



# San Francisco Small Business Tenant-Landlord Issues Fact Sheet<sup>1</sup>

## Current City and County of San Francisco (the “City”) Guidance and Mandates

The State of California and the City have declared a state of emergency, and in conjunction, have promulgated several new regulations and programs. This includes the City Order of the Health Officer No. C19-07 mandating businesses to cease non-essential operations at physical locations in the City. All businesses can continue Minimum Basic Operations. Essential Business are permitted to remain open. The City has also issued guidance for Essential Businesses.

COVID-19 has caused abrupt serious negative impacts on the local San Francisco economy and abrupt serious negative financial impacts to local San Francisco businesses. These negative impacts have put small business in serious jeopardy regarding their current commercial leases. The below provides a brief outline of the current City eviction moratorium, as well as a more general discussion of lease negotiations.

An assessment of an organization’s lease options should begin with a thorough review of the lease itself, including all amendments. An organization should also be prepared with documentation to show financial distress arising from the COVID-19 pandemic.

## San Francisco Commercial Tenant Eviction Moratorium

Mayor London Breed announced a San Francisco Commercial Tenant Eviction Moratorium on March 18, 2020, applicable to businesses with combined worldwide gross receipts for 2019 of \$25,000,000 or less. The moratorium prohibits landlords from evicting commercial tenants for failure to pay rent after March 17, 2020. This moratorium is subject to several procedural elements which must be followed by both the commercial tenant and the landlord.

1. On failure of the commercial tenant to pay rent, a **landlord must send written notice** to the commercial tenant which includes a 1 month opportunity to cure before any eviction.
2. Commercial tenant can either (1) **pay the rent**, or (2) **provide documentation** to the landlord showing that the commercial tenant is unable to pay the rent due to a financial impact related to COVID-19.<sup>2</sup>
3. If tenant pays the rent then the lease violation is cured and the lease continues. If tenant provides documentation of the tenant’s inability to pay the rent then the **cure period is extended by**

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<sup>1</sup> This handout is informational and does not constitute legal advice. Given the complexity and nuances of the law, this information is general and may not apply in specific situations. Information specific to an individual case, or generally, may be omitted. Legal advice from a qualified attorney should always be sought before taking any legal action. This is a rapidly developing area and this handout may quickly become out of date, as such this handout should not be relied upon in place of the text of any particular law or regulation.

<sup>2</sup> The Mayor’s order defines “financial impact” as a substantial decrease in business income due to illness or other disruption, reduced open hours or reduced consumer demand, or temporary closure of the business, including temporary closure required to comply with restrictions or in response to restrictions under the shelter in place or other orders of the City’s Health Officer. Financial impact is “related to COVID-19” if caused by the COVID-19 pandemic, or by any local, state, or federal government response to COVID-19.

**1 month.** Landlord and tenant must discuss the matter in good faith and attempt to develop a payment plan for the tenant to pay the missed rent.

4. At the end of the additional 1 month cure period extension, the commercial tenant can either (1) pay the rent (either fully or on a revised payment plan pursuant to discussion with the landlord), or (2) provide additional documentation to the landlord showing that the commercial tenant's continuing inability to pay the rent due to a financial impact related to COVID-19.
5. If tenant pays the rent, the lease violation is cured and the lease continues. If the commercial tenant **provides the additional documentation**, the cure period is extended by an additional 1 month period.
6. Thereafter, the commercial tenant can obtain additional monthly extensions of the cure period by providing updated documentation each month.
7. At 6 months from the original rent due date, if the commercial tenant has not paid all outstanding rent, the landlord can proceed with eviction.

### **Important Considerations**

- The moratorium does not excuse payment of rent. Instead, it effectively delays when the rent will become due. It is also ambiguous as to whether the landlord can charge late payments if such payments are provided for in the lease.
- The order is only applicable to rent due on or after March 17, 2020. Rent due before March 17, 2020, can still be subject to a tenant eviction.
- The moratorium is only effective until April 16, 2020, meaning that the moratorium does not apply to initial rent missed after April 16, 2020 (provided that the tenant is not already in a cure period described above). The Mayor is able to extend the order.
- If the tenant agrees to a payment plan, it is likely the landlord can evict the tenant if the tenant does not follow that plan.
- The landlord may be able to recover rent through application of security deposit or offset against money owed by landlord to the tenant. The enforcement of lease guaranties also appears permitted. Lease guaranties are discussed below. It is unknown whether a court would look favorably on a landlord pursuing a lease guarantee during the moratorium period.
- The Office of Economic and Workforce Development can grant waivers to landlords who can demonstrate that being unable to evict would cause them significant financial hardship.

### **Summary of Key Lease Terms**

Other than the limited provisions of the moratorium, the commercial lease itself still governs the relationship between the tenant and the landlord. Below is a summary of some key terms of the lease and a basic discussion of commercial lease law.

#### **Basic Commercial Lease Law**

A commercial lease is a written, detailed agreement between a property owner and a person (or commercial entity). The lease will describe the property, usually referred to as the premise, this written description controls over any other understanding between the tenant and the landlord.

The lease is a contract, unless the lease includes a termination provision, each party remains liable for the term of the lease. If the tenant terminates the lease prematurely without a landlord's consent and

in breach of the lease terms, the lease is considered abandoned. In such a situation, the tenant remains liable for all of its obligations under the lease (i.e., the tenant must still pay rent).

If the tenant properly ends the lease pursuant to the lease terms, the lease is considered terminated. A lease can also be surrendered, meaning that the tenant terminates the lease with the landlord's consent. When the lease is terminated or surrendered, the tenant is no longer liable for its obligations under the lease (but a lease termination provision or a surrender agreement may include other obligations).

If the tenant abandons a lease, the tenant is liable for the lease obligations. Note, a landlord must attempt to mitigate (i.e., re-rent the property), and if the landlord is successful, the landlord must deduct the new rent from the amount of what the abandoning tenant owes. In the current COVID-19 crisis, it may be difficult for the landlord to re-rent a space, which leaves the tenant with substantial liability.

## Is the Business Owner Personally Liable?

The law considers a person (the small business owner) personally liable when that person, rather than the person's business entity, is responsible for the lease obligations. When the person is personally liable, the protection of the limited liability of business entities does not protect that person from damages. This means that where usually liability only extends to the assets of the business entity, a landlord can instead collect from the person's individual assets (the person's personal home, for example). If a landlord is granted a judgment against a person who is personally liable, that person will remain liable even if the business itself ends.

Whether a business owner is personally liable depends on two factors. (1) Whether the tenant under the lease is the business owner in its individual capacity or whether the tenant is a limited liability entity (LLC, corporation, LP, etc.). This can be determined by who signed the lease. If the lease is signed by the business, then the business itself (not the business owner) is the tenant. (2) Whether the business owner signed a personal guaranty in connection with the lease. If the tenant is the business and the business owner did not sign a personal guaranty, then the business owner is not liable for the rent.

## Rent

Rent is the money, or the consideration, that the tenant pays the landlord. Rent is set either by the total amount due or a formula by which rent is to be calculated. Typically rent is comprised of: (i) base rent, which is the monthly payment of a fixed amount by the tenant; (ii) additional rent, usually comprised of the tenant's contribution towards the cost of operating the property and is frequently not a fixed amount; and (iii) percentage rent, which includes the landlord's right to receive a portion of the tenant's sales or profit. A lease may include one or more of each type of rent. Usually there is a provision requiring the base rent to increase based on inflation.

Commercial leases may contain late charges and interest penalty clauses that apply when a tenant fails to make a rent payment on time. There may also be a cure period for non-payment of rent.

## Term

Term provisions include the date the tenant can take possession of the property, the date the tenant begins paying rent, and the date the tenant must surrender. The lease can also include one or more options to extend the term of the lease by the tenant providing notice to landlord of its exercise of the option by a certain date.

## Early Termination Rights

Some leases have provisions that allow the tenant to terminate its lease before the end of the lease term. Often these provisions will require the tenant to pay some pre-negotiated amount to exercise this right. For example, the lease may state that if the tenant does not achieve a certain amount of gross sales in the first few months of the lease, the tenant can terminate the lease early for a certain fee.

## Landlord Breach Provisions

Usually the landlord is obligated to perform certain tasks under the lease. For example, leases often require the landlord to maintain the premises, repair problems, and provide the tenant with a certain number of parking spaces. If the tenant finds that the landlord has failed to perform any of these obligations, the tenant may be entitled to terminate the lease early without penalty.

## Right to Reduce Space

Some leases include the right to reduce the amount of space a tenant leases. If so, the tenant can elect to decrease the amount of space and thus decrease the rent.

## Renegotiating Lease Provisions

Before the landlord is approached, the tenant should conduct a thorough analysis of its financial situation and the terms of the lease. Consideration of the financial situation should include, whether the business expects to return to profitability at the end of the COVID-19 emergency and whether the business will need amended lease terms to suit the business after the crisis abates. If the tenant determines it will need accommodations in addition to a rent reprieve during the crisis, the tenant should thoroughly consider every term of the lease it is seeking to amend.

Once the tenant has conducted that exercise, the tenant must then determine whether it wants to terminate the lease. Either way, the tenant should analyze the lease and determine whether an early termination is possible. The tenant may be able to terminate the lease based on the following options:

1. **Exercising Early Termination Rights under the Lease.** A lease may include provisions that allow the tenant to terminate its lease early. Early termination rights can come in a variety of forms and may include the organization paying a certain amount in order to exercise the right.
2. **Invoking a Force Majeure Clause.** Many commercial lease include force majeure clauses, which are included to provide a mechanism to postpone or suspend the performance of a duty under the lease due to unforeseeable circumstances that are beyond the control of the party. A specific force majeure clause will usually describe the parties, a list of events that qualify, the obligations of the party impacted, and the remedies. Typically these clauses do not apply to monetary obligation or give the parties a right to terminate. The organization should carefully review this clause to consider if it is beneficial.
3. **Common Law Defenses.** Certain common law legal defense (impossibility, impracticability, and frustration of purpose) may apply. Such defenses are extremely difficult to prove a party must show that an intervening situation was unforeseeable and resulted in difficulties that are more than just economic hardship.
4. **Buying Out the Lease.** The landlord may be open to allowing the tenant to pay the landlord a certain amount of money in order to terminate the lease before the end of the lease term.

Next the tenant must consider their leverage vis a vis the landlord. The amount of leverage a tenant has will be informed by their ability, and willingness to break the lease. Circumstances surrounding the current COVID-19 situation may also increase a tenant's leverage over the landlord. The landlord is likely facing similar economic uncertainty as the tenant and may be eager to maintain current leases.

With the above in mind, the tenant should approach the landlord to discuss possible lease modifications. Given the eviction moratorium, the landlord is unable to evict a tenant for up to 6 months for nonpayment of rent (but, rent is not forgiven and must be repaid at the end of the cure period), therefore landlords may be open to negotiations at initial contact. If not, the tenant can pursue the process outlined in the City's eviction moratorium. Under the moratorium notice, the landlord is required to engage in good faith negotiations within 1 month from the tenant's submittal of its financial hardship documentation.

If the landlord continues to not negotiate, the tenant is entitled to the amount of 6 months' forbearance on paying rent (although rent will have to be paid at the end of the 6 months). In such a case, the tenant should carefully follow the moratorium order and include written documentation proving the tenant complied.

If the landlord is open to negotiating, the tenant should present a list of proposed lease amendments. These payment plans should be in writing, particularly if the landlord has agreed to waive any portion of the rent. These payment plan agreements can also include other provisions amending portions of the lease agreement, therefore the tenant should also present other potential lease amendments.

## **Strategies if Landlord is Refusing to Negotiate the Lease Terms**

Remember you don't need the landlord to agree in order to take advantage of the deferral of rent provided in the moratorium, but the below is useable if you want to conduct a broader negotiation when the landlord is refusing. There are many reasons why a landlord might refuse to negotiate the lease terms. The obvious reason is that the landlord believes it holds the superior bargaining position (e.g., there is high demand for the space). The landlord may have financial limitations which limits the landlord's ability to modify a lease. For example, the landlord may have taken out a loan on the property, which requires it to use a specific leasing contract (with no changes) when leasing space to tenants. Often, lenders will require landlords to use a specific leasing contract, so that the lender can guarantee its collateral (i.e., the property) is protected, and in these situations, the landlord is often not able to change the terms of a lease contract by virtue of its contract with the lender for the loan.

The landlord may simply be dissatisfied with the proposed new terms. It may be helpful to consider some of a landlord's likely strategies and motivations before engaging in renegotiation and bargain with the inclusion of provisions that a tenant can agree upon and that also would be attractive to the landlord. Here are some examples:

1. **Financial Statements.** Offer proof of economic distress in the form of gross sales reports and/or financial statements. These materials will help demonstrate to a landlord that the business is in dire financial straits as claimed and that rent relief is justified. A landlord may be more willing to believe your financial hardship given the COVID-19 crisis. However, financial statements can also support the position that the tenant would essentially be judgment proof if the landlord were to pursue legal remedies for rent against it, thus making a renegotiation more attractive to the landlord.
2. **Short Term.** Tenants can suggest a relatively short term (no more than 24 months) rent relief. The tenant and landlord may agree that at the end of the reduced rent term, rates either return to the rents in the original lease, or will be renegotiated based on the fair market rates at that time.
3. **Default Terminates Rent Relief.** Condition a tenant's receipt of a rent modification on not being in default. Provided that if the tenant goes into default, then the rent reduction automatically terminates,

and the business must resume full payment of the original contract rent. A tenant might also consider offering, in the case of a default, immediate repayment to the landlord the total amount of unpaid rent the business would have owed if rent relief had not been granted.

4. **Confidentiality Provision.** Provide that the terms of the rent relief negotiation and agreement are to be kept confidential. This strategy is often favored by landlords to keep other tenants from seeking comparable concessions.
5. **Defer Rent.** Agree to structure rent relief as a deferral, rather than as an abatement. Offer to treat deferred rent as a non-interest loan that is payable at the end of the lease term or at some other future date.

## Additional Resources

The Bar Association of San Francisco's Conflict Intervention Service ([sfbar.org/cis](https://sfbar.org/cis))

Lower Polk CDB Tenant-Landlord Clinic ([lptlc.org/covid](https://lptlc.org/covid)). Offers tenant counseling and mediation services.

Lawyers' Committee for Civil Rights (<https://www.lccr.com/get-help/economic-justice-legal-services-for-entrepreneurs-lse/>). Offers pro bono attorney referral service to assist with commercial lease negotiations.