The Effect of COVID-19 on Risk Allocation in Commercial Leases: Recent Superior Court Decision Provides Guidance

By Jeremy Weltman on February 12, 2021



In one of the first written decisions from the Massachusetts Superior Court on the practical impact the COVID-19 pandemic has had in the commercial real estate space, the Business Litigation Session in the case of *UNMV 205-207 Newbury, LLC v. Caffe Nero Americas Inc.* not only denied an attempt at summary judgment by the Lessor, but also granted partial summary judgment to the Lessee – *sua sponte.*

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The Pertinent Facts

The Lessor, UMNV 205-207 Newbury, LLC ("Lessor") leased retail space to Caffe Nero Americas, Inc. ("Lessee"). One condition of the Lease was that the Lessee could use the leased premises only to operate a "Caffe Nero themed café," and not for any other purpose. A second condition required it to operate consistent with its operations at other locations (i.e. creating an atmosphere where customers could sit and enjoy a beverage).

In March 2020 the Governor barred Massachusetts restaurants from allowing on-premises consumption of food or beverages, indoors or outside. As a result, Lessee temporarily closed its Newbury Street café and stopped paying rent. Lessor responded by terminating the Lease and then bringing a summary process eviction action. Lessee vacated the premises in late October 2020.

Lessor also filed a lawsuit in Superior Court seeking to recover unpaid rent plus interest and "administrative expenses" for the months that Lessee continued to occupy the premises, liquidated damages for the rest of the 15-year lease term, and attorneys' fees and expenses. Pointing to the Independent Covenants provision of the Lease, Lessor moved for partial summary judgment as to liability for breach of contract and as to the amount of damages, interest, attorneys' fees, and litigation costs it claims through the date that Lessee left the premises.

The Parties' Arguments

The crux of Lessee's position in defense of the Lessor's lawsuit was that under the doctrine of ***frustration of purpose***, Lessee's obligation to pay rent was discharged while it was barred from letting customers drink or eat inside the leased premises, at least from March 24 to June 22, 2020 (the timeframe in which the Governor of Massachusetts' emergency orders barred restaurants from allowing on-premises consumption of food or beverages).

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Therefore, according to the Lessee's argument, it did not breach the Lease by not paying rent for this period and the Lessor acted improperly when it terminated the Lease for non-payment of rent in May 2020.

For the Lessor's part, it argued that both the ***force majeure*** clause and the ***independent covenants*** provision of the Lease barred the Lessee's defense. Further, Lessor argued that it had no duty to waive or reduce any payments under the Lease by virtue of financial inability of the Lessee. Indeed, pointing to the Lease language itself, the Lessor not only provided proper notice of non-payment of rent to the Lessee, but the Lessee would clearly be in default of the Lease if it failed to pay rent when due and did not remedy the non-payment within five days after receiving written notice from the Lessor. Here, there was no dispute that the Lessee never paid additional rent after receiving the Lessor's notice.

The Court's Analysis

In analyzing the parties' competing arguments, the Court first applied the ***frustration of purpose*** doctrine to the facts at hand. In the Court's opinion, Lessee's continuing obligation to pay rent was discharged at least from March 24 to June 22, 2020 because "the entire purpose of the Lease was completely frustrated while the Governor's COVID-19 orders barred restaurants from serving customers indoors." In doing so, the Court noted that 1) where the Lease's stated purpose was to operate a café with a sit-down restaurant menu "and for no other purpose," said purpose was destroyed or frustrated while the Governor's COVID-19 orders barred Lessee from allowing customers to consume food or drink inside the lease premises; 2) since the Lease limited the permissible use of the leased space to a single purpose,**[1]** Lessee's continued ability to operate a café at the lease premises, and the absence of government orders barring all restaurants from serving customers inside, was a basic assumption underlying the lease; and, 3) there was no evidence that the risk of a global viral pandemic coming to Massachusetts and leading to a government order shutting down the entire restaurant industry was something the parties contemplated when they entered into the Lease.

In response to this reasoning, the Lessor argued that the Lease language itself actually did allocate the risk of this unforeseen event to the Lessee. In doing so, the Lessor insisted that the defense of ***frustration of purpose*** was barred by the *force majeure* and ***independent covenant*** provisions.

Force Majeure

The ***force majeure*** provision of the Lease stated in relevant part that:

Neither the Landlord nor the Tenant shall be liable for failure to perform any obligation under this Lease, except for the payment of money, **in the event it is prevented from so performing by** … order or regulation of or by any governmental authority … or for **any** other **cause beyond its reasonable control**, but financial inability shall never be deemed to be a cause beyond a party's reasonable control …, and in no event shall either party be excused or delayed in the payment of any money due under this Lease **by reason of any of the foregoing**.

According to the Court's interpretation, this ***force majeure*** provision provides that generally neither Lessor nor Lessee is liable for breach of contract if they are prevented from performing by any cause beyond its reasonable control; however, it includes two important

exceptions. First, financial inability shall never be considered a cause beyond a party's control. Second, failure to pay rent or other money due under the Lease will never be excused on the ground that a party was prevented from making the payment by some cause beyond its control.

Then, focusing on the phrase "by reason of any of the foregoing" at the end of the provision, the Court held that said phrase refers to a party being "prevented from … performing by" any of the listed risks or any other "cause beyond its reasonable control." Thus, held the Court, the ***force majeure*** provision addresses the risk that performance may become impossible, but does **not** address the distinct risk that the performance could still be possible even while the main purpose of the Lease is frustrated by events not in the parties' control. Where nothing in the ***force majeure*** provision says that any other limits on use of the ***frustration of purpose*** doctrine by the Lessee are exceptions to the ***force majeure*** rules the parties negotiated, ***frustration of purpose*** as applied to the facts at hand is a "different issue, arises under different circumstances, and is not addressed by the *force majeure* provision."

Independent Covenants Provision

As many modern commercial real estate leases provide, the ***Independent Covenants*** provision of the Lease here provided that Lessee's obligations are "separate and independent covenants and agreements," so that any rent owed by Lessee "shall continue to be payable in all events" unless the Lease is terminated. The effect of this provision is to negate the common law rule of mutually dependent covenants, under which a landlord's material breach of a commercial lease may be an affirmative defense to a claim for non-payment of rent. See Shawmut-Canton LLC v. Great Spring Waters of America, Inc., 62 Mass. App. Ct. 330, 339 (2004). That is not the issue here.

According to the Court's analysis, whether Lessee's obligation to pay rent was temporarily discharged due to ***frustration of purpose*** does not turn on whether Lessor materially breached its lease obligations. As the Court saw it, Lessee's obligations were discharged because of the effect of the Governor's COVID-19 orders, even though Lessor continued to perform all of its obligations under the Lease. Lessor, nonetheless, insisted that the ***Independent Covenants*** provision of the Lease demanded that Lessee keep paying rent "in all events"— and "without setoff, counterclaim, recoupment, abatement, suspension, deferment, diminution, deduction, reduction or defense excepts as specifically set forth" in the Lease. In other words, according to the Lessor, the ***Independent Covenants*** provision bars any application of the doctrine of ***frustration of purpose***.

Ultimately, the Court disagreed. Using the generally accepted principle in contract interpretation that the words of a contract must be considered in the context of the entire contract rather in in isolation, the Court held that "it would be improper to consider the "in all events" and "without defense" language as if it stood alone." Paying homage to consideration of what the parties' "intent" was under the Lease, the Court concluded that it would have made no business sense for the parties to enter into a lease providing that Lessee may only use the leased premises for one narrow purpose, but must keep paying rent even if the only permissible use is no longer allowed or possible.

Further, where the parties had negotiated and agreed to other Lease provisions specifying how ***frustration of purpose*** principles would apply in the event that the leased premises were damaged or destroyed, "the fact that the parties did not think to address the possibility that a global pandemic might lead to government orders barring restaurants from serving customers does not mean they intended to bar application of the frustration

doctrine in these circumstances." Therefore, held the Court, the "in all events" and "without defense" language cannot reasonably be construed as barring application of the doctrine of ***frustration of purpose*** with respect to the facts of this case.

Conclusion

As one of the first forays into how the Massachusetts Courts will handle what will certainly be a flood of similar lawsuits, this case is interesting in that the Court ultimately found that neither the ***force majeure*** nor ***Independent Covenant*** provisions properly allocated to the Lessee the unforeseen risk that a global pandemic could lead to government orders that barred the Lessee from operating its business on the leased premises. Where these sort of provisions are arguably intended to protect the Lessor's interests in potential breach of the Lease by the Lessee – and have historically been upheld to do so by the Courts – this opinion teaches both lessees and lessors that each commercial lease and each commercial landlord/tenant relationship will need to be scrutinized on a case-by-case basis in light of the COVID-19 pandemic.

[1] The "sole use" provision is important in the Court's analysis, as it further indicates in its Opinion that if the Landlord had allowed the Lessee to use the lease premises for other purposes not barred by government order, then the fact that Lessee's intended use was frustrated might not have discharged its obligation to pay rent.

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