



Real Estate Practice Group
GOODSILL ALERT

March 28, 2020

**COVID-19: CONSIDERATIONS FOR COMMERCIAL
LANDLORDS AND TENANTS IN HAWAII**



Faced with evidence of community spread of the COVID-19 virus in Hawaii, the state and county governments have announced various measures to contain transmission of the virus, quarantine visitors to the islands, and encourage social distancing, all of which have greatly impacted our local businesses. With the spread of the virus and the governmental response to the pandemic both rapidly evolving, commercial landlords and tenants in Hawaii should proactively review their leases and applicable loan documents and communicate with all impacted parties during this unprecedented challenge to our local economy.

In particular, landlords and tenants should be considering the following:

Obligations, Rights, and Remedies Under Their Commercial and Ground Leases

The obligations, rights, and available remedies of the parties set forth in the applicable lease should inform any decisions with respect to leased property. While every lease is different, Landlords and Tenants should consider the following legal issues. Where the lease is silent, common law rights or obligations may apply.

1. Tenants

Tenants should review their leases carefully to proactively address any potential issues with their landlords. For example, common tenant covenants include:

(a) Payment of Rent. Tenants should contact their landlords prior to missing any scheduled rent payments and keep an open dialogue with the landlord throughout the pandemic.

(b) Continuous Operations. Most retail leases require the tenant to continuously operate on the premises and/or state that “abandonment” of the premises is a default. Leases may also require a tenant to maintain minimum business hours or full staffing.

(c) Compliance with all laws. Commercial leases often contain a tenant covenant to comply with all laws. This covenant would likely require a tenant to comply with any quarantine, shut-down, or reporting orders from governmental authorities. However, whether non-mandatory guidelines from the CDC or other governmental bodies fall within the scope of this covenant may turn on the exact language used in the lease.

(d) Landlord Consent to Alterations. Many leases require the landlord's consent to any alterations. Tenants should confirm these requirements and seek consent as appropriate when efforts to decrease density of work spaces or efforts to otherwise comply with social distancing guidelines affect improvements on the premises.

2. Landlords

Landlords should also review their leases to determine whether the COVID-19 outbreak may impact their ability to perform any landlord obligations. Landlord lease covenants may include:

(a) Common Area Maintenance. Typically, commercial leases give the landlord virtually unlimited control over common areas. Hawaii law requires that landlords of multi-tenant developments keep common areas reasonably safe for permitted users, including tenants and visitors of tenants. Landlords should evaluate their obligations to their tenants and the risk that failure to properly sanitize common areas, enforce compliance with governmental mandates in the common areas, or follow appropriate virus response protocols may expose the landlord to liability for negligence. A lawsuit has already been filed in a California federal district court by a Princess Cruise Line guest alleging cruise line negligence for allowing passengers to board a departing ship despite knowledge regarding the contamination of other ships. Ultimately, landlord liability for COVID-19-related negligence in local lawsuits will likely hinge on commercial reasonableness. Landlords should therefore keep an eye on how similarly situated landlords are responding to the crisis as it evolves and proactively set and then follow appropriate virus response protocols.

(b) Covenant of Quiet Enjoyment or Constructive Eviction. When considering any voluntary project-wide closures of office or retail developments, landlords should evaluate the risk that tenants may claim a breach of landlord's covenant of quiet enjoyment or actual or constructive eviction based on inability to reasonably access its leased space.

(c) Landlord's Work. If the landlord is committed to performing work, the landlord should consider the lease timelines and whether to seek any extension of deadlines for delivery of possession, permitting or entitlements, build-out and/or completion.

(d) Co-Tenancy Requirements. Commercial leases sometimes contain a co-tenancy clause that provides the tenant with lease termination, rent reduction or rent abatement rights if a particular tenant or group of tenants in the larger project ceases operating or if the occupancy of the project falls below a specified percentage.

3. Force Majeure, Supervening Impracticability, Frustration of Purpose, or Impossibility of Performance

With respect to all of the foregoing landlord and tenant covenants, it is important to keep in mind that force majeure (typically a contract clause providing that certain acts outside the parties' control may excuse performance under the contract), supervening impracticability (a common law defense), frustration of purpose (a common law defense), and impossibility of performance (a common law cause of action for contract rescission) may be asserted by a party alleged to be in breach of a lease obligation. Hawaii state and/or federal courts have acknowledged all four legal doctrines. The potential availability of these defenses and cause of action due to the

unprecedented COVID-19 outbreak in Hawaii make legal enforcement of the foregoing lease covenants uncertain.

Negotiation of Alternative Arrangements

In addition to the legal uncertainty surrounding lease covenant enforcement due to COVID-19, parties' legal rights and remedies may be further limited by business or social pressures and emergency governmental measures. Landlords must consider that struggling tenants forced to lay off employees to meet rent payment obligations may take longer to resume operations or may not be able to resume operations at all. The municipalities of Los Angeles, Hermosa Beach, and Seattle have all taken extraordinary action to assist impacted commercial tenants as of the date of this article - including, for example, mandatory rent grace periods and various moratoria on commercial evictions, late fees, and/or charging rent during a business shut down in response to the municipality's emergency order.

Landlords and tenants should be motivated to come to a mutual arrangement which provides relief to tenants without shifting the entire burden to landlords and should consider the following:

1. Short-term arrangements to accommodate temporary inability to pay rent. Rent abatement can take many forms, including a rent holiday (free rent period), partial base rent reduction, abatement of base rent but continuation of common area maintenance payments, tacking missed payments to the end of the lease, incremental payment of deferred rent, application of security deposit, or deferred payments with a future guaranty or promissory note. The parties may also consider creative percentage rent or profit-sharing arrangements that could allow landlords to recoup some lost rents in the case of a robust economic recovery. Regardless of the arrangement agreed upon by the parties, any lease modification should be in writing, should include defined reinstatement dates, should indicate its effect on any prepaid rent and any impacted lease covenants, and should consider the parties' obligations to third parties such as a ground lessor or lender.
2. Temporary relaxation of continuous operation or operating hour covenants. Ideally, tenants should communicate any need for relaxation of lease covenants, and landlords should reasonably accommodate tenant requests for short-term adjustments. Formal written acknowledgment of the relaxation of any covenants should consider the impact, if any, on other lease covenants and set a clear window for reinstatement of the covenants.
3. Insurance coverage. Landlords and tenants should consult any business interruption insurance policies required by the lease prior to entering into any alternate payment arrangements.

Obligations to Lenders

It is important to note that the parties should review their loan documents and consider any obligations they may have to their respective lenders. For tenants, leasehold mortgagors typically covenant with their lenders to keep the lease in full force and effect and not in default. An uncured lease default would also be an event of default under a leasehold mortgagor's loan. For landlords, before agreeing to alternative payment arrangements, loan documents should be reviewed for any debt to income ratios or other covenants which may require minimum monthly or annual rental revenue. If the COVID-19 outbreak has a lasting impact on our economy, loan documents should also be reviewed for vacancy or tenant delinquency rate covenants which may

need to be addressed. Finally, borrowers should also consider that lender consent is required for most lease amendments and seek consent as needed.

RECOMMENDATIONS

The global COVID-19 pandemic has wreaked unparalleled havoc on our local economy, and the duration and extent of the disruption is yet to be seen. Given the legal uncertainty surrounding strict enforcement of lease covenants and the rapidly changing governmental responses to the local outbreak, we recommend that landlords and tenants come together to find creative solutions which allow tenants to maintain operations and landlords to maintain their investments and compliance with their loans. Negotiations should be undertaken with the understanding that the parties will only be bound by a written lease amendment executed by both parties and not by any verbal or email statements made by brokers or other representatives.



This Goodsill Alert was prepared by Jennifer Chin and Dale Zane of Goodsill's Real Estate Practice Group. For more information or assistance with negotiating or documenting lease modifications due to COVID-19, contact a member of Goodsill's Real Estate Practice Group.

Notice: We are providing this Goodsill Alert as a commentary on current legal issues, and it should not be considered legal advice, which depends on the facts of each specific situation. Receipt of this Goodsill Alert does not establish an attorney-client relationship.