

AS THE ECONOMY RE-OPENS, LANDLORDS AND TENANTS WILL CONFRONT RENT DEFAULTS

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As businesses begin to emerge from the COVID-19 crisis, many are optimistic about returning to profitable, thriving operations. For some businesses, however, particularly those unable to operate during the pandemic, reopening means having to face rent defaults, which piled up while they were temporarily closed. This is particularly true for retail and restaurant businesses, most of whose operations were significantly impaired during the last few weeks. For their landlords, who were forced to forbear from enforcing lease obligations and seeking evictions during the crisis, reopening of the economy may mean relief and the ability to pursue legal remedies for these defaults. It may also mean having to deal with their own mortgage obligations and defaults, which similarly accrued during the pandemic and may have been deferred by special COVID-19 governmental actions.

During the COVID-19 crisis, many states took action to provide relief to commercial tenants. New York State, for example, issued Executive Order 202.8, which placed a complete moratorium on filing new, non-essential (including rent-related) evictions until June 20, 2020. This was extended until August 20, 2020 if the non-payment of rent is “by someone that is eligible for unemployment insurance or benefits under state or federal law or otherwise facing financial hardship due to the COVID-19 pandemic[.]” Neither New Jersey nor Connecticut has a specific statewide moratorium on commencing eviction proceedings against a commercial tenant. However, the state court systems have halted filing eviction cases until June 14, 2020 in New Jersey, and August 1, 2020 in Connecticut. Massachusetts implemented a moratorium on evictions for qualifying commercial tenants, which will remain in effect until at least August 18, 2020. Qualifying commercial tenants are also able to avoid late fees on rental payments if they give their landlord notice each month that the missed payment was due to COVID-19. In California, tenant relief is handled locally. Some municipalities, such as the County of Los Angeles and City of San Francisco, have eviction moratoriums in place for certain small business commercial tenants. Statewide relief is being considered with State Senate Bill 939. This bill would bar evictions of qualifying commercial tenants impacted by COVID-19, grant rent relief, and allow affected commercial tenants to modify or even terminate leases with limited financial consequences. As these state provisions protecting tenants expire, landlords and tenants will find themselves facing difficult rent default,

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eviction, and landlord mortgage default issues.

On June 2, one of the largest mall operators in the country faced this issue head on. Simon Property Group, the largest shopping mall operator in the United States, filed a lawsuit in Delaware state court against one of its largest tenants, apparel retailer The Gap. In its complaint, Simon alleges that Gap has failed to pay more than \$65.9 million in rent and other charges due for April, May, and June 2020. Simon malls have 412 Gap stores, including under its Old Navy, Banana Republic, Intermix, and Athleta brands. Beginning in April, Gap suspended rent payments for all of its stores that were temporarily closed as a result of the coronavirus pandemic. In an April 23 SEC filing, Gap stated: “Although we believe that strong legal grounds exist to support our claim that under common law we are not obligated to pay rent for the stores that have been closed...there can be no assurance that such arguments will succeed.” Simon, on the other hand, made its position clear during a May 11 earnings conference call: “The bottom line is, we do have a contract and we do expect to get paid.”

On June 10, Simon filed objections in the Texas bankruptcy case of one of its other retail tenants, J.C. Penney, arguing that J.C. Penney should not be permitted to delay rent payments for its stores that have reopened and are now operating after coronavirus-related restrictions have been lifted. As a general rule, Section 365(d)(3) of the Bankruptcy Code requires a debtor—like J.C. Penney—to timely perform its obligations under an unexpired lease of nonresidential real property. A bankruptcy court, however, may extend the debtor’s time to perform such obligations “for cause.” In its objection, Simon argues that “cause” to suspend J.C. Penney’s rent payments does not exist, emphasizing that “landlords have likewise been adversely affected” by the coronavirus pandemic. In a decision issued on June 11, a Texas bankruptcy judge granted J.C. Penney’s request to delay \$34 million in rent payments until mid-July.

The objections raised by Simon and J.C. Penney’s other landlords are not without merit. Earlier this month, Wells Fargo commenced foreclosure proceedings against the owner of Southland Mall in Cutler Bay, Florida. Wells Fargo alleges that the borrower defaulted on its loan payments in April. It appears the borrower’s default came after its brick-and-mortar retail tenants—including J.C. Penney—could not make their rent payments.

While tensions between commercial landlords and retail tenants over suspended rent payments have been rising for weeks, and prior lawsuits have been filed, Simon’s litigation against Gap, in particular, will pit two goliaths against each other over a critical issue currently affecting lenders, landlords, and tenants of all sizes: whether a retail tenant’s obligation to pay rent is temporarily suspended or excused as a result of the coronavirus pandemic. And, while the outcome of the case will depend primarily on the specific language in Gap’s lease agreements and which state law is applied to the issues, there is no doubt that this litigation will be closely monitored as retail stores and courthouses across the country reopen for business in the coming weeks.

If you have any questions on your company’s options for pending rent payments, contact Carmine Castellano (646.218.7571), Beth Holden (716.848.1692) or Garry Graber (716.848.1273).

Please check our Coronavirus Resource Center and our CARES Act page to access information related to both of these rapidly evolving topics.