

REPRINT

CD corporate
disputes

COMMERCIAL LEASE DISPUTES AND RENEGOTIATION

REPRINTED FROM:
CORPORATE DISPUTES MAGAZINE
JUL-SEP 2021 ISSUE



www.corporatedisputesmagazine.com

Visit the website to request
a free copy of the full e-magazine

 **White** and
Williams LLP

Published by Financier Worldwide Ltd
corporatedisputes@financierworldwide.com
© 2021 Financier Worldwide Ltd. All rights reserved.

HOT TOPIC

COMMERCIAL LEASE DISPUTES AND RENEGOTIATION



PANEL EXPERTS



Kim Clifford
Senior Associate
Ashurst LLP
T: +44 (0)20 7859 1257
E: kim.clifford@ashurst.com

Kim Clifford is a real estate disputes lawyer who advises on disputes within the commercial real estate sector and acts for developers, investors, landlords, occupiers and funders. She regularly advises in relation to a variety of contentious property matters including dilapidation liabilities, insolvency issues, rights of light, contractual disputes, breach of covenant claims and asset management. She is also a member of the Junior Property Litigation Association committee.



Andrew Whitehead
Senior Associate
Stephensons Solicitors LLP
T: +44 (0)1942 774 039
E: awh@stephensons.co.uk

Andrew Whitehead is a commercial litigation solicitor and senior associate at Stephensons Solicitors LLP who undertakes work for a national client base. He specialises in all types of commercial litigation with a particular interest in commercial property litigation.



Joseph H. Langerak IV
Partner
Stoll Keenon Ogden PLLC
T: +1 (812) 759 3817
E: joe.langerak@skofirm.com

Joseph Langerak is a partner with Stoll Keenon Ogden PLLC who advises companies ranging from small businesses to Fortune 500 companies on litigation arising from disputes and various transactional matters. He has expertise in counselling commercial landlords through leasing disputes, bankruptcy and creditor rights matters, and shopping centre conflicts throughout the eastern US.



Steven E. Ostrow
Partner
White and Williams LLP
T: +1 (212) 714 3068
E: ostrows@whiteandwilliams.com

Steven Ostrow represents parties in commercial leasing and sales transactions and in bankruptcy, foreclosure and receivership proceedings throughout the US. His landlord representations include real estate investment trusts, shopping centres, malls, mixed use owners, cooperatives and receivers. He also represents national and local businesses that lease or sublease office, retail, warehouse, storage, medical, industrial, personal fitness and other space.

CD: What have been among the most common causes of disputes in connection with commercial leases over the past 12 months or so? How would you characterise the impact of the coronavirus (COVID-19) pandemic in this regard?

Clifford: In the UK, there has been a resurgence in the last year of commercial rent arrears court proceedings. This is particularly prevalent in light of two important High Court decisions in *Commerz Real v. TFS Stores* and *Bank of New York Mellon (International) Limited v. Cine-UK Ltd and others*, which awarded summary judgment to the landlords for all of the arrears. The pandemic has impacted a vast cross section of tenants across the industry, particularly in the hospitality and retail sectors. In this regard, the pandemic has accelerated changes which were already on the horizon, with a movement to turnover rent models and greater emphasis on online retail. It has been estimated that there will be £7bn of commercial rent arrears alone by June 2021. That is unprecedented and is having a colossal impact across the industry.

Langerak: There were two primary drivers causing lease disputes over the last 12 months. First, the US government-ordered closures.

Those orders compelled tenants to shutter and, obviously, impacted tenant income streams and the tenant-perceived utility of its space. Second, the voluntary avoidance by customers and employees of the businesses in commercial space even after

“Court closures and ejection moratoriums caused bravado from tenants and panic from landlords. Landlords saw no relief if tenants refused to open, pay or maintain their space.”

*Joseph H. Langerak IV,
Stoll Keenon Ogden PLLC*

government closures lifted, in full or in part. Those drivers caused tenants to quickly see little value in their commercial space, at least for some period of time, and they, in turn, looked to landlords through lease terms or other legal doctrines to obtain some relief from rent or reopening. Obviously, those requests and objections to paying rent ran contrary to landlords’ mostly unabated obligations to pay their lenders and keep the commercial space in good order.

Ostrow: Over the last year, most commercial leasing disputes have centered largely around the impact of the pandemic on both tenants and landlords, financially and operationally. The disputes were generally the result of tenant financial distress due to revenue reductions and related cash flow problems. The economic downturn hit the retail, travel, restaurant, hospitality, health and fitness, and entertainment sectors the hardest. The pandemic created unanticipated leasing issues or exacerbated pre-existing ones at all stages of the leasing relationship. In the early phases, the pandemic often resulted in the renegotiation of letters of intent or modification of leases with respect to lease and rent commencement dates, rental rates and concessions, space needs and layout, assignment, subleasing and early termination rights. During the remaining phases, leasing disputes primarily involved rent deferments and abatements, landlord and lender forbearances, lease assignments and sublets, early lease terminations, lender approvals and tenant releases in favour of landlords.

Whitehead: The financial impact of coronavirus (COVID-19) has been significant for both commercial landlords and tenants, particularly regarding rent. From a landlord's perspective, much of the focus has been on whether a lease can be forfeited for the non-payment of rent. As many businesses have either been closed or negatively impacted, many tenants are either unable or unwilling to pay

rent which, in most cases, has led to significant arrears accruing or there being a desire for the early termination of leases.

CD: To what extent has legislation introduced in response to COVID-19 caused some confusion among landlords and tenants as to how commercial leases may be affected?

Langerak: Legislation is historically introduced at a glacial pace, allowing all impacted parties to digest the ramifications and plan. However, legislation in response to the pandemic was introduced at an electric pace that, perhaps, caused lawmakers to ignore the ancillary impact of what they were doing. Court closures and ejection moratoriums caused bravado from tenants and panic from landlords. Landlords saw no relief if tenants refused to open, pay or maintain their space. Tenants, however, felt some relief as they sought to get a handle on how to move forward. At the same time, government assistance programmes where a tenant received money designed for rent payments caused confusion when landlords went unpaid. In the US, landlords felt the assistance for tenant rent relief should have come directly to them rather than the tenant passthrough.

Ostrow: There have been two principal types of legislation affecting commercial landlords

and tenants. First, the US federal government's Coronavirus Aid, Relief, and Economic Security (CARES) Act, the Consolidated Appropriations Act and the American Rescue Plan provided trillions of dollars of pandemic relief to individuals and businesses who suffered losses. The legislation also expanded the availability of fast, cost-effective reorganisations under Subchapter V of Chapter 11 of the Bankruptcy Code for a one-year period. In addition, through the Paycheck Protection Program (PPP), two of these laws provided funding for banks to make unsecured loans directly to hundreds of thousands of small and medium size businesses to pay salaries and wages to employees and rent and pass-through expenses to landlords. Ultimately, the PPP loans helped thousands of commercial tenants stay in business and pay their lease obligations typically under rent deferment or abatement agreements with their landlords.

Whitehead: The emergency legislation and regulations have been extended at short notice on several occasions in response to how the pandemic has developed. The extensions have created uncertainty, particularly in cases where agreements have been reneged on and where one or both of the parties wished to take further action but may have been prevented from doing so. Understandably businesses have been decimated if they have been unable to trade, but government support and grants have, in some cases, soured relationships between

landlords and their tenants due to a widely perceived failure for such financial relief to be passed on from tenants to landlords.

Clifford: The UK government measures have been very stringent on landlords and have taken away most of their usual enforcement measures including forfeiture, statutory demands and commercial rent arrears recovery until, currently, 30 June 2021. The government also introduced a voluntary Code of Practice on 19 June 2020 regarding commercial leases and premises, which was updated with an annexure in May. This code was intended to reinforce and promote good practice among landlord and tenant relationships and, while not changing the underlying legal relationship, strongly encouraged parties to negotiate by acting in good faith, reasonably and flexibly. Accordingly, many tenants, including those who could pay, took the measures and guidance as a green light that they did not have to pay their lease liabilities.

CD: In the event of a dispute, what resolution options are you seeing landlords and tenants explore to reach an amicable solution? How effective does mediation tend to be in reaching a compromise?

Ostrow: For tenants whose businesses are strong enough to ride out the pandemic, landlords have

been willing to provide temporary rent relief and other concessions to avoid the cost and difficulty of finding replacement tenants during the pandemic. Depending on the severity of a tenant's financial and operational condition, office tenants are typically getting rent deferrals while tenants in the retail, travel, entertainment, gym and restaurant sectors are receiving a combination of rent restructurings in the form of rent abatements and deferrals. For many existing tenants under financial stress, landlords are also willing to lower or maintain existing rental rates on lease renewals or relocate tenants to smaller locations. Landlords are offering longer free rent periods and more generous tenant improvement allowances for new tenants to increase occupancy rates to help pay property expenses and debt service to their lenders. Most parties do not engage third-party mediators to facilitate lease workouts, except if they are in litigation.

Clifford: While mediation can be an effective tool more widely in litigation, we have not seen it widely deployed in these types of disputes to date. That is because of the gulf between the positions of the landlord and tenant with either the liability being due in whole or not at all, in respect of the lockdown periods where tenants have been unable to trade. The ongoing nature of the landlord and tenant

relationship means that there are longer term issues to consider in terms of reaching any compromise.

Whitehead: Both parties have and continue to be encouraged to work together to resolve issues wherever possible and mediation is often a useful

“Grants have, in some cases, soured relationships between landlords and their tenants due to a widely perceived failure for such financial relief to be passed on from tenants to landlords.”

*Andrew Whitehead,
Stephensons Solicitors LLP*

tool to help constructively focus parties' minds. The UK government has pointed landlords and tenants to the Code of Practice implemented in response to the pandemic, the purpose of which is to “reinforce and promote good practice amongst landlord and tenant relationships as they deal with income shock caused by the pandemic”. In many situations there has been goodwill and flexibility shown by landlords and tenants to agree temporary rent reductions or the surrender of a lease, but in other cases parties have had little choice but to consider insolvency

processes such as company voluntary agreements (CVAs) and administration.

Langerak: The dialogue between landlords and tenants has increased exponentially as they have worked together during the pandemic to overcome obstacles. That dialogue became the vehicle for reaching solutions. Appreciating the other's respective position was essential for finding common ground during an unbelievable economic and public health crisis. However, the legal vehicles for resolution, short of court intervention, were not foreign to commercial real estate parties – they remained roughly the same as those prior to the pandemic. Forbearance agreements, lease amendments and other payment deferral mechanisms were utilised significantly during the pandemic. Mediation can be a good tool but only if the dispute is not based on a failure to pay rent. For example, perceived violations of exclusive uses, permitted uses or failure to honour non-monetary leasing obligations can be good disputes for mediation. Monetary disputes are too clear cut, and the utility of a mediator becomes less apparent.

CD: What essential advice would you offer to landlords and tenants on dealing with typical challenges arising from a commercial lease dispute?





Whitehead: It is imperative that landlords and tenants understand the terms of the lease in place and consequently, what action can be taken by either party. If the parties are at an impasse, often a lease will contain a pre-agreed route for disputes and the parties should be encouraged to engage with each other via the agreed route. As many disputes centre around the devastating financial impact that the pandemic has had on businesses and individuals alike, funds are likely to be limited so the parties are encouraged to meet and resolve disputes between them before consideration is given to costly litigation.

Langerak: Landlords and tenants should start with the lease because it governs their relationship. Critically review its terms, along with any applicable governing law. Make sure you know your respective positions before you start negotiating. Understand if there is a grey area regarding the dispute. If there is not, you may have a strong bargaining position or a weak one. If there is, see if you and the other party can find an amicable solution before invoking any lease or legal remedies. If you reach an impasse, understand the pros and cons of proceeding to court because it is often difficult to reverse such a measure after the parties have become that entrenched.

Clifford: In any type of commercial lease dispute, it is important to keep the commercial goal of the

parties in mind and to ensure that this is the focus of the parties. It is important that parties are open and cooperative in terms of providing information about their respective positions and that the parties consider alternative dispute resolution mechanisms which may give rise to a more efficient resolution for both sides, both in terms of time and cost.

Ostrow: The path to working out leasing disputes involves a combination of trust, disclosure and an understanding, to the extent possible, of each side's unique problems and concerns. When advising a landlord, we focus on achieving its goals which vary from lease modification to preserve a lease to repossessing a tenant's space and maximising rent recoveries by consensual arrangement or legal proceedings. In the former situation, we generally advise landlords to try to work with distressed tenants unless they can find a better replacement tenant within a reasonable period of time or the tenants are financially incapable of recovering or highly likely to file for bankruptcy. Landlords should consider workout options and strategies that are reasonable and feasible. To do so, a landlord must understand the tenant's status and leverage the best deal possible. How has the pandemic changed the tenant's business and financial condition? What is the tenant's business plan? What is the status

of a tenant's financing and eligibility for COVID-19 financial assistance? Does the tenant have any viable defences under force majeure or other lease provisions or rent relief laws? It is important for a tenant to communicate early to a landlord its

"The path to working out leasing disputes involves a combination of trust, disclosure and an understanding, to the extent possible, of each side's unique problems and concerns."

*Steven E. Ostrow,
White and Williams LLP*

business and financial issues, a viable path forward and to assert good faith claims and defences, but at the same time not to overplay its hand. Without landlord 'buy in', it is often very difficult for a tenant to establish a sufficient level of trust and good faith with its landlord to get a deal done.

CD: Have you seen an increase in the number of tenants seeking to renegotiate the terms of their commercial lease? What are some of the common rights and obligations being addressed?

Langerak: The last year has seen an increase in tenants seeking to renegotiate lease terms. Primarily, tenants sought rent reductions and shortened lease terms. The rent reductions have often resulted in some temporary forbearance or reduction, with the tenant returning to original lease terms thereafter. However, large-scale tenants with hundreds of locations sought to close poor-performing locations by shortening or buying out the term, all in an effort to increase their overall company performance, shore up losses, and avoid insolvency or bankruptcy. In addition, some tenants sought more certainty in financial projections by seeking a transition from net to gross leases.

Clifford: Tenants are commonly seeking to readdress their rent and service charge liabilities. In the circumstances of the pandemic, where tenants have shown that they are in genuine financial difficulty, many landlords have negotiated with tenants to achieve a mutually beneficial solution, for example by agreeing an extension of the term of the lease or the removal of a break option, in return for a rent holiday or deferral. Across the market, several tenants have also served contractual break notices so that they can negotiate revised favourable terms with landlords considering the current market. Tenants are seeking in those circumstances to minimise their liabilities and the length of their commitments, through a shorter term or more frequent break opportunities, to secure greater

flexibility. Landlords should keep in mind in these negotiations potential dilapidations liabilities which will also arise at the end of the lease.

Ostrow: We have seen an uptick in lease renegotiations to varying degrees. The most common negotiations involve short-term rent deferment, abatement and sales percentage arrangements. In many cases, however, parties have agreed to long-term rent restructurings to reset the economics of the lease based on significant changes in the real estate market and tenants' existing business and projections to improve the long-term viability of the lease. As part of the 'give and take' of renegotiations, landlords have secured lease extensions, tightened up force majeure clauses, removed or limited tenant co-tenancy clauses and 'kick-out' rights and obtained tenant releases of claims and defences, in particular those arising out of the pandemic and related governmental orders and the doctrine of impossibility of performance.

Whitehead: Interestingly, while an influx of enquiries from struggling tenants was anticipated, the number of tenants seeking to renegotiate the terms of their lease has been limited. This is likely due to the availability of government funding but also in part due to some landlords being flexible with their tenants. This may change when funding ends. For the parties that are seeking to renegotiate their leases, the most common clauses being

renegotiated are, of course, the rent payment provisions. Usually, dependant on how badly a tenant's business has been affected, some tenants may seek long-term rent reductions, while others may seek rent payment holidays. In some cases, where they see no prospect of recovery, tenants are even seeking to surrender their leases before the end of the term.

CD: When seeking to renegotiate a commercial lease, how important is it for parties to obtain legal advice at an early stage?

Whitehead: Both landlords and tenants should seek advice as early as possible. It is important that the parties understand their existing obligations in the lease before they enter negotiations, as well as what options are available to them. Obtaining legal advice at an early stage can also help provide alternative solutions that the parties may not have considered. This may reduce the costs paid for both parties.

Ostrow: It is important for landlords and tenants to involve legal counsel at the early stages of most lease workout negotiations. Attorneys provide a buffer and can facilitate resolutions and anticipate and raise deal points that need to be resolved. A tenant that engages an attorney can get the landlord's attention, demonstrate that it is prepared

to seriously negotiate or litigate and effectively communicate its concerns and positions during negotiations. With the help of a lawyer, landlords should also obtain pre-negotiation agreements from their tenants before meaningful lease modification discussions start to limit tenants' ability to raise in litigation commitments, agreements and waivers that landlords allegedly made during workout discussions outside of final written lease amendments.

Clifford: Seeking legal advice is vital. For landlords, they need to ensure that they are not varying the terms of the lease on a permanent basis when they are granting a temporary concession, inadvertently releasing any guarantors and that they have considered the wider consequences of any concessions. Landlords also need to be confident that the negotiated position can be enforced against the tenant. Tenants will want to be sure that they are being released of their obligations sufficiently and that the terms between the parties are also clear. The tenant will also want to be careful that there has not been an implied surrender and re-grant of the lease, which will have tax consequences.

Langerak: It is important to secure legal advice early when renegotiating. At the outset, a lawyer can help determine if the other party is in breach, which can provide significant leverage in the renegotiation. For example, helping determine whether a co-tenant is now violating an exclusive use afforded

to a tenant because the co-tenant changed its use over the years – think, a coffee shop that started selling alcohol or a dollar store now selling groceries. In addition, legal counsel can provide novel ways for either party to accomplish its goal in renegotiating through unique drafting and leasing concepts. Unless these measures are considered early on, the deal may be struck in principle before the drafting even begins and opportunities may be lost.

CD: What are your predictions for commercial lease disputes in the months ahead? How are legislative changes or the end of grace periods likely to affect resolution and renegotiation processes?

Ostrow: The likelihood and ability of parties to resolve outstanding leasing issues should increase as the economy and businesses rebound from the pandemic, the cost of capital remains low and eviction moratoriums and governmental restrictions expire. These factors should reduce uncertainties that impeded resolutions. However, this will not be the case for tenants that have or will permanently shutter their businesses or for landlords whose properties are in foreclosure absent lender cooperation. The downturn in most real estate markets should also continue to help

tenants leverage workouts and negotiations with landlords. This is because current lower rental rates and higher inventories in many markets may only improve in the long term. Over the next few

“There are several variables in place in the property market currently, all of which will have an impact on commercial lease disputes in the months ahead.”

*Kim Clifford,
Ashurst LLP*

years, we also expect an increase in Chapter 11 bankruptcy reorganisations for businesses that are overleveraged, including tenants with significant leasing footprints and costs that want to downsize and reduce such liabilities by rejecting some leases and renegotiating other above-market ones.

Clifford: There are several variables in place in the property market currently, all of which will have an impact on commercial lease disputes in the months ahead. The UK government restrictions on many landlord remedies are due to end in June 2021 and the government has called for evidence to inform its policy regarding the exit measures and the

need for any further measures has recently closed, all of which is going to be critical for any recovery. Accordingly, the government response is going to be critical in terms of the resolution and renegotiation process for lease parties, as this will dictate the strength of hand of landlords. It is also expected that the number of insolvencies is likely to increase once the restrictions are lifted, especially following the recent court decisions in respect of the Virgin Active restructuring plan and New Look CVA challenge, and this will also impact the overall position between landlords and tenants.

Langerak: Q1 and Q2 2021 produced far fewer large-scale tenant bankruptcies than most expected. However, as government subsidies and assistance programmes begin to sunset, there is a fear disputes will increase, primarily regarding rent payments. After all, many landlords were willing to permit some type of forbearance or amortisation of rent over time, but most do not allow that to continue beyond a year and the pandemic onset anniversary has now come and gone. The departure from traditional brick and mortar retail, coupled with reduced demand in the office space market considering continued work-from-home business models, has caused landlords to fill more vacancies than normal, especially in large markets. As a result, commercial landlords

may seek to backfill those vacancies in unique and unconventional ways, thus potentially producing more permitted and exclusive use disputes. Hopefully, the lesson of coming together to find an amicable solution learned by landlords and tenants during the pandemic will continue into the second half of 2021 should defaults and disputes rise.

Whitehead: Regardless of the differences between landlords and tenants, even in those cases where goodwill is at a minimum, it is likely to be in both parties' interests for the tenant's business to continue once the moratorium ends and COVID-19 restrictions ease. While many landlords may be keen to forfeit a lease to prevent any further loss of rent, the commercial property landscape has fundamentally changed due to the pandemic. For example, in towns and cities, with many people working from home on a more permanent basis, landlords may wish to give thought to whether their properties are going to be as attractive to potential new tenants if the 'new normal' sees fewer people commuting to a place of work. We are expecting parties when renegotiating future leases to seek agreement on clauses dealing with unforeseen, emergency measures to help legislate how landlords and tenants will work together should any such circumstance arise in the future. **CD**