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COVID-19 and Massachusetts retail leases

By: Damon M. Seligson August 13, 2020

As the COVID-19 virus outbreak and its rapid, ongoing spread continues to affect all aspects of life as we know it, businesses are evaluating the nature of their commercial relationships.

Contagion concerns have led to a litany of governmental orders, including travel bans, shutdown orders, large-gathering restrictions, quarantine requirements, and social distancing. The impact on business has been devastating, particularly for retailers.

Indeed, as is the case throughout the country, across Massachusetts the declaration of COVID-19 as a "pandemic" has disrupted countless retail tenants who were initially forced to close as "non-essential" businesses only to slowly reopen in phases to a dwindling customer base.

This, in turn, has affected the ability of retailers to meet their lease obligations, including the payment of rent.

Commercial landlords, on the other hand, have been impacted by the resulting loss of revenue, which, in turn, has impacted their obligations to cover mortgage and financing costs as well as paying taxes.

The resulting tensions between commercial landlords and retail tenants over missed rent have been brewing to a boil, and now those tensions have started to spill over into courtrooms across the country as landlords are seeing

unprecedented numbers of defaults in rent payments and/or requests for rent or other relief from their retail tenants.

This unfortunate reality has brought the once boilerplate lease provision — the "force majeure" clause — back into focus. Accordingly, commercial landlords can expect to see the force majeure clause invoked as retail tenants claim that the obligation to pay rent has been cancelled by the pandemic.

How Massachusetts courts will treat arguments based on these clauses in the era of a global pandemic is difficult to predict, particularly where there is a dearth of legal precedent for such arguments under more typical circumstances.

What can be predicted, however, is the fact that there is a high bar when such a clause has been invoked in other, similar contractual settings, and secondly, the specific language that was negotiated will govern while courts may also factor in notions of fairness and equity.

According to Black's Law Dictionary, a force majeure clause is "a contractual provision allocating the risk of loss if performance becomes impossible or impracticable, especially as a result of an event or effect that the parties could not have anticipated or controlled."

As an initial matter, the application of a force majeure clause depends on the specific language of the clause in the lease, which can vary considerably from lease to lease.

Most commercial leases will include a standard force majeure clause that is often not the subject of significant time in the negotiations. Typically, the clause is broadly written, specifying unpredictable events that include natural disasters or "acts of God," including blizzards, hurricanes, catastrophic storms and earthquakes, as well as human-caused disruptions such as labor strikes, civil war and unrest, and terrorism.

In some general commercial contracts, the force majeure clause may reference an "epidemic," "pandemic," "disease outbreak" or even "public health crisis" as a triggering event giving rise to a force majeure. However, the inclusion of such terms in leases for commercial premises is rare.

Additionally, some clauses in a commercial lease will include an express disclaimer that the obligation to pay rent is an independent covenant and is excluded as a qualifying event, even in the case of a pandemic. In such a case, courts usually will not excuse performance based on the obligor's inability to pay or financial unpreparedness, unless specified.

In addition to specifying what events will trigger application of the clause, certain force majeure provisions explicitly incorporate a performance standard that requires performance of contractual obligations be "prevented," "delayed," "interrupted" or made "impossible" as a result of the force majeure event before performance will be excused.

In that context, courts in other states have been reluctant to accept claims of a force majeure event when such event merely made performance more expensive or inconvenient, especially where the clause expressly requires performance to be made impossible.

Simply put, some force majeure clauses relieve the obligor entirely from performance, thereby triggering termination or rescission of the contract. Other force majeure clauses, however, are more limited and simply allow for a delay in performance only while the force majeure event is ongoing. The lesson here is that the precise language will govern.

In Massachusetts, unless specified in the provision, ordinary or garden variety business disruption seldom will constitute a force majeure event and relieve the breaching party from performance.

While there is no Massachusetts precedent addressing this issue in the context of a commercial lease dispute, where the clause has been addressed by a Massachusetts court in other situations, an event constituting force majeure is one that is "construed as unforeseeable, unanticipated, or uncontrollable." *Harper v. N. Lancaster, LLC*, 95 Mass. App. Ct. 1119 (2019).

In *Harper*, a member of a limited liability company commenced suit based on the defendant's breach of an installment agreement. Relying on the force majeure language set forth in the agreement, the defendant claimed

that its breach stemmed from financial constraints that were "beyond its control."

The Appeals Court disagreed, holding that financial constraints did not, under the circumstances, constitute the type of qualifying event that would excuse performance.

In contrast, in *Itek Corp. v. First Nat. Bank of Bos.*, 730 F.2d 19, 26 (1st Cir. 1984), the 1st U.S. Circuit Court of Appeals held that the Iranian revolution was a force majeure.

In *Itek Corp.*, the plaintiff, an American company, was obligated to sell certain optical technology to Iran before the revolution resulted in the suspension of all U.S. expert licenses to Iran. The revolution, the 1st Circuit found, was a force majeure event sufficient to relieve the plaintiff of its performance.

Because a global pandemic is not always specified in the force majeure clause, a devastating event like the COVID-19 global contagion may not be a qualifying event. Yet, it would be futile to claim that this pandemic, and the resulting disruption and loss of business that has arisen from government action, are foreseeable, anticipated or controllable events.

Thus, commercial landlords, who are rightfully entitled to see performance under a commercial lease, will continue to confront this force majeure argument as retail tenants push back and contend that the pandemic has caused the cancellation of the obligation to pay rent.

Many commercial landlords are trying to work with their retail tenants and allowing rent payments to be deferred, notwithstanding their own obligations (tax bills, mortgage payments and the like).

> ***Some retailers are acting preemptively. For example, Gap Inc. recently filed suit against its property manager in Illinois state court, claiming that it does not owe any more rent under the terms of its leases.***

Others, however, have simply had enough, and around the country litigation is underway with commercial landlords pursuing unpaid rent, attorneys' fees and related collection costs.

For instance, Simon Property Group, the nation's biggest mall owner, recently filed a $66 million lawsuit against Gap Inc. for failing to pay rent at its stores. Other big-name retailers such as PetSmart Inc. as well as the retail arm of the National Basketball Association are among those being taken to court and accused of breach of contract for withholding rent.

Retail tenants are responding to these suits with arguments based on force majeure and the related contract defenses such as impossibility and frustration of purpose. They are contending that the rent obligation has been cancelled, or that their leases should be modified due to the shutdowns that forced some businesses to close.

Some retailers are acting preemptively. For example, Gap Inc. recently filed suit against its property manager in Illinois state court, claiming that it does not owe any more rent under the terms of its leases. Gap, Inc. — the parent to Athleta, Banana Republic, Janie & Jack and Old Navy — claims it leases were signed without consideration that a pandemic would cause a "radical change in circumstances" and lead revenues to fall "to zero overnight."

As such, the corporation is asking an Illinois court to rule that it has not owed rent since mid-March, when government mandates forced it to shutter its doors.

"Under principles of good conscience, [the property manager] should not be allowed to retain the rent and other consideration paid for the period of time that [Gap and other retailers] were unable to operate retail stores at the premises as originally contemplated by the leases," the complaint reads.

Gap, Inc. argues that its leases should be modified or terminated because coronavirus-related restrictions made the core purpose of those leases "illegal, impossible, and impracticable." It also wants a refund of rent and expenses paid in advance for March 2020. The retailer alleges breach of contract, declaratory relief and unjust enrichment.

Thus, the battles over these issues will rage on in the coming months, both in Massachusetts and around the country, and courts will be tasked with deciding how to adjudicate these contentious issues that now implicate both parties to commercial leases and with dire consequences on both sides of the dispute.

While not all force majeure clauses are identical, they do not vary markedly either. The decisions that will be issued by courts around the country can be expected to establish a framework for how these unfortunate circumstances will play out, especially given the daunting reality that until a vaccine is available, surges in COVID-19 cases are expected to occur. This, in turn, may very well lead to renewed government action that will bring these issues to a head all over again.

Going forward, it will behoove both commercial landlords and retail tenants to negotiate the language of these clauses in a way to allow them to be flexible and modify their business relationships in a post-pandemic arena.

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