COVID-19 Orders and Commercial Tenants’ Potential Arguments for Terminating Leases

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As state and local officials have issued COVID-19 stay-at-home and shelter-in-place orders, numerous businesses deemed “non-essential” per the terms of those orders have had to close their doors, and for many, those closures have resulted in a complete cessation of business operations.

With these COVID-19 restrictions in place, many commercial tenants argue that they are left unable to operate their businesses, and therefore, unable to pay rent and meet their other obligations under their leases. Commercial leases may contain one or more (or none) of a variety of provisions intended to address the inability to use the leased property as expected or to perform obligations in the lease, including force majeure and casualty and condemnation provisions. If a lease does not contain any such provisions or the provisions do not address circumstances like those caused by the restrictions contained in COVID-19 orders, some tenants may feel compelled to breach their lease and perhaps hope to terminate their lease.

Tenant’s Breach of a Lease

Impossibility or Impracticability

When a tenant stops paying rent, courts will look to the express terms of a lease first to determine whether performance should be excused. While a force majeure clause in a lease is likely to be interpreted narrowly based on the specific language in the clause, where no such clause exists, tenants may have an argument that their performance of the lease has been made impossible or impracticable by supervening circumstances that could not have been foreseen. That is, if it is physically impossible to access leased property, and therefore, impossible or impracticable to operate a business out of that property due to a COVID-19 order restricting non-essential businesses, it may quickly become impossible to pay rent.

Texas, however, does not recognize economic impracticability where performance simply becomes more economically burdensome than anticipated. This means that tenants in Texas have a steep uphill battle in making an impossibility or impracticability argument when the argument is based purely on the fact that it has become difficult or less economically feasible to pay rent. Further, the reason for breach cannot be the result of a tenant’s voluntary act. In determining whether the act was voluntary, courts may look at the language of the specific COVID-19 order to determine what type of business the tenant operated and whether the restrictions applied. This is also related to a question of whether a tenant has a duty to mitigate damages to a landlord by attempting to avoid a breach of the lease. In determining whether the tenant could have mitigated damages, courts will examine whether the tenant attempted to operate its business in some substantive way as allowed under the COVID-19 restrictions. For example, can a restaurant tenant already on the verge of failure simply cease operations and stop paying rent, or does it have an obligation to attempt to perform its duties under the lease by altering its service model in some way?

Potential for Just Compensation under Takings Law

If a tenant cannot avoid its obligations under a lease using impossibility or impracticability arguments, does the tenant have any other right with respect to the damages it suffered because of restrictions in a COVID-19 order? At least one lawsuit has already been filed asserting the argument that COVID-19 orders closing non-essential businesses constitutes a regulatory taking in violation

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1 See Huffines v. Swor Sand & Gravel Co., Inc., 750 S.W.2d 38, 40 (Tex. App.—Fort Worth 1988, no writ); Alamo Clay Products, Inc. v. Gunn Tile Co., 597 S.W.2d 388, 395 (Tex. App.—San Antonio 1982, writ ref’d n.r.e.).
of the Fourteenth Amendment. It has yet to be determined how courts will decide such issues, but an analysis of prior regulatory takings case law may offer some guidance.

**Takings Considerations in Commercial Leases**

Parties have a fundamental right to enjoy land in which they hold a recognized interest. "The general rule is that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 415 (1922). However, when a regulation completely restricting use is temporary in nature, it requires a weighing of the facts and circumstances to determine whether a taking has occurred.

With this in mind, a takings analysis may prompt the following questions and associated analysis: (1) What is the property right that was taken? (2) Was the taking partial or whole, temporary or permanent? (3) What are the specific circumstances surrounding the alleged taking?

When a commercial lease contains a condemnation clause, that clause may terminate a tenant’s rights just prior to the taking, leaving the tenant without an interest in the condemnation compensation at all. If a condemnation clause does not exist or does not provide for termination of the lease, the tenant may then have an interest in only an apportionment of a condemnation award once it has been awarded. Without any reference to a condemnation clause in a commercial lease, arguing that the government has taken a property right will likely be similar to arguing that it has become impossible or commercially impracticable to perform under the lease.

The question then is what compensation measure should apply where a right of occupancy has completely, albeit temporarily, taken from a tenant or where the right of occupancy has been so diminished that it is impossible for the tenant to perform under the lease. Simply put, a tenant’s right to occupy and use property has value, but courts will have to determine the value of that right. Moreover, it remains unclear whether or to what extent such a compromise or diminution in value establishes a legal basis for a tenant to terminate its lease.

For more information on the matters discussed in this Locke Lord QuickStudy, please contact the authors.

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Visit our COVID-19 Resource Center often for up-to-date information to help you stay informed of the legal issues related to COVID-19.

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6 There is Supreme Court precedent for the idea that when fixtures and equipment are either destroyed or depreciated in value by the taking or that when a tenant’s ability to occupy leased property, just compensation is owed See U.S. v. General Motors Corporation, 323 U.S. 373, 380 (1945).