

Be Aware of the Interplay Between Co-Tenancy and Force Majeure Clauses

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Summary

- ❑ The COVID-19 pandemic brought both co-tenancy clauses and force majeure to the forefront of landlord-tenant disputes. Many tenants claimed the pandemic was a force majeure event, while many landlords disputed the notion.
- ❑ Force majeure provisions in commercial leases frequently contain exceptions such as monetary obligations from the excused performance, meaning that rent and other payment obligations are not excused during force majeure.



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Co-tenancy clauses and force majeure provisions are commonplace in commercial retail center leases. The COVID-19 pandemic brought both clauses to the forefront of landlord-tenant disputes, when many tenants claimed the pandemic was a force majeure event that excused performance of their obligations under leases, with many further arguing that co-tenancy clause violations also allowed them to pay reduced rent when other tenants shuttered their doors.

Co-tenancy clauses afford rent relief where another key tenant in the retail center ceases operating. They typically provide that a tenant is not obligated to pay full base rent but rather some form of alternative rent amount (e.g., rent at a reduced rate or based on a percentage of actual sales) when specified anchor tenants or a percentage of key tenants are not open and operating, or when a minimum gross leasable area in a shopping center is not open. The rationale is that anchor tenants benefit all tenants by driving foot traffic to the center such that when anchor tenants are not operating, a corresponding reduction in rent is appropriate.

Force majeure (French for “superior force”) events are those acts, circumstances, or events that are beyond the reasonable control of the parties, such as a natural disaster, act of war or terrorism, riot, governmental action, public health crises, etc. A typical force majeure provision will excuse a party’s performance of its obligations under the lease during the period of interruption. However, force majeure provisions in commercial leases frequently contain exceptions such as monetary obligations from the excused performance, meaning that rent and other payment obligations are not excused during force majeure.

Interplay Between Provisions: *Arciterra Olathe Pointe Olathe KS LLC v. Michaels Stores, Inc.*

Frequently, a key issue for determining whether a co-tenancy failure has occurred is assessing the interplay between the co-tenancy and force majeure provisions. That was certainly the case during the height of landlord-tenant disputes during the COVID-19 pandemic, when government shut-down orders throughout the country forced stores to close, triggering co-tenancy failures in many commercial leases.

One such scenario arose in a lawsuit against Michaels, a specialty craft retailer, in *Arciterra Olathe Pointe Olathe KS LLC v. Michaels Stores, Inc.*, No. 20CV3304, 2021 WL 4290526 (Kan. Dist. Ct. Sep. 21, 2021). There, the trial court ruled that the confirmed co-tenancy failure was unaffected by the lease’s force majeure provision, thereby excusing the store’s obligation of paying full base rent under the lease during the government shut-

down orders. This ruling later became a final judgment following Michaels' successful petition for an award of its attorney fees pursuant to the lease.

The landlord in *Arciterra* attempted to default Michaels and terminate the lease due to Michaels' nonpayment of base rent for April and May 2020 during government shutdown orders. The landlord sought to terminate the lease and evict Michaels due to the non-payment, along with recovering unpaid base rent and holdover rent that landlord contended was due when Michaels refused to vacate the premises. Michaels filed an affirmative defense and a counterclaim seeking declaratory relief based on a co-tenancy failure under the lease, asserting landlord was not entitled to the relief sought. Specifically, the co-tenants identified in the lease's co-tenancy clause were likewise shutdown during this period, resulting in a co-tenancy failure. Michaels argued the landlord's default and termination notices were overstated and defective as a matter of law because Michaels did not owe the full amount of base rent sought. The parties each moved for summary judgment, with the landlord arguing Michaels must be open and operating to avail itself of the co-tenancy failure and that the lease's force majeure provision contained a monetary carve-out, such that Michaels' obligation to pay full base rent was not excused. The court entered summary judgment in favor of Michaels on both motions.

In reaching its decision, the court noted that landlord was in control of information and facts, should have known the co-tenancy requirement was not met, and improperly demanded payment of full base rent instead of alternative rent. The court rejected the landlord's principal argument that Michaels could not avail itself of the co-tenancy failure because it too was shut down:

Part of the difficulty the Court has with [the landlord's] argument is that nowhere in the Co-Tenancy provision does it state any condition for the obligation to pay [reduced rent]. It does not say that the tenant first must be open and operating. In fact, it makes sense that if the same economic conditions (or shutdown) cause the anchors to close, that those same conditions might also require the tenant (relying on anchor foot traffic) to also close.

Arciterra, 2021 WL 4290526, at *9. The court further concluded that the "Co-tenancy provision bears no relation to the *force majeure* provision. Neither provision, in fact, references the other." *Id.* at *11.

Co-Tenancy Clauses Can Benefit Tenants *and* Landlords

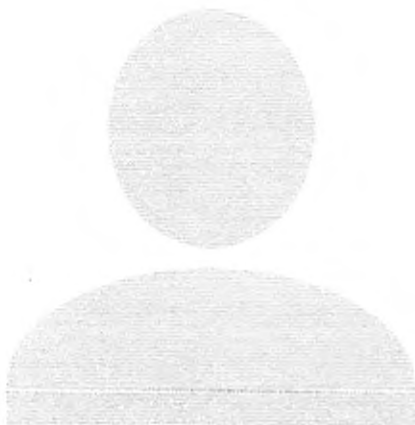
Co-tenancy clauses provide tenants in shopping centers with valuable lease rights. As with all lease rights and obligations, however, co-tenancy clauses are heavily negotiated between the parties. Landlords can protect themselves by negotiating for various

conditions precedent to the triggering of a co-tenancy failure and the relief permitted. Some of the more typical conditions include: (1) a co-tenancy threshold (e.g., that specific anchors or a certain minimum percentage threshold of key tenants or gross leasable space are shut down); (2) a cure period (e.g., the co-tenancy failure continues for a minimum period before the tenant is entitled to rent relief, during which period a landlord is permitted to find a replacement anchor tenant); (3) an operating contingency (e.g., the tenant seeking relief must itself be open and operating); and (4) reduced relief (e.g., the specific rent relief to which the tenant is entitled).

As demonstrated by the *Arciterra* case, determining whether a co-tenancy provision will provide relief to a tenant may hinge not only on the co-tenancy conditions, but also on the language in the larger lease. Understanding the relationship between co-tenancy and force majeure provisions will help potential landlord-tenant litigants assess their claims and defenses arising under these terms.

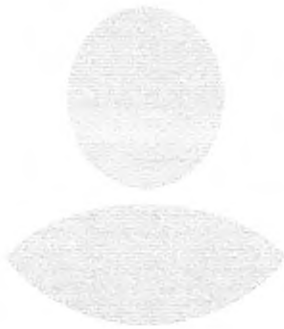
Indeed, the issues litigated in the *Arciterra* case are not unique to the COVID-19 pandemic. Regardless of the reason for the co-tenancy failure, based on the provisions of the lease as agreed upon by the parties, Michaels' ability to seek relief despite its own closure was not affected by the force majeure clause. One could certainly envision other scenarios where there may be multiple closures in a shopping center due to other events, such as strikes, lockouts, labor disputes, acts of God, fires, or other casualties unrelated to pandemics or government shutdown orders that may be force majeure-type events. Whether such events would trigger force majeure clauses or whether they would constrain the enforceability of co-tenancy clauses will be dependent upon how the parties have allocated those risks amongst themselves in the lease.

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About

Mark is an accomplished construction attorney, having represented owners, developers, general contractors, and subcontractors in a variety of matters, in both the dispute resolution and transactional contexts.

Mark is also an accomplished commercial litigator and has particular experience in real estate litigation, having represented institutional investors, commercial and retail landlords and owners, as well as commercial and retail tenants in a variety of disputes. He has lectured and authored articles on real estate litigation-related issues. Mark serves as co-chair of the firm's Real Estate Litigation group.