COVID-19 Consequences for Landlords

Updated as of 27/04/2020

With COVID-19 impacting on every aspect of the UK economy, we consider the potential issues for commercial landlords and property investors. In particular, what happens to the liabilities under a lease if the tenant is forced to close their premises or if a landlord is required to close a multi-let building, business park, shopping centre or retail park?

Insurance to the rescue?

It is tempting for landlords to treat this as the tenant's problem; after all, surely they have business interruption insurance to cover such situations. But tenants could easily find that their insurance (if they have it) won't cover business interruption losses caused by a forced closure for COVID-19 reasons. Tenants may have procured business interruption policies, but this is usually linked to property damage. Non-damage business interruption cover (which might cover the impact of a pandemic like COVID-19) has been available in the insurance market, but not commonly bought. Nevertheless, tenants should check their policies.

In the UK, the government has confirmed that COVID-19 is a "notifiable disease" under the Health Protection (Notification) Regulations 2010. This is a formal classification required by many insurance policies, so tenants who have business interruption cover may be able to claim under it, depending on the specific terms of their policy, and they should be prepared to challenge insurers who seek to deny their claims. If the tenant has no such cover, however, tenants may seek to argue that they should not have to comply with their covenants (e.g. to pay the rent) when they cannot use the premises. In the case of rent suspension provisions, this will require landlords to look carefully at their own insurance policies. This is discussed in further detail at point 3 below.

This guidance note considers the following liabilities under a lease:

1. Quiet Enjoyment and Derogation from Grant
2. Withholding rent
3. Rent suspension – landlord's insurance
4. Frustration
5. Repudiatory breach
6. Other issues including emergency regulation and maintenance obligations

1. Quiet Enjoyment and Derogation from Grant

Whether or not there is an express provision in the lease, landlords are required to give their tenants 'quiet' and uninterrupted use of the premises for the duration of the term of the lease.

Additionally, landlords must ensure that they do nothing to derogate from (i.e. nothing that is inconsistent with) the grant of the lease of the property to the tenant. Should a landlord be forced to close a shopping centre or a multi-occupied office building or business park, one can see that their tenants could reasonably argue that, by being deprived of access to the premises, the landlord is acting in a way that is inconsistent with the lease – indeed, the landlord is preventing the tenant from accessing the subject matter of the lease.

On the face of it, these circumstances would give rise to a claim for breach of both the covenant for quiet enjoyment and the covenant not to derogate from the landlord's grant. Such a claim might ordinarily result in the court granting an injunction to compel the landlord to remedy the breach and compensation might be awarded to the tenant for loss of trade and/or to compensate the tenant for all or part of the rent that they have paid for that period. Alternatively, such breaches could amount to repudiatory breaches which would allow the tenant to argue that the lease is terminated and to claim damages. But in the event of a forced closure (presumably as a result of legislation) the landlord would be acting in accordance with statute (and therefore lawfully) and have a complete defence to such claims. Only if the landlord has chosen to close the shopping centre/retail park/office building/business park (i.e. it is a voluntary measure) could the tenant have a claim.

Assuming the landlord has simply reacted to a new statutory requirement, the tenant will need to consider other remedies.

2. Withholding rent

Tenants might be tempted to withhold rent in these situations but, as any well advised tenant will know, most modern leases contain a provision prohibiting tenants from withholding rent even where they would otherwise be entitled to set off the rent against a valid counterclaim (e.g. for breach of covenant for quiet enjoyment). As well as prohibiting tenants from withholding rent, such clauses usually expressly prohibit the tenant from setting off counterclaims. So this is no answer for the tenant either.

3. Rent suspension

Most leases contain rent suspension clauses which (as the name suggests) suspend the tenant's obligation to pay rent in the event that the premises are physically damaged and/or rendered unfit for occupation/use or rendered inaccessible by an insured risk or some other event specified in the clause. It would be unusual for these clauses to specifically anticipate a pandemic so it is important to review the landlord's insurance policy to establish whether COVID-19 is a risk that is covered and is therefore as an insured risk that triggers the rent suspension clause.

Most rent suspension clauses are drafted by reference to a named risk that the landlord is required to insure against; or, an unspecified risk that the landlord has chosen to insure against regardless. In some cases, COVID-19 may fall into the latter category. Some policies may feature a geographical exclusion clause: e.g. the notifiable disease must have manifested itself within a set radius of the insured premises. The scale of the infection is now so high as to make it unlikely that any premises will be far enough away from a recorded case to qualify for an exclusion.

However, the fact that a landlord's insurance policy may respond to a claim for loss of rent does not mean that

the case will be open and shut. The landlord will still be under a duty to 'mitigate' its loss. In practice, this will usually mean showing that the landlord is unable to recover the rent from the tenant because the lease contains a rent-suspension clause which has been triggered as a result of the happening of the insured risk in question.

As mentioned above, most rent suspension clauses are limited to situations where actual physical damage is caused (to the premises or common parts) rendering the premises unusable or inaccessible. However, some clauses refer to the premises being inaccessible or unusable (as a result of the insured risk) without making reference to physical damage. It is in these instances that the rent suspension clause could be triggered so as to produce a loss that the landlord would seek to claim under its policy COVID-19 is an insured risk. It is though arguable that the insured risk has not resulted in the premises being inaccessible; instead, it may be argued that the tenant can still access the premises but it is simply that (due to government regulations) the tenant cannot trade from the premises. A nuanced point that will generate a lively debate no doubt.

The key issue here is for landlords to check the terms of their insurance policy and, if COVID-19 is an insured risk, review the rent suspension clauses which may or may not align with their insurance policy. Each case will need to be considered on its particular facts and, if the policy seems to cover COVID-19 related losses, landlords should seriously consider placing their insurers on notice of potential claims to avoid the possibility of a denial of cover at a later date.

Even if their policies do not cover COVID-19 related losses, landlords should check the rent suspension clauses to see if they are triggered by risks that are not insured (uninsured risks) which may be defined in such a way as to cover COVID-19 and therefore trigger a rent suspension. It is particularly important to review such provisions where they are not limited to physical damage or destruction.

This is a complex area which requires the specialist advice of our insurance lawyers as well as our real estate lawyers so please contact us if you have concerns.

4. Frustration

Most leases do not contain force majeure clauses so the tenants may seek to rely on the common law principle of frustration which does not need to be provided for in contract. Frustration arises where an event occurs, after contract formation, which is beyond the parties' control rendering it impossible to perform the contract or where the relevant obligation is transformed into a radically different obligation from what was contemplated at the time the contract was entered.

A frustrating event generally must be unforeseen, unexpected or uncontemplated at the time the parties entered the contract. A two-stage test is usually applied to assess whether the Coronavirus outbreak constitutes a frustrating event:

- *Stage 1* – Was the particular event/situation provided for in the contract? If yes, frustration is not possible. If not, proceed to the next stage.

- *Stage 2* – Was it an event of such nature that continued performance of the contract was rendered impossible or such that performance was rendered so radically different from what was originally contemplated that it would be unjust to hold that the parties remain bound by the contract? If yes, the contract may be frustrated.

While the Coronavirus outbreak and related epidemic control measures may be unforeseen at the time of entering into the contract, the key obstacle for tenants will be showing that there is 'radical difference' in the parties' obligations. Bearing in mind that English courts apply the principle of frustration within very narrow limits, it is not sufficient that a contract becomes unexpectedly difficult or more expensive to perform on one or both sides. The courts will not relieve a party from a turn of events that makes performance more onerous, or leads to a delay that is merely transient.

The difficulty of successfully arguing frustration of leases was illustrated most recently in Canary Wharf Limited v European Medicines Agency [2019] EWHC 335 (Ch). In that case, the European Medicines Agency argued that Brexit would frustrate its lease as it was forced to relocate to another member state. The High Court did not agree.

Drawing from available case law (most of which relates to shipping cases), there is arguably at least a possibility that tenants who are occupying either under a short term (i.e. pop-up) tenancy, or the tail end of a longer lease, might be in a better position to argue that the contract has been frustrated. This is because the impact of even a temporary interruption on a shorter lease will be proportionally greater than it would for a long term lease. The courts may have regard to such proportionality when deciding whether the lease has been frustrated – such a decision would create new law insofar as there is no reported case of frustration applying to leases.

As things stand, we think it is generally unlikely that a tenant would be successful in claiming that a lease has been frustrated due to the impact of a closure caused by COVID-19, with a caveat in relation to very short term leases where some new law could be created if a tenant were courageous enough to take up the gauntlet and seek to expand the current limitations of frustration.

5. Repudiatory breach

If the landlord is obliged (under the lease) to provide the tenant with access over common parts (to gain access to the tenant's premises) or is obliged to keep a shopping centre or office building open between specified hours, it could be argued that a breach of such obligations amounts to a repudiatory breach of the lease that entitles the tenant to argue that the lease has come to an end. The tenant could also seek to claim damages for losses incurred as a result of such termination. Again, any such breach caused by a forced closure is likely to provide the landlord with a defence to such a claim.

6. Other issues

- *Emergency measures/moratorium on evictions* – we have now seen the government introduce a moratorium on landlord enforcement action for at least three months, meaning tenants who miss rent payments because of COVID-19 related issues can keep their leases for now – landlords will not be able to evict them in that time (a similar eviction holiday was granted to residential tenants on 18 March 2020).

  The Coronavirus Act also introduces some protection for landlords who may be in discussion with tenants by expressly providing that (unless the contrary is made clear) such discussions or action by the landlord will not amount to a waiver of the landlord's right to forfeit the lease for non-payment of rent.

- *PD 51Z* – in addition to the above legislation, a new practice direction has been issued under the Civil Procedure Rules (PD51Z). The effect of PD51Z is to immediately stay certain possession claims for a

period of 90 days, including all claims for forfeiture of commercial premises (no matter what the breach).

- *Enforcement moratorium* – in a further press release issued on 23 April 2020 the government announced more measures to curtail any enforcement action that a landlord can take:
  1. Firstly, it plans to temporarily ban the use of statutory demands and winding up orders ''where a company cannot pay the bill due to Coronavirus''. The measures will be introduced in a Corporate Insolvency and Governance Bill but the detail of how this will work in practice is not yet available. This would seemingly only apply to a company who cannot pay the bill due to Coronavirus.
  2. Secondly, it plans to prevent landlords using Commercial Rent Arrears Recovery (CRAR) unless the tenant owes at least 90 days of unpaid rent.

  We do not have any further detail on these measures yet but will continue to monitor the position and will update this note as soon as further detail is announced. Interestingly, in the 23 April 2020 press release, the Communities Secretary said ''we understand that landlords are facing their own very serious pressures and are concerned about their position with lenders. We are working with banks and investors to seek ways to address these issues and guide the whole sector through the pandemic.'' Could this be a sign that some overdue help is on the way for landlords?

- *Rates* – The government has also introduced business rates relief for some. This includes a 12-month business rates holiday for all retail, hospitality, leisure and nursery businesses in England; small business grant funding of £10,000 for all businesses in receipt of small business rate relief or rural rate relief; and grant funding of £25,000 for retail, hospitality and leisure businesses with property with a rateable value between £15,000 and £51,000.
- *Keep open provisions* – It must go without saying that, in the same way that the landlord would have a defence to a tenant's claim for breach of the covenant for quiet enjoyment (in the event of a forced closure), a landlord would not be able to enforce keep-open clauses in lease. We would counsel caution against any landlord seeking to obtain injunctive relief against a tenant that closes their shop in furtherance of government guidelines. Most UK commercial leases will contain an obligation on the tenant to comply with statutes. The tenant would be in breach of covenant if it fails to comply with any clear direction issued by the government, such as the closing of premises.
- *Building/common parts maintenance obligations* – Landlords with a controlling interest over a property/centre/park and who provide services (cleaning, maintenance, and repair) usually have obligations to their tenants and occupiers. Landlords operating in a capacity as management company have obligations in relation to common or retained parts of a building, and employer landlords may have obligations to staff in occupation.

  The duties in relation to COVID-19 might be limited given that it appears to spread by human contact rather than through the building management system so it may be that such duties are limited to: (i) routine deep cleaning and (ii) taking further measures where a COVID-19 case has been confirmed. It will also be necessary to consider the landlord's duties under the Control of Substances Hazardous to Health Regulations 2002 given that COVID-19 has been categorised as a biological agent. Where a landlord has control over the common parts and structure of a building or centre then they should consider their obligations under this regulation. If the non-availability of materials or labour means that it is impossible to provide particular services, the landlord should be able to rely on any provisions in the lease that say that the landlord is not obliged to provide services where it is prevented from doing so for reasons beyond its control. If a landlord needs to provide more intensive cleaning services, it is

likely that the additional costs incurred would be recoverable under the service charge provisions under which tenants will remain liable.

Summary

We are seeing the consequences of COVID-19 (and the closure of public spaces, shopping centres, retail parks, business parks and other areas of congregation) across the board and disputes between landlord and tenants are arising from time to time.

In most cases, tenants will not be able to pass on their COVID-19 related losses to their landlords (in the event of forced closures) but there are exceptions to that rule and each case will need to be considered on its facts, having regard to the specific terms of the lease (and the insurance policies of the tenant and landlord) so legal advice should be taken in each situation.

In the meantime, we would hope that landlords and tenants can work together to support each other in countering the impact of COVID-19 so as to mitigate the effects of the virus and its effect on the economy generally. With so many businesses operating a hand-to-mouth existence, both landlords and tenants will need support to get through any period of forced closure.

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