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**Seminar 4**

# Balancing Competing Sides to Every Policy Provision in Your Lease

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**Force Majeure:** the traditional view is that force majeure clauses do not apply to anything that could be solved by the payment of money. One post-COVID lease issue is whether a prolonged event can constitute force majeure and, if so, the allocation of risk. The rationale behind the landlord's position is if they still must pay their lender every month, why shouldn't the tenant still have to pay rent?

Based on our experience and anecdotal accounts, we observed most landlords started with a hard stance. Some landlords, however, were able to get their lenders to abate mortgage payments and were able, in turn, to offer their tenants rent deferral. Such abatement-deferral solutions usually manifested as fixing a firm amount of full or partial abatement of rent and extending the lease to recapture the abated amount at the end of the term. Most tenants whose rent payments were delayed in this manner still had to keep current on their CAM payments but there are cases where landlords abated CAM as well as rent. In those cases, the amount of abated CAM was paid current at the annual reconciliation instead of at the end of the term.

We have learned by negotiating thousands of COVID leases what solutions/alternatives we can agree on when a pandemic occurs. Indeed, solutions and alternative provisions are now routinely being addressed up front in the negotiation of new leases. The sticking point in negotiation post-COVID force majeure clauses is how to define a triggering event. Specifically, defining terms like "pandemic" and "public health emergency" is the most difficult part of negotiating a force majeure clause which will apply to future pandemics.

Force majeure goes beyond just pandemic related issues. The mass protests this past summer in the wake of the death of George Floyd have raised questions for landlords and tenants as to what constitutes a force majeure event. Imagine you're a tenant and you operate a business on a main thoroughfare in a city in a building with multiple other retail/restaurant tenants. Protests in your city have caused significant damage to other businesses and you decide that the best thing for you to do is board up your store-front until the protests have ceased. Before you hang the plywood you review your lease and it says that you are required to operate a certain number of days a year and any unpermitted closure would result in a default under the leases terms. Also, the lease does not permit you as the tenant to hang anything from the exterior of the building, or do anything to the windows facing the street. What do you do? Does force majeure cover you?

Well, if your lease has specific language that force majeure covers not only "acts of god" but also "causes outside the control of a party," then you have a very good argument that force majeure controls. In addition, case law on the issue varies from jurisdiction to jurisdiction. Some require that the lease agreement expressly identify the cause of the business interruption or the reason for your inability to perform, and others take a broader view. Either way, force majeure is not an equitable right; it is a contractual term and the absence of a force majeure clause in your lease generally means the parties did not agree to it and therefore cannot be invoked. The more expansive the list of covered items, the better protected a tenant will be if the instance should arise. Parties negotiating leases are sure to see Tenants and their counsel adding new language to force majeure provisions such as "civil unrest," "protests," "political unrest," and "civil strife."

**Capacity and Queuing:** Knowing, tracking, and enforcing capacity and queuing rules has historically presented a challenge. The COVID-19 pandemic added new layers of complexity as states, counties, and even some municipalities promulgated rules based on the guidance of world and national organizations. The consequence was both landlords and tenants had to sort through hundreds of public health orders. And if a property located in a jurisdiction where it could operate during the pandemic, there was an issue of calculating queues and capacity consistent with all applicable rules, establishing sufficient queuing space, and enforcing capacity restrictions.

Except for enclosed malls, enforcing capacity restrictions typically fell on tenants. But in all cases, areas with cones or other markings spaced six feet apart needed to be established for queuing. When these queuing areas spilled into common areas, a question arises about whether a tenant's use of that previously common area for queuing to serve their exclusive interest changes the character of the area.

Common queuing lease drafting concerns can include: calculating square footage of common areas for queuing by a single tenant; responsibility for insuring and policing such staging areas; and identifying which costs should be passed through as a CAM expense and which should be paid for by the tenants exclusive using term. And there is the question about whether such queuing areas should be added to the square footage of the leased premises for purposes of calculation pro rata share of CAM. The trend appears to be landlords expressly designating the costs of complying with public health orders as CAM expenses which are passed through and, importantly, *not* subject to CAM caps.

**Curbside Pickup:** Landlords and tenants have grappled with curbside pickup areas for decades. Tenants, particularly in the food and dry-cleaning industries, often ask for exclusive customer curbside pick-up areas. In leases where recorded declarations permit exclusive use areas, the square footage should be removed from the common area and added to the square footage of the lease premises. Failure to deduct exclusive use area from common area square footage will almost always become an issue when other tenants do a CAM audit, which can trigger clauses requiring the landlord to pay for tenant's audit costs. In leases where recorded declarations or other leases do not permit exclusive use of the common area by a single tenant, a common solution is to provide for sign-designated non-exclusive short term parking spaces.

During the pandemic, however, curbside pickup was the only way many tenants could operate at all. The issues of exclusive versus non-exclusive areas were the same as before the pandemic but now everyone needed a curbside pickup area. The most common solution was to create non-exclusive multi-tenant curbside pickup areas. The non-exclusive use of these pickup areas eliminated the argument that the square footage and expenses related thereto should be excluded from the calculation of CAM expenses. However, there were additional costs associated with operating, maintaining, and insuring these areas that leases did not address. These types of extraordinary costs should be expressly dealt with in the lease and, from the landlord's perspective, should be excluded from any CAM caps in the same way other uncontrollable expenses (e.g., snow removal, security, insurance, taxes, et cetera) are treated as outside of such limits.

**Outdoor Restaurant Sales:** During the pandemic, restaurants often were allowed to serve food outdoors before they were permitted to have inside dining. As a result, landlords found themselves scrambling to assist tenants in creating outdoor dining areas. One side effect of this nasty scramble was frequently running into unanticipated obstacles such as local liquor laws and prohibitions contained in recorded in declarations and anchor store leases. In many localities, a restaurant may only serve alcohol in an enclosed area that is adjacent to and only accessible from the leased premises. These restrictions tripped up many landlords and tenants who failed to

create the required barriers to outside entity and/or attempted to setup dining areas in the parking area that were not immediately adjacent to the restaurant property. Landlords also often needed to amend their liability insurance to cover these types of uses. Additionally, the CAM issues discussed under curbside pickup apply here as well.

**Staging of Delivery Vehicles:** Besides an increase in curbside pickup, the pandemic also caused many tenants to pivot to have delivery service. We expect that many of our tenants will continue delivery services to their customers in the post-pandemic world. Significant for landlords is that tenant delivery services will necessarily require a place to park/stage delivery vehicles. And, in addition to the exclusive/non-exclusive use of common areas and CAM expenses issues discussed above, designated parking spaces for delivery vehicles bring the additional concern that many recorded declarations and anchor store leases prohibit the parking of delivery vehicles in front of buildings and/or within designated view corridors. So, delivery vehicle and staging should be addressed in the lease.

**Cleaning Standards:** Another development we have seen in lease negotiations is the introduction and expansion of cleaning standards in lease negotiations. Historically, cleaning standards has been more of a negotiation in office leases than in retail leases, and retail landlords and tenants still rely on cleaning standards such as "commercially reasonable manner." Another recurring cleaning standards issue is in jurisdictions that dictated higher standards for businesses wanting to operate during a public health order. Landlords and tenants seem to be content relying on "compliance with all laws" type clauses to satisfy the needs of such jurisdictions. One potential pitfall for landlords to consider in lease drafting is to make sure any additional cleaning costs can be passed through as CAM expenses and exclude from any CAM caps.

**Facial Recognition Technology/Security Concerns**: While not necessarily helpful for retail and restaurant leasing, one area where facial recognition technology has proven useful is for short term rentals such as self-storage facilities. The ability to provide a completely touchless rental process allowed those businesses who were willing to shift with the ongoing crises to succeed where others failed. By using biometrics, companies provide an avenue for customers to continue patronizing their business without the need for in-person contact. One side-effect of the pandemic crises has been that customers are more willing and more comfortable submitting personal information via biometrics to avoid in-person contact. It also provides a benefit to employees as they also feel safer doing their jobs with less face-to-face interaction.

Another area where facial recognition has affected commercial real estate is in video surveillance. Many landlords already have video surveillance for their properties so that they can determine criminal activity, fraudulent tenant activity and to identify criminals. Now that the technology has upgraded to allow for facial recognition in

those videos, new legal concerns have been raised. One issue is whether the video surveillance includes audio recording. Generally, it is illegal to record private conversations between two individuals without the consent of one or both of the parties. When negotiating leases, it is important to know whether the state whose jurisdiction will control is a "One Party Consent State" or an "All Party Consent State" (also known as "Two Party Consent"). You also need to understand how the state law and federal law differ since the more restrictive will typically control. The following chart provides a simplistic view of what is permitted and/or required:

**Can I Video Record Someone Without Their Consent?**

| | **One Party Consent States** | **All Party/ Two Party Consent States** |
|---|---|---|
| Public Space Video Recording (No Audio) | Yes | Yes |
| Public Space Audio Recording | Yes | Need Consent |
| Private Space | Need consent of one party | Need consent |
| | | |
| | | |

Having video surveillance, with or without facial recognition, may also create a Landlord duty where one did not exist before. Landlords who have cameras installed should review the footage to determine if the video reveals any security or safety concerns. The footage may end up being used as evidence supporting a negligence claim if video footage reveals a long-standing safety or security issue that the Landlord failed to address. The same concerns apply to Tenants if those tenants operate retail and/or restaurant establishments which invite customers into their premises. A public policy issue that arises with the use of video surveillance and facial recognition is when the footage is used for racial and/or ethnic profiling. A few guidelines for Landlords will help alleviate issues later:

1. Only surveil public areas and/or common areas.

2. No cameras in sensitive areas such as bathrooms.

3. Only record audio if you are permitted in your jurisdiction. (this should be reviewed and approved by legal counsel).

4. Notify people of Video Surveillance. This includes adding a provision in leases notifying tenants that common areas are surveiled and that by signing the lease the tenant is agreeing to said surveillance. Tenants need to review leases carefully and understand what that means for them and their employees.

**First Amendment Rights.** EXAMPLE: City of New York had a law on the books prohibiting "harassment" by Landlords of commercial tenants. In May 2020, the New York City Counsel enacted a bill to expand existing provisions of law. "Harassment" is defined in the Administrative Code as "any act or omission . . . that is intended to cause a commercial tenant to vacate covered property, or to surrender or waive any rights under a lease," if such an act is coupled with an improper threat, like the threat of physical force or threats based upon age, race, creed, color, national origin, gender, and so forth. "Harassment" does not include "[a] landlord's lawful termination of a tenancy, lawful refusal to renew or extend a lease or other rental agreement, or lawful reentry and repossession of the covered property."

Under the new law, "harassment" would also include threatening a commercial tenant based upon its "status as a person or business impacted by COVID-19 or [its] receipt of a rent concession or forbearance for any rent owed during the COVID-19 period." The new law defines "impacted by COVID-19" as including individuals diagnosed with COVID-19, businesses "subject to seating, occupancy or on-premises services limitations" pursuant to COVID-19-related governmental orders, and businesses whose revenue declined by more than 50% during "the COVID-19 period" as a proximate result of the pandemic.

Three New York landlords sued the City of New York, arguing that the law was unconstitutional and that their first amendment rights were being restricted. Melendez, et al. v. The City of New York, et al., 2020 WL 7705633, Case No. 20-CV-5301 (S.D.N.Y.) The landlords argued that the amended law violated firs amendment rights by restricting landlords from sending routine rent demand notices and discussion about consequences flowing from unpaid rent and efforts to collect rent. They also argued that their due process rights were violated because the amended law was vague with regards to whether routine rent demands constituted "harassment" as defined. The United States District Court for the Southern District of NY dismissed the lawsuit stating that the amended law was not unconstitutional. The first amendment argument was struck down because the court said the new law did not restrict landlord from making routine rent demands and that commercial tenants were not relieved of paying their rent obligations. Since the court determined that routine rent demands were not "harassment," the court struck down the landlord's due process arguments as well.

The landlords have filed an appeal to the Second Circuit.

**Good Faith and Fair Dealing**. The implied covenant of good faith and fair dealing requires each party to a contract, including leases, to refrain from acting in a manner that would impair the right of the other party to receive the benefits of their agreement.

EXAMPLE: Retail tenant has a lease that includes an express right to quiet enjoyment of the premises. The lease also provides the landlord with an express right to remodel the shopping center where the retail tenant is located. The landlord begins renovations to the shopping center and the tenant argues that the work made it impossible for the tenant to operate its business in the premises. The language in the lease included a limitation of liability for damages resulting from any renovation, but included the right of tenant to abate rent to the extent the use of the premises was impaired. The lease also had express language exempting landlord from liability for certain damages, including damages arising from the condition of the premises and injury to tenant's business or loss if income or profits regardless of whether those losses resulted from landlord's negligence or breach of lease. In California, public policy (as articulated by California courts) disfavor contractual provisions which exempt a party from liability from such party's fraud or willful or negligent actions which cause injury to another. Therefore, in this example, the court determined that the lease provisions which limited landlord's liability did not apply to gross negligence, and any exemption for ordinary negligence would be strictly scrutinized. *See* Frittelli, Inc. v. 350 North Canon Drive, LP (2011), 202 Cal. App. 4th 35.

**Social Justice**. How does the concept of systemic racism impact landlord-tenants disputes? While not an example from the United States, it is an interesting case study on the types of arguments we may see more of as we move forward. EXAMPLE: The Elias Restaurant is a small restaurant located in Toronto, Canada. The restaurant has found a niche with its Afro-Caribbean menu which has been in place since 2013. The lease expired in 2017 but provided that the tenant could renew if it wanted to stay. The tenant did not formally renew, but continued to operate its restaurant in the space and continued to pay rent at the holdover rental amount of 125% of the rent. The Landlord sought to evict the tenant arguing that the lease expired since the tenant failed to formally renew the lease.

In rendering a decision for the tenant, the Superior Court found that not only could the tenant remain in the premises, but that the landlord was motivated to try and evict the tenant because of the landlord's prejudice against the black proprietors and black customer base. On appeal, the Ontario Court of Appeals upheld the lower court ruling stating that the superior court judge was entitled to conclude that anti-black racism was relevant in a commercial landlord-tenant dispute over the continuation of the lease. See 8573123 Canada Inc. (Elias Restaurant) v. Keele Sheppard Plaza Inc., 2021 ONCA 371. The facts in the above case seem to indicate that despite the

financial benefit to keeping the restaurant as a tenant, the landlord still sought to evict the tenant due to an expiration of the lease. Obviously, the court felt that the impetus behind the desire to evict was based on the landlord's prejudice and not on the finances behind the arrangement. The example raises other items that parties to commercial leases should be aware of. To avoid having to litigate these types of issues, tenants should be aware of deadlines for exercising various rights in their lease agreements, specifically renewals for option periods and options to purchase. By timely exercising their rights, tenants can avoid unnecessary litigation.

**Implied Warranty of Suitability**. In residential leasing, there is an implied warranty of habitability. Simply put, landlords are required to provide rental properties that meet basic living and safety standards before a tenant can occupy the space. Generally, leases for commercial property do not have the same warranty. The basic idea behind the lack of this implied warranty is that commercial tenants are more sophisticated than their residential counterparts and are therefore in a better position to negotiate a lease's terms. Despite this, some courts have begun to read into commercial leases, specifically for commercial office spaces, an implied warranty of fitness or suitability. The courts that have found that this implied warranty exists have done so because office space leases resemble their residential counterparts more than a commercial lease for manufacturing space, retail or residential space. Many courts who have been reluctant to extend this implied warranty to commercial leases do so for the public policy reason that if implied warranties are extended to commercial tenants, landlords will raise rents and that extra expense will get passed down to customers by the tenants.

Generally speaking, the types of defects that courts have found to violate the warranty of suitability include:

(i) latent physical or structural defects in the premises;

(ii) persistent leakage of water through the roof/ceiling or walls;

(iii) defects in the sewer or drainage system; and

(iv) inadequate or defective HVAC, electrical or other building service.

Those that have not been deemed sufficient to rise to the level of a violation of the warranty include such things as:

(i) leaky bathrooms;

(ii) lack of humidity control in a steam heated building;

Another important facet for parties to remember is that while the implied warranty of habitability in residential leases cannot be waived, the warranty of suitability can be contractually waived in a lease. Therefore, it is important to make sure that you are clear on the lease's terms, specifically, the rights that you may be waiving therein.

Texas' Supreme Court was the first to stop distinguishing between residential and commercial leases when it comes to the space being suitable for a specific purpose In Texas, "[t]o prove a breach of the implied warranty of suitability in leased property, the evidence must indicate that (1) latent defects existed in the leased premises at the inception of the lease and (2) such defects were vital to the use of the premises for their intended commercial purpose." Davidow v. Inwood N. Prof'l Group-Phase I, 747 S.W.2d 373, 377 (Tex. 1988). "The implied warranty of suitability covers latent defects in the nature of a physical or structural defect which the landlord has a duty to repair." Le v. HG Shopping Centers, LP., No. CV H-06-458, 2006 WL 8445228 (S.D. Tex. Dec. 19, 2006).