is one of the largest fixed costs for tenants / no income
- Landlords suing for defaulting on rent or defaulting on lease by abandoning property
  - Seek back rent, late fees, attorneys' fees and all future rents / eviction
- Tenants may countersue for breach
  - Some tenants even file for a declaratory judgment
- Very few legal decisions issued on key law



# Pre-litigation / Litigation

- **Lease-based Defenses** (providing for abatement or termination)
- **Force Majeure** (addressing gov. closures and acts of god)
- **Common Law Defenses**
  - Frustration of purpose
  - Mutual mistake (as to a mutual assumption in the formation)
  - Unilateral mistake (as to a known assumption of tenant)
  - Quiet enjoyment (implied by law)
- **Statutory Defenses** (eviction moratorium, "good guy" guarantee)
- **Summary Proceedings** (be wary of so-called "landlord / tenant" courts)



# Pre-litigation / Litigation

- **Start The Conversation**
  - Initial discussion / negotiation with property manager fails
  - Preliminary letter to landlord / landlord's agent
  - Don't be afraid if landlord files suit
- **Consider An Offensive Position**
  - Declaratory judgment
  - Motion to dismiss
- **Don't Sign Anything**
  - Avoid temporary resolutions that waive future claims



# Lease Restructuring

- **Landlord Perspective**
  - Preserve all rights and remedies
  - Limit financial concessions
  - Ensure continued tenant at property
- **Tenant Perspective**
  - Ensure flexibility
  - Limit financial concessions/obtain financial support
  - Reputation



# Lease Restructuring

- Other Considerations
  - Claims and defenses under the Leases
  - Lender approval
  - Force Majeure/COVID clauses
  - Existing or future laws/cases impacting leased properties
    - Eviction moratoriums
    - Decisions with respect to on-going litigation



# Labor & Employment

- Current trends in employment litigation
  - Failure to provide a safe working environment or sufficient protections against virus
  - Age and disability discrimination claims
  - Whistleblower retaliation
  - Wage-and-hour claims



# Labor & Employment

- Employers must ensure workplace safety and follow regularly evolving local safety guidelines
  - Employers may be required to retrofit premises (elevators, recirculated air, barriers)
  - Outfitting staff with masks
  - Cleaning and disinfecting
  - Ensuring capacity limits
  - Responding to potential outbreaks
- Employers may ask landlords to make accommodations and revisit lease provisions
- Non-compliance will trigger labor and employment issues
- Risk of class actions by employees



# Bankruptcy: Chapter 11 Overview

## General Bankruptcy Provisions

- Pursuant to section 365 of title 11 of the United States Code (the "**Bankruptcy Code**") a debtor may elect to assume (retain) or reject (breach) any unexpired lease
  - What constitutes an "unexpired lease" is not always clear
- A motion to assume or reject an unexpired lease requires court approval, but in practice the standard is a fairly deferential one
- For leases of non-residential real property, a debtor has 120 days after the date of the order for relief, or until the date of the entry of a plan confirmation order, whichever is earlier, to assume a lease of nonresidential real property
  - Deadline may be extended for cause, but only for up to 90 days



# Bankruptcy: Chapter 11 Overview

## General Bankruptcy Provisions

- Section 502(b)(6) of the Bankruptcy Code limits the claims allowable to a landlord of a debtor for damages resulting from the termination of a lease of real property (often referred to as the "rejection damages cap")
  - The landlord must still prove and substantiate the claim as to both the incidence and the measure of damages
  - There is no limit on amounts owed under the lease as of the petition date
- Pursuant to section 365(d)(3) of the Bankruptcy Code, a debtor shall timely perform all of its obligations arising from and after the commencement of the bankruptcy under any unexpired lease of nonresidential real property, until such lease is assumed or rejected
  - In the case of a debtor-tenant, this includes the obligation to pay post-petition rent

# Bankruptcy: Recent Trends



## Reliance on Force Majeure

- The ongoing COVID-19 pandemic has raised questions about how a **force majeure** provision in a lease affects the obligation of a debtor-tenant to pay rent
- This issue was addressed recently in Hitz Restaurant Group, LLC ("**Hitz**")
  - The court found that the force majeure clause unambiguously applies to the rental payments that became due after an executive order banning in-person restaurant service went into effect
  - The court noted that the executive order did not prohibit Hitz from performing carry-out, curbside pick-up, and delivery services. In fact, it encouraged such services
  - As such, to the extent that Hitz could have continued to perform those services, its obligation to pay rent is not excused by the force majeure clause



# Bankruptcy: Recent Trends

## "Mothballing" Orders

- Certain retailers and restaurants that have commenced chapter 11 cases in the last several months are finding it difficult to meet their ordinary course business expenses and conduct planned liquidation sales in light of stay-at-home orders and forced retail closures
- As a result, a number of these debtors have filed "mothballing" motions, which generally seek relief to, among other things, suspend or minimize payment of "non-critical" postpetition expenses, including rent, for a period of time
- Non-payment of rent has become a hotly contested issue, particularly in light of section 365(d)(3)
- Even after many stay-at-home orders were lifted, courts have been willing to grant mothballing relief



# Key Points

- Think long-term
- Take a look at insurance policies
- Use smart negotiation tactics
  - Take initiative with early demand letter
- Involve lawyers early
  - Example of a company that signed a waiver of all COVID-19 defenses and NDA in exchange for rent payment deferral
- Consider tax implications of rent deferral/abatement
- Special rules for long-term leases and companies in distress
- Litigation as last resort

# Contact Us



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**Thank you!**

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