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CLIENT ALERT

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A CODA TO THE COVID PANDEMIC: DO LOCAL AND STATE CLOSURE LAWS PROVIDE COVER FOR TENANT NONPAYMENT OF RENT?

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In what may turn out to be a lesson on the limits of the application of equitable doctrines supporting rent relief in the face of good lease drafting, a California court of appeal panel in San Diego has taken a narrow view on the application of the doctrines of quiet enjoyment, frustration of purpose, impracticability and impossibility as a defense to the payment of rent under a lease following State and local closure orders issued in response to the COVID 19 pandemic. The case is SVAP III Poway Crossings, LLC v Fitness International, and was decided on January 20, 2023 (case no. D079903). The take-away is that, at least for this appellate court panel, in the face of a well written lease, State and local COVID 19 closure orders applicable to "non-essential" businesses did not "delay, hinder or prevent" the Tenant from performing its lease contract.

The facts of the case are straightforward. The parties entered into a retail lease in 2002, Tenant opened and operated a large fitness center for over 19 years. Beginning in 2020, the pandemic resulted in a governmentally mandated order closing the fitness center, tenant stopped payment of rent for 8 months (over $520,000), Landlord filed suit for breach of lease and the trial court heard arguments based on Landlord's motion for "summary judgment" (meaning, the Landlord argued there were no factual issues in dispute). The trial court agreed, and found in favor of the Landlord that Tenant's performance under the lease was not excused due to COVID 19 because there was no event of force majeure, Tenant's performance under the lease was not impracticable or impossible and the purpose of the contract had not been frustrated. The court of appeal agreed completely with the trial court and ruled in favor of the Landlord.

What helped the landlord in this case?

- The permitted use clause, while stating the "initial use" of the premises "shall be" for the operation of a health club and fitness center, the lease expressly allowed Tenant to change the use of the premises to "any alternate retail use" not expressly prohibited under the lease. While the lease contained a representation of Landlord that Tenant's initial use – as a fitness center – did not violate any applicable laws, the language clearly was limited to laws applicable as of the date of the lease. Careful drafting helped the court find that Landlord did not represent or promise that the Tenant could operate a fitness center, and that Landlord only covenanted to provide Tenant with possession of the premises in exchange for the payment of rent.
- The force majeure provision of the lease stated that delays in performance "which can be cured by the payment of money" are not deemed a force majeure event. The court's analysis here is both simple and nuanced. First, since the obligation at issue was the payment of rent, the obligation could be performed by the payment of money and that was specifically excluded from the definition of force

majeure. A pretty simply drafting fix! Secondly, and more nuanced, since the Landlord did not represent or ensure the right of Tenant to use of the premises for a fitness center, that specific use was not part of the consideration for the lease, and therefore the pandemic did not hinder or prevent the Tenant from performing under the lease. Landlords should give this rationale close attention (even in the context of office, industrial and life science leases). Major retail tenants will include (if they have not already) specific language in their leases to negate this argument.

- The court's application of the equitable doctrines of impossibility and impracticability was based on a narrow interpretation of what obligations the Tenant was required to "perform" and whether the governmental orders made it unlawful, impossible or impracticable to perform due to extreme and unreasonable difficulty or expense. Because the performance at issue was the payment of rent, the court found that nothing about the pandemic or resulting closure orders made Tenant's performance of its obligations under the Lease – paying rent - impossible or impracticable.[1]
- This was a 23 year lease and the pandemic occurred after 19 years of lease occupancy, with the inability to operate for a limited period of 8 months. The court found that such a temporary impact, even assuming the purpose of the lease was to operate a fitness center, did not undermine the value of the contract, and did not rise to the threshold required to uphold the equitable remedy of frustration of purpose. The court found that frustration of purpose must rise to a level where termination of the lease is required, not a mere suspension of a contract obligation. In this case the conduct of the parties supported the fact that neither party believed the contract had terminated – in large part because the Tenant continued to occupy the premises. The court distinguished a line of cases on temporary frustration of purposes relied upon by the Tenant.

When viewed in an historical context of cases decided during other crises dating back 75 years (see Lloyd v. Murphy, a California Supreme Court decision from 1944), this decision is not precedential. While the court's policy arguments are consistent with past decisions, other appellate panels may find room to distinguish the decision based on the court's reliance on the lease's specific language. Nevertheless, this is an important decision that provides guidance to landlords and tenants in the face of current and future health crises.[2]

Please contact us if you have leases that may be impacted by this decision.

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[1] The lease did not contain a "continuous operations" clause. It is an open question whether this might have impacted the court's analysis on this issue – even where rent is not directly based on results from operations.

[2] In a sign of the time required and the cost and expense of pursuing a breach of lease case, the initial complaint was filed in May 2000, the trial court opinion (in favor of Landlord) was issued in October, 2021, and the court of appeal decision was issued on January 20, 2023. The court of appeal awarded the Landlord its costs on appeal. The lease contained a prevailing party attorneys' fees clause, and the trial court appears to have awarded the Landlord attorneys' fees.