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When Companies Shut Their Doors – Despite Covenants To Continue Operations

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Major retailers across the country have closed some or all of their stores and are even withholding rent due to the coronavirus pandemic. Some are closed in response to government orders because they are deemed non-essential. Some have asserted that they qualify as essential businesses yet have strategically closed certain locations. And, others are located in states without any mandated closures but chose to close for economic and/or health-related reasons. This article explores an additional tool that commercial landlords may use to deal with tenant vacancies that fall in the latter two categories: "continuous operations clauses." In deciding how to deal with commercial tenants who have ceased operations, landlords should consider the following questions.

1. **Does The Lease Have A Continuous Operation Clause?**

A continuous operations clause is one in which the tenant expressly agrees to continuously conduct its regular business operations. For instance, a continuous operations clause may provide: "Tenant shall operate its business on all regular business days at least eight hours each day between 9 a.m. and 10 p.m." Such a clause requires a business to operate or breach the lease, even if it is no longer financially capable of performing. These clauses are important to retail landlords, who often receive a percentage of tenants' sales and who depend on achieving a certain mix of tenants for the overall success of a retail center.

Courts generally enforce *express* continuous operation clauses, but they will not imply such a clause. Continuous operation clauses should be distinguished from restrictive use covenants. For instance, a provision that limits the use of property to "no other purpose than a restaurant or bar" will not be construed as a continuous operations clause. It does not require the tenant to put the

property to use at all times; rather, it limits the purposes for which the tenant may use the property.

1. **If So, Is It Qualified?**

Tenants may be looking to take advantage of "force majeure" clauses to get out of their obligation to pay rent. The same goes for the obligation to continue operations. Some continuous operations clauses are expressly "subject to force majeure" while others are unqualified. It is important to assess whether your continuous obligations clause contains any exceptions or qualifications.

1. **How Does This Help A Landlord?**

A tenant's violation of the continuous operations clause may give rise to an event of default. Generally, the lease will define "Events of Default," which may include the cessation of operations for a certain number of consecutive days – for example, the cessation of business operations for 60 consecutive days. The lease may also require that notice and an opportunity to cure be given before declaring default. Thus, the vacancy may not give rise to a default unless it continues for months.

If the tenant defaults under the continuous operation clause, this may give rise to additional remedies and damages – above and beyond those that could be awarded for breaching the lease's payment obligations. The lease should be consulted to determine the remedy. For instance, the lease may make clear that the landlord can pursue equitable remedies, which would include specific performance, or a mandatory injunction requiring the business to continue to operate. Even if permitted by the lease, however, such injunctions are rarely granted in practice. Courts do not like to be put in the position of supervising future performance, or as one Illinois court put it, "in the business of managing a shopping center." *New Park Forest Assocs. II v. Rogers Enters., Inc.,* 195 Ill.App.3d 757 (1st Dist.1990). Courts also look to the reasonableness of enforcing specific performance and will not grant it if doing so would inflict significant harm on the adverse party or if monetary damages are available. The current crisis makes equitable relief even more unlikely, as the balance of equities is more likely to favor tenants. Despite this, on occasion, courts do award injunctive relief, mandating that a business continue operating. Thus, after the health crisis abates, it may be possible – though still difficult – to secure specific performance.

It is more likely that the landlord can obtain monetary damages in excess of the rent that would be due under the remaining term of the lease to compensate it for the additional damages caused by empty storefronts, such as the loss of goodwill, loss of foot traffic, loss of synergies with other tenants, etc. For instance, some leases call for an additional 25% to 50% of the minimum rent due under the lease to compensate for the vacancy. Because it is difficult to calculate the harm caused by a vacancy above and beyond loss rental income, leases will often contain liquidated damages

provisions that set forth the remedy. Courts usually enforce such provisions so long as they are not deemed punitive.

1. **Practical Considerations**

So, assuming you have a continuous violation clause that could be implicated, should you enforce it given the state of the world? This is a multi-faceted and relationship-specific decision, but it should be a deliberate decision. While this may not be the right time to use this tool, it is a good time to educate yourself about it and make sure to preserve it. For instance, you should consider sending a formal letter to the tenant at the time that cessation of business becomes an event of default to provide notice of default and/or reserve all rights. In sum, the continuous violations clause may be a powerful tool in a commercial landlord's arsenal to deal with the fallout from this pandemic – and should not be mistakenly waived.

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