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General Session 7

Litigation: Is It Implied in Your Lease?

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by:

Howard K. Jeruchimowitz
Shareholder
Greenberg Traurig, LLP
77 West Wacker
Suite 3100
Chicago, Illinois 60601
Jeruchimowitzh@gtlaw.com

Paul S. Magy
Member
Clark Hill PLC
151 S. Old Woodward
Suite 200
Birmingham, MI 48009
pmagy@clarkhill.com

Michelle McGeogh
Partner
Ballard Spahr LLP
300 E. Lombard Street,
18th Floor
Baltimore, MD 21202
mcgeoghm@ballardspahr.com

"Shopping center lease disputes often call for application of this doctrine of necessary implication in order to carry out the parties' clear intentions with respect to fundamental terms of a bargain. 'Implied terms in a contract carry as much force as express terms. The implied terms either must arise from the language of the contract, or must be 'indispensable to effectuate the parties' intention.'"[1]

Introduction

General Overview of Implied Covenants

Implied covenants in contracts, whether leases, purchase agreements, vendor contracts or others are just that—obligations that are deemed to exist, even if not expressly stated. They are terms that, unless expressly disclaimed, are found to be a part of every contract. The implied covenant is most generally a tool of interpretation designed to help a court achieve a result that fulfills the court's idea of the reasonable expectations of the parties and to give the contract a spirit it could deem violated even if an action is not purely prohibited.

An implied covenant (another word for obligation or responsibility) is the opposite of its counterpart, the express covenant, that is an obligation spelled out in the case of a written agreement or actually articulated in an oral contract. The types and elements of implied covenants that exist vary from state to state but developed over time as the courts and legislatures of the states worked to mitigate the harsh effects of the ancient common law of independent covenants in the leasing of real estate. It had been the law that a tenant's obligation to pay rent was independent of any Landlord responsibility, even if the Landlord violated an express covenant in a lease. The Tenant at common law was also primarily responsible for the property's condition. This was the doctrine of caveat lessee. As long the Landlord did not violate the original implied covenant—the right of quiet enjoyment, a tenant's sole remedy is a suit for damages.

The combination of the law of independent covenants and caveat lessee was deemed too unfair to tenants in urbanizing society. The law developed exceptions for cases where the reasonable expectations of decent and innocent human behavior have been overwhelmed by behaviors that society could no longer justify and that seemed to defy all notions of fairness.

The laws of implied covenants first evolved as protections of those perceived as weak or innocent against those perceived to be taking advantage of others or taking advantage of the inability of the law to protect those who lacked the resources or were otherwise not savvy enough to protect themselves. The concept of "constructive eviction" was an early example of a new remedy that terminated a tenant's obligation to pay rent if a Landlord's actions or inactions effectively deprived a tenant of the use of the leased property. In the residential leasing context, courts began to find implied warranties of habitability and fitness and legislatures begin to enact statutory warranties. These statutes created obligations and warranties in leases whether they were stated or not and some states prohibited them from being waived as a matter of public policy. While the first changes were seen in residential leases, implied covenants have slowly come to find their places in commercial leases as well.

Unlike residential cases, Courts have been less willing to interfere with the agreements of parties in commercial settings. Implied covenants are not technically favored by the law. Their use and justification is almost always based on some finding of ambiguity and necessity. It arises from the need to give full effect to the terms of a contract as likely intended by the parties if they had considered the factors in suit at the time of executing the contract. It thus tracks closely with rules of contract interpretation to give full effect to the intent of the parties as established by whatever evidence is allowed in a particular state depending on whether a finding of ambiguity is a prerequisite.

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[1] *Commercial Leasing. Implied Covenants of Operation in Shopping Center Leases*, 95 Dick. L. Rev. 383, 402 (1991), cited in *Downtown Barre Dev. v. C & S Wholesale Grocers, Inc., 2003 Vt. Super. LEXIS 13 (Vt. Super. Ct. 2003).*

The most ubiquitous of the implied covenants are 1) the implied covenant of good faith and fair dealing and 2) the implied covenant of quiet enjoyment. These two implied covenants then act as foundations for finding obligations, responsibilities and duties between the lines of a contract or put flesh on the bones of a contract's express language, including such subjects as continuous operations, exclusivity, cotenancy, the quality of maintenance; these in addition to the general elevation of the manner in which express obligations in a lease may be performed.

Meaning of and Application of Implied Covenants

Implied covenants are tools for one party to impose an obligation on another and obtain a benefit not expressly required or disclaimed in an agreement. When parties cannot resolve a dispute over the interpretation of their respective obligations under a particular agreement and litigation results, it will be a finder of fact and law that resolves that dispute.

Over the years, some states have, by common-law, established protocols and factors for determining when and if a contractual covenant can be implied. These factors were succinctly summarized in *Lippman v. Sears, Roebuck & Co*., 280 P.2d 775, 779 (Cal. 1955), a case implying a continuous operating covenant in a retail lease heavily reliant on percentage rent:

> The rules which govern implied covenants have been summarized as follows: "(1) the implication must arise from the language used or it must be indispensable to effectuate the intention of the parties; (2) it must appear from the language used that it was so clearly within the contemplation of the parties that they deemed it unnecessary to express it; (3) implied covenants can only be justified on the grounds of legal necessity; (4) a promise can be implied only where it can be rightfully assumed that it would have been made if attention had been called to it; (5) there can be no implied covenant where the subject is completely covered by the contract."

Each of the foregoing factors may be weighted differently and each has its own body of subfactors, criteria and case law in each of the states where implied covenants are allowed to be found.

As a practical matter, the starting point in the analysis of a case and application of principles related to implied covenants is whether there is an ambiguity in the contract in regard to the particular obligation at issue and whether the integration and merger clause, if any, can be overcome. Most case law on the subject requires that a term in a commercial contract be found ambiguous before evidence outside its four corners can be deemed admissible to prove it. Counsel seeking to imply a covenant must first identify and describe an ambiguity or be able to establish that silence on a subject is not in and of itself dispositive of the issue and allows for the admissibility of evidence on the other elements—such evidence being oral (representations of parties), course of dealing or industry custom.

In addition to the sterile sounding factors described about, the similarities between and the lessons to be gleaned from the cases described below where implied covenants were imposed can be summarized as follows:

1. Each had a compelling case where justice and fairness begged for that result because of the nature of the injury sustained or harm sought to be avoided and

2. The party found in breach of the implied covenant had engaged in an act that could be described as morally wrong or unethical though not expressly prohibited.

Other cases, where a party seeks to interpose a defense using implied covenant law, such as expanding the reach of a force majeure clause to include a pandemic or abating rent when a law prohibits or restricts operations fall less obviously between those points.

Interplay of Implied Covenants with Express Covenants

Except for the implied covenant of quiet enjoyment, it is the rare implied covenant case that does not relate directly or indirectly to some express language or covenant in the lease. This makes sense since the law

of implied covenants, particularly the covenant of good faith and fair dealing, is frequently employed as a rule of interpretation and construction and not the basis of a separate cause of action. Examples of this include construing (i) the manner in which an obligation is to be performed such as maintenance and landscaping, (ii) the nature and quality of a shopping center (e.g. "first class", "discount", "outlet"), (iii) the breadth of an exclusive use, what constitutes a violation and the area covered by the exclusive), (iv) the area of a shopping center covered by a particular requirement (e.g. no-build zone, parking field restrictions), (v) relocation rights, (vi) co-tenancy requirements and qualifications for replacements, (vii) requirements for consents (assignments, improvements, and changes to a center), (viii) notice requirements, (ix) efforts to fulfill contingency obligations (e.g. permits, liquor and other operating licenses), (x) the ability to modify a site plan, and many more.

As discussed above, there must generally be an ambiguity within the express language of a document or silence. There are cases where the covenant, express or implied is found in the language of a contract and cases where the covenant is created by a drawing such as a site plan or a photograph. Essentially anything that is within the body of an agreement or an attachment upon which a party can rely is fodder and fair game.

The best defense to an implied covenant is a determination that there is no ambiguity and that the subject at issue was completely addressed by the express language. From a drafting standpoint, to combat the potential for findings of implied covenants, parties are certainly encouraged to be as thorough as possible, describe and define qualities and criteria and to expressly disclaim duties and obligations that are the common subject of these cases. Of course, there is also the tactic of purposeful vagueness and ambiguity in drafting when a party believes it lacks the leverage to obtain a result in negotiations and leaves a point open, even going so far inserting contract language that avoids construction against a party merely by virtue of the origin of the language. Accordingly, the best practice, where the economics permit, is to make sure there is an integration clause and that, as the standard integration clause states, the clause is not mere boilerplate and actually does contain the complete agreement of the parties. For that statement to be accurate, therefore, there must be a provision regarding every material term of the agreement whether by description or disclaimer.

The Litigation of Implied Covenants

Implied Covenant of Good Faith and Fair Dealing

1. Introduction/Overview

Generally speaking, the implied covenant of good faith and fair dealing is implied by law in every contract for both its performance and its enforcement. The covenant is read into contracts to supplement express contractual covenants to prevent a contracting party from engaging in conduct which frustrates or injures the other party's rights to the benefits of the contract. The covenant also generally requires each party to do everything the contract presupposes the party will do to accomplish the agreement's purposes. This implied covenant is not disclaimed through an integration clause. Some jurisdictions find a breach of the implied covenant of good faith to be an independent and additional cause of action to breach of the contract while others hold that the implied covenant is merely part of the same breach of contract claim.

2. Application of the Implied Covenant of Good Faith and Fair Dealing

Of the implied covenants, this is the most commonly used covenant alleged in cases. Some examples of how the implied covenant of good faith and fair dealing have been used:

a. Implied Covenant to Use Discretionary Power

This implied covenant is applied when one party is vested with a discretionary power affecting the rights of another. For example:

- *Thrifty Payless, Inc. v. The Americana at Brand, LLC*, 218 Cal. App. 4th 120, 160 Cal. Rptr. 3d 71 (2013) - The California Court of Appeals reversed the lower court's demurrer of tenant's claims, including the implied covenant of good faith and fair dealing, for tenant's increase in the pro rata expenses at the shopping center. During lease negotiations, the landlord provided written estimates of the tenant's probable pro rata share of property taxes, insurance, and common area maintenance for a shopping

center under construction. The lease, which contained an integration clause, stated that the tenant would pay its pro rata share of such expenses. After the tenant moved into the shopping center, the amounts due for its share of the expenses substantially exceeded the landlord's estimates. The court found that the tenant did not have to allege a specific lease provision to pursue its claims for breach of lease and breach of the implied covenant. The court concluded:

> Here, the terms of the contract simply provide for Thrifty to pay its pro rata share of common expenses (taxes, insurance, and CAM) and no precise "pro rata share" in terms of a percentage or a square foot basis is set forth. Merely charging higher rates for these items than estimated during negotiations does not ostensibly breach the express language of the lease. However, Thrifty has alleged Americana has breached [the lease] by improperly exercising its discretion in allocating costs between retail and nonretail space; this conduct as alleged can constitute both a breach of contract and breach of the implied covenant.

- *Best Buy Stores, L.P. v. Manteca Lifestyle Cente*r, 2010 U.S. Dist. LEXIS 47193 (E.D. Cal. 2010) – District Court found in denying motion to dismiss that Best Buy can allege the implied covenant of good faith and fair dealing for failing to build the shopping center as exhibited in site plan attached to the lease, stating:

> Although the lease does provide defendant with the discretion to construct the Shopping Center "at various times, and in various phases or sections," this does not preclude plaintiff from pleading a claim for breach of the implied covenant of good faith and fair dealing. In fact, "[t]he covenant of good faith finds particular application where one party is invested with a discretionary power affecting the rights of another. Such power must be exercised in good faith."

Best Buy alleged that defendant acted in bad faith by refusing to construct various buildings in the promenade and slowing the pace of construction despite its promises to the contrary. The District Court reasoned that this "may have frustrated plaintiff's ability to realize the economic benefits from leasing space in the [p]romenade if defendant dragged its feet in constructing the buildings in bad faith."

b. Bad Faith Conduct

Sometimes the court finds the conduct by the landlord or tenant so egregious that equitable relief is afforded a party based on an implied breach of the covenant of good faith and fair dealing. For example:

- *Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Center Associates,* 182 N.J. 210, 864 A.2d 387 (2005) –New Jersey Supreme Court reversed the appellate court affirmance of lower court judgment in favor of landlord for a tenant's purported failure to exercise a purchase option in a lease. Tenant gave timely notice of its intent but failed to make payment believing the payment was not due until closing. After 19 months of negotiating with the landlord about the closing and the landlord not saying a word about the missed option payment, the landlord for the first time pointed out the deficiency of nonpayment after the deadline for option passed.

  The Appellate Division affirmed the trial court's denial of relief to the tenant, stating that the tenant had no legal recourse in light of its failure to abide by the strict terms for executing the option. The panel found that the covenant of good faith and fair dealing was not violated by the landlord's artful dodging and studied silence.

  The New Jersey Supreme Court disagreed finding that even though the tenant failed to exercise the option correctly under the lease, the tenant still had relief under the implied covenant of good faith a fair dealing. In the court's own words:

> We are not eager to impose a set of morals on the marketplace. Ordinarily, we are content to let experienced commercial parties fend for themselves and do not seek to "introduce intolerable uncertainty into a carefully structured contractual relationship" by balancing equities. But as our good faith and fair dealing jurisprudence reveals, there are ethical norms that apply even to the harsh and sometimes cutthroat world of commercial transactions. Gamesmanship can be taken too far, as in this case. We do not expect a landlord or even an attorney to act as his brother's keeper in a commercial transaction. We do expect, however, that they will act in good faith and deal fairly with an opposing party. Plaintiff's repeated letters and telephone calls to defendant concerning the exercise of the option and the closing of the ninety-nine-year lease obliged defendant to respond, and to respond truthfully. In concluding that defendant violated the covenant, we do not establish a new duty for commercial landlords to act as calendar clerks for their tenants. We do not propose that attorneys must keep watch over and protect their adversaries from the mishaps and missteps that occur routinely in the practice of law. The breach of the covenant of good faith and fair dealing in this case was not a landlord's failure to cure a tenant's lapse. Instead, the breach was a demonstrable course of conduct, a series of evasions and delays, that lulled plaintiff into believing it had exercised the lease option properly. Defendant acted in total disregard of the harm caused to plaintiff, unjustly enriching itself with a windfall increase in rent at plaintiff's expense. In the circumstances of this case, defendant's conduct amounted to a clear breach of the implied covenant of good faith and fair dealing.
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> We are mindful of the potential pitfalls in enforcing the covenant of good faith and fair dealing. If courts construe the covenant too broadly, it "could become an all-embracing statement of the parties' obligations under contract law, imposing unintended obligations upon parties and destroying the mutual benefits created by legally binding agreements." We have warned that "'an allegation of bad faith or unfair dealing should not be permitted to be advanced in the abstract and absent an improper motive.'" "'Contract law does not require parties to behave altruistically toward each other; it does not proceed on the philosophy that I am my brother's keeper.'" We stress that while a commercial party does not have to act with benevolence towards an opposing party, it cannot behave inequitably.

But, other times, the conduct does not rise to the level of bad faith, especially when the lease does not preclude the conduct in question. For example, in *Downtown Barre Dev. v. C & S Wholesale Grocers, Inc.* 2004 VT 47, 177 Vt. 70 (2004), the Supreme Court of Vermont reversed the Superior Court's ruling that found that the tenant's assignment of supermarket space was invalid because the assignment would have led to the opening of a drugstore and a sublease to another retailer.[2] The Superior Court found that there was an implied covenant that the space was to be used only as a supermarket even though there was no such limitation in the lease. This portion of the decision will be discussed further in Section E.3 *infra*. The Superior Court also found that the former tenant and assignee tenant's steps to change the supermarket space violated the implied covenant of good faith and fair dealing and awarded damages for the structural changes that were being made. The Superior Court stated: "[P]roceeding to gut the building, including making changes to structural components, without even providing basic information about the instructions given to the contractor, and making a fundamental change in the character of the shopping center, cannot be viewed as consistent with the Tenant's obligation of good faith and fair dealing under the lease as it was written and had been implemented over 29

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[2] The Superior Court's decision can be found at *Downtown Barre Dev. v. C & S Wholesale Grocers, Inc.,* 2003 Vt. Super. LEXIS 13

years." The Vermont Supreme Court disagreed, particularly because the lease did not prohibit using the premises for purposes other than as a supermarket or dividing up the space, stating that:

> Although there may be instances in which a contracting party exercises a retained contractual right in bad faith, … that is not the case here. Neither Maxi Drug nor GUMB violated the terms of the lease or prevented DBD from obtaining the benefits provided under the lease…. Although Maxi Drug did not disclose to DBD the extent and timing of its renovation plan, it entered into negotiations with DBD and informed DBD of its desire to divide the premises. Under the circumstances, neither Maxi Drug nor GUMB acted in bad faith.

c. Implied covenant of exclusivity and Implied Covenant to Refrain from Destructive Competition.

Courts have grappled with two implied covenants when a tenant believes it was to be the only tenant of that purpose in a shopping center or in close proximity to that shopping center and the landlord subsequently leases to a competitor of the tenant.

In *Eastern Shore Markets, Inc. v. J.D. Associates Limited Partnership*, 213 F.3d 175 (4th Cir. 2000) (*see* Section III.E.1 for application of the implied covenant to a site plan), the United States Court of Appeals for the Fourth Circuit, applying Maryland law, rejected the notion of an implied covenant of exclusivity, but recognized the potential for a claim based on an alleged breach of the implied covenant to refrain from engaging in destructive competition. The parties entered into a lease under which the plaintiff leased space for use as a grocery store in the defendant's strip mall. The terms of the lease did not give explicitly the plaintiff an exclusive right to be the only grocery store in the shopping center, but the lease incorporated a site plan that was "approved by the parties" and which outlined and labeled the remaining space in the mall as future department and retail stores. While the lease was in effect, the defendant leased one of the remaining spaces, listed in the site plan as a "future department store," to a developer who constructed a competing grocery store. When plaintiff's sales dropped, it filed suit against the defendant in the U.S. District Court for the District of Maryland, alleging that the defendant engaged in destructive competition. *Id*. Upon the defendant's motion, the plaintiff's action was dismissed for failure to state a viable claim.

The Fourth Circuit Court of Appeals confirmed that no implied right of exclusivity exists: "In the absence of any direct Maryland authority implying an exclusivity clause in leases akin to the one in this case, the Court holds that the governing … Maryland law bars all claims grounded on the existence of an implied exclusivity clause, which includes the idea that the same result (implied exclusivity) is compelled by the general duty of good faith and fair dealing." The courts, however, have found an implied covenant to refrain from destructive competition, such as the Fourth Circuit Court of Appeals in *Eastern Shore Markets*, which overruled the lower court stating that:

> Eastern Shore has treated as interchangeable its claim for breach of a covenant of exclusivity and its claim for breach of an implied covenant against destructive competition, and it has used both labels to describe aspects of the implied covenant of good faith and fair dealing. Significantly, however, Eastern Shore's complaint, on which our decision must be based, explicitly couches its claim in terms of a breach of the implied covenant of good faith and fair dealing, which Maryland clearly recognizes. Giving the claim its asserted scope, we cannot say that it fails under any probable set of facts to state a claim upon which relief can be granted. *Food Fair*[3] and *Automatic Laundry*[4] together establish that, under Maryland law, the intentions of parties as expressed in the lease providing for rent calculated in part as a percentage of sales, combined with the circumstances surrounding the lease's formation, may give rise to

[3] *Food Fair Stores, Inc. v. Blumberg*, 234 Md. 521, 200 A.2d 166 (1964).
[4] *Automatic Laundry Serv., Inc. v. Demas*, 216 Md. 544, 141 A.2d 497 (1958).

> an implied covenant to refrain from competition that is destructive to the mutual benefit of the contracting parties.

The Second Restatement of Contracts also provides a helpful illustration that courts have adopted to imply a covenant to refrain from destructive competition:

> If A, the owner of a shopping center, were to lease part of the premises to B with the exclusive right to conduct a supermarket, it would be a breach of the implied duty of good faith and fair dealing for A to acquire the adjoining land and lease it to C to run a competing supermarket. Restatement (Second) of Contracts § 205, illus. 2, at 101. Although leasing the adjoining land to C would not literally violate the express terms of A's lease with B, it would nevertheless constitute a breach of contract by implication for violating the obligation of good faith and fair dealing. See id. The point is: The express right to operate the only shopping center on the premises carries with it the implied right not to have the landlord go into competition next door.

(cited in *Alta Vista Propos., LLC v. Mauer Vision Ctr.*, 855 N.W.2d 722 (Iowa 2014)).

d. No implied covenant when contract does not impose obligation

There are a series of cases where a court would not apply the implied covenant when the lease does not impose such an obligation. In *Weco Supply Co. v. Sherwin-Williams Company*, 2012 U.S. Dist. LEXIS 110659 (E.D. Cal. 2012), where the parties entered into a written agreement for the distribution of Sherwin-Williams paint products, Sherwin-William did not breach the implied covenant of good faith and fair dealing by selling directly to end users outside its retail stores because the agreement specifically allowed Sherwin-Williams to sell directly to end users and there was nothing in the agreement that limited it to retail stores. The court concluded:

> In other words, a claim for breach of the implied covenant of good faith and fair dealing must be based on a specific contractual obligation. Here, there is no contractual requirement that prohibits Sherwin-Williams from selling directly to any of Weco customers. On the contrary, there is a specific provision permitting Sherwin-Williams to do precisely that.

In *Wauseon Plaza, Ltd. Partnership v. Wauseon Hardware Co.*, 156 Ohio App. 3d 575, 807 N.E.2d 953 (2004), the Ohio Appellate Court found that the breach of good faith does not stand as a separate claim but rather is part of a contract claim and, in that case, reversed the trial court and found that a commercial landlord could not be liable for breaching the implied covenant of good faith and fair dealing by failing to maintain the anchor stores or foot traffic in a shopping center where the lease imposed no obligation. The court concluded:

> If the parties had intended to obligate the landlord to maintain anchor stores, then such a provision could have been added … It is not the responsibility or function of this court to rewrite the parties' contract in order to provide for a more equitable result. In the absence of fraud or bad faith, this court will not save one party from an improvident contract when both parties had equal bargaining power. Plaza Limited certainly has an incentive to find new anchor tenants for it loses rent both from empty anchor stores and from tenants such as Wauseon Hardware who have the option of paying percentage rent. The contract, however, does not require Plaza Limited to maintain or replace anchor tenants; therefore, Plaza Limited did not breach paragraph 22 of the lease

Based on the lack of such an obligation under the lease, the court found that the landlord "cannot be liable for failing to perform in good faith and fair dealing an obligation that was not imposed upon it by the lease."

e. Limitation of the Implied Covenant

The implied covenant of good faith and fair dealing can be limited by the express terms of the lease. For example, in *Frittelli, Inc. v. 350 North Canon Drive, LP*, 202 Cal. App. 4th 35, 135 Cal. Rptr. 3d 761 (Cal. Ct. App. 2011), the court found that "[t]o the extent the exemption in paragraph 8.8 purports to shield the lessor

and its agents from liability for breaches of the covenants in the lease, it is well established that the tenant under a commercial lease may agree to limit the scope of the covenant of quiet enjoyment, whether express or implied as well as the implied covenant of fair dealing."

Implied Covenant of Operation / Force Majeure

1. Introduction / Overview

Covenants relating to the failure to operate come in a number of forms. Some leases expressly require certain operating hours, while some courts have evaluated claims that such terms are implied by other clauses, such as percentage rent clauses.

Currently, there is increased attention on clauses and implied clauses that may excuse a tenant from operating. Force majeure clauses are contract clauses, and courts interpret them by the general principles of contract interpretation. The intent of the parties, as expressed in the specific language of the contract, is paramount. As such, there is no universally applicable determination of when force majeure applies and when it does not. Typically, courts read *force majeure* clauses narrowly, and require that the clause must unambiguously cover the triggering event for performance to be excused.[5] As an example, in prior cases courts have held that sudden market downturns[6] were not covered by a particular *force majeure* clause, based on the scope of the specific language in the applicable contracts, although these events may have been covered under a more inclusive clause.

The party claiming *force majeure* must show a causal connection between the claimed event and the inability to perform.[7] This is a high bar.[8] An event that makes performance merely more expensive or difficult, but not impossible, may not qualify.[9] For COVID-19, this requirement introduces much uncertainty. Whether a *force majeure* clause is triggered may vary based on the degree of state and local restrictions. For example, in a jurisdiction where the local permitting agencies are closed, a construction contractor may be excused from performance if it cannot get the necessary permits to proceed with the work. In that case, there is a clear causal connection. By contrast, in a jurisdiction where permits are still obtainable but there is a labor shortage because the schools have been closed, performance may not be excused because the causal connection is more attenuated.

Some contracts do not contain a *force majeure* clause, such that an implied covenant may become more important. If there is no *force majeure* clause, affected parties may still have common law contract defenses, like impossibility or frustration of purpose, available to them. Some jurisdictions permit these defenses even if the contract includes a *force majeure* clause,[10] while others do not allow common-law defenses

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[5] *Kyocera Corp. v. Hemlock Semiconductor, LLC*, 886 N.W.2d 445 (Mich. Ct. App. 2015) ("[T]he clause will generally only excuse a party's nonperformance if the event that caused the party's nonperformance is specifically identified.") (internal citations and quotations omitted).

[6] *Langham-Hill Petroleum, Inc. v. Southern Fuels Co.*, 813 F.2d 1327 (4th Cir. 1987) (holding that sudden drop in oil prices did not excuse performance); *Elavon, Inc. v. Wachovia Bank, NA*, 841 F. Supp. 2d 1298 (N.D. Ga. 2011) ("The economic downturn in 2008 and the subsequent events that followed do not constitute a force majeure . . . .").

[7] *Frigillana v. Frigillana*, 266 Ark. 296 (1979) ("The burden of proving impossibility of performance, its nature and extent and causative effect rests upon the party alleging it."); *see also* 14 Corbin on Contracts § 74.16.

[8] *Frigillana*, 266 Ark. 296 at 302-03 ("The burden of proving impossibility of performance, its nature and extent and causative effect rests upon the party alleging it. He must show that he took virtually every action within his power to perform his duty under the contract. It must be shown that the thing to be done cannot be effected by any means.").

[9] *Publicker Industries, Inc. v. Union Carbide Corp.*, 1975 U.S. Dist. LEXIS 14305* 5 (E.D. Pa. 1975) ("Increased cost alone does not excuse performance unless the rise in cost is due to some unforseen [sic.] contingency which alters the essential nature of the performance. Neither is a rise in the market in itself a justification, for that is exactly the type of business risk which business contracts cover.").

[10] *Rembrandt Enters. v. Dahmes Stainless, Inc.*, 2017 U.S. Dist. LEXIS 144636 (N.D Iowa Sept. 7, 2017) (applying Minnesota law).

when the contract includes a *force majeure* clause, instead allowing the allocation of risk in the contract to prevail.[11]

2. Case Law Discussion

a. Force Majeure / Impossibility / Frustration of Purpose

Sage Realty Corp. v. Jugobanka, D.D. New York Agency, No. 95 Civ. 0323, 1998 U.S. Dist. LEXIS 15756, 1998 WL 702272 (S.D.N.Y. Oct. 8, 1998).

Takeaway: Tenant may still be obligated to pay rent even though a presidential Executive Order prevents Tenant from operating its business.

Facts: Plaintiff Landlord brought suit against Tenant bank for failure to pay rent. Landlord owned a building in New York, NY and Tenant was a Yugoslavian bank that leased a space in the Landlord's building in order to operate its New York branch office. The lease term was 15 years from the rent commencement date, through August 2007. The lease contained a *force majeure* provision which stated that Tenant would not be excused from paying rent if Landlord was unable to fulfill its obligations under the lease due to rule or order by a government agency. In April 1993, President Clinton issued an Executive Order implementing sanctions that blocked Yugoslavian businesses from using any of their assets located in the United States. Thereafter, Tenant's license to conduct business was revoked and its employees were ordered to vacate the premises. As a result, Tenant stopped paying rent to Landlord. After serving Tenant with a notice of default and demand for payment, Landlord brought suit to recover all amounts owed under the lease.

Issue: Was Tenant obligated to pay Landlord despite the President's Executive Order?

Holding: Yes.

Tenant argued that it was not liable under the lease because the doctrine of commercial frustration excused its duty to pay. The Court found that the sanctions resulting in the Tenant's frozen assets were reasonably foreseeable and that Tenant was not excused from paying rent. The Court explained that before the lease was signed, there were news articles regarding the deteriorating relationship between Yugoslavia and the United States and that Tenant's principals were aware of these events. For example, one of Tenant's principals testified that as part of his job description he was obligated to keep up to date about the relations in Yugoslavia and that he was aware that the United States and Yugoslavia were having political issues. Because the events in question were foreseeable, Tenant was not excused from performing.

In interpreting the f*orce majeure* provision, the Court found that whether it was ambiguous or not was a question of law. Finding that the provision was not ambiguous, the Court stated that the language of the *force majeure* provision was broad enough to cover the Executive Order. Tenant argued that the lease provision applied to the Landlord and not the Tenant, but the Court found that the Executive Order prevented Landlord from giving Tenant access to the premises—which was the Landlord's primary duty under the lease. Therefore, Tenant's primary obligation to pay rent was not impaired by the Executive Order. The Court awarded Landlord unpaid rent from the time Tenant stopped paying rent to the time Landlord re-let the premises to another tenant.

Bayou Place Ltd. P'ship v. Alleppo's Grill, Inc., No. RDB-18-2855, 2020 U.S. Dist. LEXIS 43960 (D. Md. Mar. 13, 2020).

Takeaway: Tenant may still be liable to Landlord for unpaid rent even when a hurricane disrupts its business.

Facts: Plaintiff Landlord brought suit against Defendant Tenant alleging violations of a commercial lease agreement for a property in Houston, Texas. In April 2012, Landlord and Tenant executed a

[11] *Perlman v. Pioneer P'Ship*, 918 F.2d 1244, 1248 (5th Cir. 1990) (applying Wyoming law).

commercial lease to open a restaurant in a mixed use development project for a term of ten (10) years. As part of the lease, Tenant was required to maintain business interruption insurance sufficient to cover 12 months' rent. Tenant began to miss payments in July 2017 and then in August 2017, Hurricane Harvey hit. As a result, the shopping center where Tenant operated and Tenant's restaurant closed in August 2017. The hurricane caused substantial damage to the property and Tenant's restaurant basement flooded, resulting in damages in excess of $146,000. The surrounding "Theater District" was also damaged by the hurricane. Tenant reopened in late September 2018. Tenant failed to make any payments in the three (3) years after it reopened. Tenant owed Landlord over $500,0000 at the time Landlord filed suit.

Issue: Could the Tenant invoke *force majeure* to excuse the $40,000 in missed payments that occurred during the time the hurricane occurred?

Holding: No, the *force majeure* provision was inapplicable.

Tenant argued that it should be excused from paying rent due to Acts of God: in this case, Hurricane Harvey. Tenant argued that the hurricane caused substantial damage, interfered with access to the property and should excuse its performance under the lease. Tenant also argued that the damage the hurricane caused to the surrounding community diminished the value of its business and frustrated the purpose of the contract—thereby making performance under the lease impossible. Tenant argued that the location of the "Theater District" was one of the reasons it entered into the lease, and that by that area being damaged, it frustrated the purpose of their lease.

The Court found that under Texas law, an act of God does not relieve the parties of their contractual obligations unless the parties expressly provide otherwise. Moreover, Texas courts recognize that Hurricane Harvey was an act of God. Furthermore, Tenant began to miss payments almost two (2) months *before* the hurricane occurred and continually failed to make payments thereafter. Hurricane Harvey was not a proper defense to justify Tenant's failure to perform. The Court also found that Tenant failed to provide sufficient evidence that it was unable to perform due to the "Theater District's" circumstances and damages to the surrounding area. Tenant did not provide evidence that it failed to receive significant business after the hurricane. Evidence of damages to inventory and invoices of repairs to its basement was insufficient to establish that Tenant could not pay rent.

Whole Foods Mkt. Grp. v. Wical L.P., 288 F. Supp. 3d 176 (D.C. Cir. 2018)

Takeaway: A *force majeure* provision may excuse a Tenant from opening its business beyond a set time that was provided in the lease.

Facts: Plaintiff Tenant Whole Foods filed suit against Landlord for breach of lease. The lease contained an "Excuse for Non-performance" provision. The provision provided that "if either party shall be delayed from performance under the contact due to strikes, lockouts, labor troubles, plan approval delay, inability to procure materials, restrictive governmental laws or regulations, adverse weather, unusual delay in transportation, delay by the other party hereto or other cause without fault and beyond the control of the party obligated to perform (financial inability excepted)," the performance of such act shall be excused for the period of the delay provided that the party makes a good faith effort to remedy the delay. Additionally, another provision stated that Tenant could close the store for a period of time necessary to modernize or improve, but not for more than 60 days. D.C. issued ordinances for rodent problems. Tenant was required to close the store in order to complete demolition work to address the rodent issue. Because Tenant had to rebuild the inside of its store, it decided that it made sense to also perform some renovations to modernize the store. In order to complete these renovations, Tenant would need Landlord's consent. Landlord refused to consent. Tenant remained closed during this time and Landlord issued a notice of default instructing Tenant to open or else it would be in default. Tenant filed suit arguing that Landlord breached the lease based on its refusal to consent to the renovations. Tenant sought declaratory judgment that it did not breach the lease by failing to reopen.

Issue: Did Tenant breach the lease by refusing to open when Landlord failed to approve renovation plans?

Holding: No, Tenant did not breach the lease. The *force majeure* provision in the contract applied.

Landlord argued that Tenant had been closed for more than 60 days, so it was in breach of the lease. The Court asserted that the lease's *force majeure* clause justified the Tenant's closure beyond 60 days. Within that provision, a party would be excused from performance due to some other cause beyond the control of the party obligated to perform and also a party would be excused from performance due to plan approval delay. First, Tenant was forced to close due to a cause beyond its control—the rodent issue. Tenant had to close in order for contractors to dig up the building and resolve that issue. Second, Landlord's refusal to approve the renovation plans, as well as the backlog of the City in issuing permits, triggered the *force majeure* provision regarding plan approval delay. The Court found that based on the evidence, Tenant was excused from reopening the store within 60 days.

b. Implied Covenant of Continuous Operation

Oakwood Vill. LLC v. Albertsons, Inc., 104 P.3d 1226 (Utah 2004)

Takeaway: Where a Tenant decided to "go dark," but continued to pay rent and the lease lacked certain provisions indicating an obligation to operate, the Court refused to find that there was an implied covenant to continuously operate.

Facts: Plaintiff Landlord, commercial real estate developer, and Defendant Tenant entered into a lease containing an exclusive that prevented Landlord from leasing space in the shopping center to other supermarket tenants. The lease also provided that the parties would work together to develop the center "as an integrated retail sales complex for the mutual benefit of all real property in the Shopping Center." After 21 years of operating in Landlord's shopping center, Tenant moved to another center to become the anchor tenant there. After it relocated, Tenant "went dark," while continuing to pay its ground rent, but kept the space empty. Landlord filed suit against Tenant for breach of lease and argued that the lease contained an implied covenant of continuous operation that required Tenant to remain open during the entire term of the lease. Landlord sought declaratory relief allowing it to terminate the lease and to re-enter, re-let the premises and obtain damages. The trial court dismissed the suit and Landlord appealed.

Issue: Was a covenant of continued operation implied in the lease?

Holding: No.

The Court found that there was no express or implied covenant of continuous operation and that it would have to look at the language of the lease and the conduct of the parties. The Court noted the following which led to its conclusion:

1. There was no percentage rent provision in the lease. This substantially undermined Landlord's position that there was an implied covenant of operation. The court explained that 'a tenant's agreement to pay percentage rent coupled with an inadequate or insubstantial minimum or base rent has been "[b]y far, the most popular rationale among the courts that have found implied continuous operation covenants in leases." 104 P.3d 1226, 1233-34. Therefore, the absence of the provision from the lease strongly suggested that the parties never intended the lease to bind Tenant to operating a grocery store continuously at the shopping center. *Id.* at 1234.

2. There was no "use of premises" provision in the lease that supported Landlord's argument that Tenant had a duty to generate consumer traffic in the shopping center by operating its supermarket store. The Court stated the following: "The lease states that a tenant may use any property leased in the center 'to permit the construction and operation of retail facilities and parking on the Leased Premises, including supermarkets, drug and variety stores, or combinations thereof, and other similar retail uses, without conditions thereto which in Tenant's reasonable opinion would cause construction and operation to be uneconomical' (emphasis added). Thus, the language of the lease contemplates very broad use of the premises by Albertsons with no specific business restrictions and no apparent requirement of ongoing operation." *Id.*

3. The provision in the lease allowing Tenant to sublet or assign the lease without Landlord's consent and no restriction on the type of sublessees or assignees, undermines Landlord's claim that Tenant was supposed to operate on the premises for the entirety of the lease term.

4. The provision in the lease permitting Tenant to own and install "in the Leased Premises such fixtures and equipment as Tenant deems desirable" and to remove "Tenant's personal property from the Leased Premises at any time," a provision commonly seen in combination with a right to sublet or assign the lease, is not consistent with a duty of continuous operation. *Id.* at 1235.

5. The lack of any provision allowing Landlord to reenter and re-let the premises in the event that the tenant vacates weighs against a finding of an implied covenant of continuous operation.

6. The lease did not impose a legal duty on Tenant to erect any structure on the premises and that, having constructed a building, Tenant is under no legal obligation to occupy the building. The court explained that the lease stated: "[i]n the event any building on the Leased Premises is damaged or destroyed by a casualty, Tenant shall either repair or restore the building, or remove the rubble and leave the ground in a sightly condition" *Id*. at 1235. This suggests that the parties contemplated a scenario that Tenant would pay rent on bare ground. Drafters should include provisions in their contracts compelling construction and reconstruction in the event of destruction and specifying the time frame for completing such activities.

Piggly Wiggly S. v. Heard, 261 Ga. 503 (1991)

Takeaway: An obligation to pay percentage rent does not automatically create an implied covenant to continuously operate.

Facts: Plaintiff Landlord and Tenant supermarket entered into a lease agreement in 1963. As part of the lease, Tenant would pay an annual base rent, as well as a percentage rent of the annual gross sales exceeding $2,000,00. The lease was renewed on the same terms for an additional seven years in 1979, with options to renew for two additional three-year terms. Tenant was acquired by a new corporation. In the second term, Tenant vacated the premises and moved into a nearby shopping center. Tenant continued to pay the base rent, but refused to sublease the vacant store, even though there were interested parties. Landlord sued for breach of lease. The trial and appellate courts found for Landlord and held that the lease contained an express continued use covenant and an implied covenant of continued operation.

Issue: Did the lease contain an express covenant of continuous operation or an implied covenant of continued operation?

Holding: No.

The Court reversed the lower court's ruling. The Court concluded that the lease did not contain an express or implied covenant of continuous operation. The Court found that the lease's provision for free assignability by Tenant, without Landlord's consent, weighs strongly against a construction of the contract requiring tenant to continuously operate its business. Also, the existence of a substantial minimum base rent, and a provision for percentage rental payments suggests the absence of an implied covenant of continuous operation. The court cited to *Kroger Co. v. Bonny Corp.* to support its contention that "when the rental to be received under a lease is based on a percentage of the gross receipts of the business, with a substantial minimum, there is no implied covenant that the lessee will operate its business in the leased premises throughout the term of the lease. 134 Ga. App. 834, 838-39 (1975).

Hornwood v. Smith's Food King No. 1, 105 Nev. 188 (1989)

Takeaway: A court may find that there is an implied covenant to operate continuously when an anchor tenant brings in a significant amount of consumer traffic to a shopping center.

Facts: Plaintiff Landlord and Defendant Tenant supermarket entered into a 30-year lease. The lease contained a provision for a $92,398 minimum annual rent, about 2.7 million dollars in total rent over the 30-year span of the lease. There was also a provision for percentage rent based on sales generated during the previous calendar year. Tenant paid percentage rent for 1979 and 1980, but stopped paying percentage rent due to insufficient sales volume. Tenant closed its business and stopped operating in 1986 without notifying Landlord. After closing the store, Tenant continued to pay minimum rent and Landlord did not act to evict Tenant immediately. Eventually Landlord filed suit against Tenant arguing that Tenant breached its lease by ceasing operations and vacating the demised premises before the lease expired. The trial court held that Tenant breached an implied covenant of continuous operation by ceasing operations with approximately 20 years remaining on the 30-year lease. The court found that the shopping center decreased in value over $1 million after Tenant stopped operating, but that the diminution of property value was not foreseeable and compensable. Also, the court held that, because Tenant continued to pay minimum rent, Landlord was not entitled to an award of compensatory damages for breach of lease. The landlord appealed.

Issue: Was the Landlord entitled to damages as a result of the breach of the lease?

Holding: Yes.

The Court upheld the trial court's decision that there was an implied covenant of continuous operation. The Court noted that Tenant was a sophisticated business entity and that its role as an anchor tenant significantly impacted Landlord's Shopping Center. Without Tenant, the financial viability of the Shopping Center was impacted, and this was foreseeable. The Court found that the trial court erred in ruling that the diminution in value was unforeseeable and remanded the case for an assessment of the Landlord's damages. The Court also reversed the trial court's award of attorney's fees to Tenant as the Court found that Landlord was also a prevailing party and itwas also entitled to attorneys' fees and costs.

Implied Covenant of Quiet Enjoyment

1. Introduction/Overview

Although the implied covenant of quiet enjoyment may differ slightly depending on the jurisdiction, there are some similar elements to this implied covenant. The covenant of quiet enjoyment is implied in every lease if not expressly stated. It typically involves the landlord having good title and giving a free and unencumbered lease of the premises for the term of the lease. The breach of the covenant amounts to an eviction though that eviction need not be actual. This would constitute a constructive eviction which is typically defined as a disturbance of grave and permanent character that would render the premises unfit for the business for which it was rented and would deprive the tenant of its enjoyment of the premises. Usually, the premises must be rendered untenantable and not just uncomfortable. Although a covenant of quiet enjoyment is implied in every lease, when the parties expressly provide for it in the lease, there is no need to imply the covenant. The implied covenant, however may be applicable to the extent it does not contradict the language used by the parties in the lease or impose obligations not contemplated by the parties.

2. Case Law Discussion

Jaraysi v. Sebastian, *Plaza, LLC v. Taher*, 318 Ga. App. 469, 733 S.E.2d 785 (2012).

Takeaway*:* Although the implied covenant of quiet enjoyment exists in every lease, there must be evidence of actual or constructive eviction and if the lessee remains on the premises and operates it, there is no actual or constructive eviction or a substantial interference with the lessee's right to use and enjoy the leases premises.

Facts: The lessee was a former tenant of the landlord's shopping center and had used the leased space as a night club. There was an unfinished office building across the street from the shopping center which the lessee understood was to have been completed in May of 2006. The lessee sent a letter to the landlord asserting that the criminal activity in the parking lot and in the unfinished office building caused him to lose business and constituted constructive eviction. After sending such a letter, lessee claims the landlord orally agreed to accept less rent and lessee started paying the less rent.

After ten (10) months of paying the reduced rent, landlord rejected the reduced rent and the lessee moved out of the premises. The landlord obtained possession and subsequently sued for the unpaid rent.

Issue: Was the lessee entitled to avoid paying full rent based on the defense of breach of the covenant of quiet enjoyment that led to a substantial decrease in the lessee's business?

Holding:

The Appellate Court held that the trial court properly found that a valid and binding lease agreement existed, and that the landlord did not breach it or its written amendment, including the express covenant of quiet enjoyment. The court further found that none of the failures involving the unfinished office building constituted a breach of the lease or the covenant of quiet enjoyment. With respect to the implied covenant of quiet enjoyment, the lessee alleged that the landlord breached the contract by breaching the implied covenant of quiet enjoyment. The lessee argued that the landlord breached the covenant because of the increase in criminal activity in the parking area, the need for more lighting and the unfinished office building. The court would not imply such obligation because it would be inconsistent with the terms of the lease, which was leased "as is" and the landlord had no "obligation or liability whatsoever for care, supervision, repair, improvement, addition, change, or alteration of the Premises, the building of which it is a part or the Shopping Center." *Id.* at 470.

The Appellate Court addressed the implied covenant of quiet enjoyment. The court found (i) it is implied in every lease, (ii) that landlord has good title and gives a free and unencumbered lease of the premises for the term stipulated, (iii) to constitute breach of the covenant of quiet enjoyment, an eviction or equivalent disturbance by title paramount must occur, (iv) the disturbance must be "of such grave and permanent character as would render the premises unfit for tenancy, and is such as would actually deprive and would legally import the intent to deprive the tenant of their enjoyment, it amounts in law to an eviction of the tenant"; (v) the covenant of quiet enjoyment obligates the landlord to protect the tenant only against the landlord's own acts and not against the acts of strangers that disturb the tenant in its quiet enjoyment and possession of the premises.

The Appellate Court affirmed that there was no evidence in the record that any of the landlord's conduct prevented the lessee from using his premises for a nightclub. Despite the increase in criminal activity, incomplete office building, and need for improved lighting, the lessee remained on the premises and operated his nightclub until April 2010 when the landlord refused to accept the reduced rent. The Appellate Court found that such conduct does not amount to an actual or constructive eviction or a substantial interference with his right to use and enjoy the leased premises, which were not rendered untenantable.

Hassan Khanbabpour v. H.C.M., 2009 Cal. App. Unpub. LEXIS 4127 (2009)

Takeaway*:* The parties can contract away, and the landlord can limit, its liability with respect to the implied covenant of quiet enjoyment.[12]

Facts: Tenant, a rug and furniture store, leased space at a shopping center in Tarzana. The lease contained a quiet enjoyment covenant and an exemption of lessor from liability. On November 28, 2006, tenant initiated a lawsuit against the landlord and another tenant for water damage to the tenant's merchandise, asserting claims of breach of lease, breach of the covenant of quiet enjoyment and negligence against the landlord and negligence against the other tenant. The landlord filed, and the lower court granted, the landlord's motion for summary judgment, in part, because the exemption provision precluded the quiet enjoyment claim.

[12] For other cases that hold this principle in California, see *Frittelli, Inc. v. 350 North Canon Drive, LP*, 202 Cal. App. 4th 35, 135 Cal. Rptr. 3d 761 (Cal. Ct. App. 2011) and cases cited therein.

Issue: Whether the landlord can limit the implied covenant of quiet enjoyment and any remedies provided for such a breach.

Holding: The California Court of Appeals affirmed the lower's court's granting of the summary judgment. The court agreed that California courts have long held that the tenant to a commercial lease may agree to limit the scope of the covenant. "Courts have affirmed lease terms that exempted the landlord from liability arising from conduct by the landlord and neighboring tenants, as well as lease terms that limited the tenant's remedies for breach of the covenant." *Id.* at *8.

The lease at issue entitled the tenants to the quiet enjoyment of their premises "in accordance with the provisions of th[e] Lease," but expressly exempted the landlord from liability for damage and injury to merchandise "caused by . . . water," regardless of the water's source, including "defects of pipes, sprinklers, wires, appliances, plumbing, air conditioning or lighting fixtures, or from any other cause," and regardless of "whether the cause of [the] damage or injury or the means of repairing the same [was] inaccessible to [appellants]." The exemption barred tenant's claim for breach of the covenant of quiet enjoyment.

Pollock v. Morelli, 245 Pa. Super. 388, 369 A.2d 458 (1976)

Takeaway*:* Changes made by landlord that made the lessee's business less visible and less convenient to customers and compelled the lessee to relocate the business is a breach of the covenant of quiet enjoyment. However, because the damages were limited, question remains whether it was worth it regardless for landlord to make alterations.

Facts: Lessee purchased a dry-cleaning business and entered a seven-and-a-half-year lease. The lessee's store's windows and overhead sign were easily visible to potential customers using the shopping center. Conveniently for shoppers, the dry-cleaning store was next door to a large supermarket. Approximately ten months into the lease, the landlord, without prior notice to the lessee, made structural changes to the shopping center creating a "mini mall" that enclosed and surrounded the lessee's establishment. Lessee was no longer occupying an outside store with visible display windows next to a parking lot. Instead, they now had a six and one-half year lease for one of eleven shops in a mall which extends over what had formerly been the small parking area. A store is located directly in front of the cleaning establishment and access is now gained by entering a set of double doors into the mall and proceeding down a hallway. The display windows are only visible from inside the mall and can be completely viewed only when a customer has passed through the double doors, traveled the full length of the hallway and turned the corner. The sign once directly over the store is now outside the mall over the discount center which is the store directly in front of the lessees. The nearest parking spaces in the remaining parking area are now 100 feet away. Those changes made lessee's business less visible and less convenient to customers. The lessees sought an injunction to compel lessees to relocate their business together with an award of damages.

The lower court held that appellee had not breached the implied covenant of quiet enjoyment in the lease and denied the lessee's damages for relocation. The court affirmed the order sustaining the demurrer of the landlord, noting that there was no allegation that the premises were entered or the tenant's possession disturbed by the landlord. The lower court defined the covenant of quiet enjoyment as ensuring only that the tenant would not be disturbed by good title in the possession of the demised premises.

Issue: Whether the alteration of the building where the tenant leases space breached the covenant of quiet enjoyment if the tenant's actual space is not disturbed or altered, and if so, what is the measure of damages.

Holding: Because appellants had vacated the premises and had been released from their obligations under the lease, the Appellate Court limited its review to issues of liability and damages because injunctive relief was moot. The Pennsylvania Superior Court reversed and found that the landlord's structural changes substantially interfered with anticipated use of the premises and constituted a breach of the implied covenant of quiet enjoyment. The court stated: "In view of the decisions of the court of this Commonwealth and other jurisdictions which recognize a tenant's right to the use of the leased property without disruption by the landlord, it is clear that a remedy exists in favor of the appellant-

tenants in the present case due to the landlord's activity in making structural changes detrimental to the tenant without obtaining his consent." *Id.* at 397.

Because the lessee's business was new, the measure of anticipated profits was too speculative to provide a basis for damages. The court limited the lessee's damages to recovering relocation expenses. The dissent agreed that there was a breach of the covenant of quiet enjoyment but disagreed that the lessee was precluded from lost profits and would have remanded the case for a trial on damages.

Implied Covenant to Maintain Commercial Property

1. Introduction/Overview

Some leases contain implied or hidden obligations to maintain commercial property or operate the property in a certain manner. General statements that require operation in a "first class" or "reputable" manner may lead to litigation about what that general term means. For example, is a liquidation sale consistent with operating in a "first class" manner? In the absence of clear terms as to the meaning of these terms, courts are left to determine what obligations are implied.

2. Case Law Discussion

Wallington Plaza, LLC v. Taher, 2011 N.J. Super. Unpub. LEXIS 1807 (N.J. Super. Ct. App. Div. July 7, 2011)

Takeaway*:* Tenant may be excused from paying rent if Landlord fails to maintain the condition of the premises in a first-class manner, especially if the lease provides that the Tenant is obligated to maintain a first-class business.

Facts: Plaintiff Landlord owned a small commercial shopping center and entered into a lease agreement with Tenant jewelry store for a lease term of ten years. Under the terms of the lease, Tenant agreed to operate business in a "first class and reputable manner." Tenant left the premises six months before the lease expired. Landlord filed suit for unpaid rent, property taxes, and common area maintenance charges. Tenant filed a counterclaim alleging Landlord breached the lease by failing to maintain shopping center.

Issue: Was the Tenant was obligated to pay rent even though Landlord failed to operate a "first-class" shopping center?

Holding: Tenant was not obligated the pay rent through the end of the Lease term as the Landlord failed to maintain the premises in a first-class manner. Tenant was obligated to pay only two months' rent instead of six months' rent.

Tenant argued that prior to executing the lease, Tenant spoke to Landlord's manager and that because the shopping center appeared to be a first-class center, Tenant entered into the lease. Tenant argued that during the years it was a tenant, the center's parking lot deteriorated and was in a state of disrepair. Also, Tenant argued that many other stores in the shopping center closed and left the area. Tenant argued that it had to leave the shopping center because there was no customer traffic and that it lost business.

The trial court found that Landlord breached its implied covenant to operate a first-class shopping center. Even though the lease obligated only Tenant to operate its business in a "first class and reputable manner," the court found that Landlord also had a responsibility to keep the premises in a reasonable condition if Tenant has the obligation to operate a first-class business. The court found that the parking lot was in a deplorable condition as there were no white lines, and the pavement was uneven. The court also found that the vacancy signs and general condition of the mall was substandard. The court also found that Tenant should have provided the Landlord with reasonable notice of its intent

to vacate as it only gave one month's notice. The Court held that two months' notice prior to vacating was appropriate. Tenant was ordered to pay rent for two of the six remaining months of the lease term.

On appeal, Landlord argued that the trial court erroneously concluded that tenant was relieved from the obligation of paying rent pursuant to the lease because of the vacant stores in the shopping center. However, the appellate court affirmed the trial court.

Legacy Vill. Investors LLC v. Z Gallerie, No. CV 09 6860552009 2009 Ohio Misc. LEXIS 538 (Ohio C.P. 2009)

Takeaway*:* When a lease provision requires that tenant operate its business in a first class and reputable manner, a liquidation sale may be a violation of that provision.

Facts: Plaintiff Landlord filed a complaint against Tenant Z Gallerie after Landlord became aware that it was conducting a liquidation sale. As part of the lease, there was a continuous operation clause which required Tenant to be fully stocked and open, prohibited auctions, and obligated Tenant to conduct its business in a first class and reputable manner. Landlord found out that Tenant was not continuously operating and filed a complaint seeking a Temporary Restraining Order. The TRO was granted and at the hearing for the preliminary injunction, there was testimony presented that the continuous operation clause of the lease was specifically required because the Tenant was an anchor tenant.

Issue: Whether a liquidation sale was a violation of the first class and reputable manner of a lease?

Holding: Yes, the liquidation sale was a violation of the lease. The tenant was ordered to reopen and re-stock the store.

The Court granted the preliminary injunction, finding that if Tenant closed, the shopping center would lose the customers attracted by the store and other tenants would lose business—which would be detrimental to the whole shopping center. Additionally, the Tenant had a prime location within the center (at a discounted price) that exposed it to shoppers at a favorable vantage point. The Court reasoned that an empty store would discourage shoppers. Keeping the store open served the public interest by helping ensure the viability of the center. Tenant was enjoined from closing its store and was enjoined from conducting a liquidation sale and conducting its business in anything less than a reputable and first-class manner.

Carlson Real Estate Co. v. Soltan, 549 N.W.2d 376 (Minn, Ct. App.1996)

Takeaway: A Court can imply a covenant requiring a general standard of conduct.

Facts: Plaintiff Landlord filed suit against Tenant convenience store/gift shop for breach of lease for failure to operate during the hours specified in the lease. Tenant was located below a restaurant, another one of Landlord's tenants. Tenant experienced leaks and odors from the restaurant and Landlord fixed the issue and cleaned Tenant's store. Tenant's store was closed for about four (4) months while repairs were completed. After it reopened, Tenant complained of ongoing leaks and odors and closed the store a month later. Landlord asked the Tenant to reopen the store, and Tenant did so, but their relationship deteriorated. Landlord argued that Tenant threatened and verbally abused store patrons, the restaurant's employees and guests, as well as other tenants. Landlord argued that this constituted a breach of the Lease, requiring the tenant to operate its business "in good faith and in a reputable manner."

Issue: Whether Tenant was obligated to conduct its business in good faith and in a reputable manner despite the fact that Landlord allegedly breached the lease by failing to make repairs?

Holding: Tenant was obligated to conduct its business in good faith and in a reputable manner even when Landlord breached the lease. Landlord's breach was not a direct cause of or a justification for Tenant to not conduct its business according to the reputable manner provision.

The trial court found that the provision of the lease that required Tenant to operate its business "in good faith and in a reputable manner" established a general standard of conduct and that Tenant breached

that provision. The court found that the record provided evidence of Tenant swearing at employees, customers and patrons was evidence of failure to operate the business in a reputable manner

Tenant argued on appeal that the trial court erred in imposing this as a standard of conduct and that it should be read as only to prevent Tenant from circumventing the hours of operation provision. However, the appellate court disagreed with Tenant and upheld the trial court's decision. The appellate court interpreted the plain meaning of the provision in the context of the entire agreement and affirmed that the phrase "in good faith and in a reputable manner" imposes a standard of conduct. The appellate court reasoned that the alleged breach by the Landlord (failure to repair leaks) would have permitted Tenant to terminate the lease or bring an action to enforce its rights, but it did not permit Tenant to breach the lease by failing to conduct business in a reputable manner.

Other Implied Rights/Restrictions

1. Site Plans

Some rights parties rely on are not expressly in the lease, but may be implied from attachments to the lease or are related to the shopping center itself. One common attachment that leads to litigation is the site plan, even though landlords usually intend the site plan to be attached as a draft, for illustrative purposes only.

For example, in the *Best Buy Stores, L.P. v. Manteca Lifestyle Center* case, 2010 U.S. Dist. LEXIS 47193, noted in Section III.A above, Best Buy paid 50% rent based on its interpretation of the co-tenancy provision in the lease. That provision required 60% of the gross leasable area of the shopping center to be open and operating, including at least two or more of the following tenants: (1) JC Penney, (ii) Bass Pro; and (iii) a cinema. There was a site plan attached to the lease which identified the Best Buy location in relation to other buildings in the promenade, detailed the square footage of each building and included a table summarizing the space and listed the gross leasable area as 743,908 square feet. When Best Buy opened, J.C. Penny, Bass Pro and the cinema were open, but only 320,000 square feet of the Promenade was open. Best Buy argued that the 60% percent threshold of the gross leasable area of the shopping center as depicted on the site plan was not met. The owner argued that the co-tenancy was satisfied, because based on certain language in the lease, buildings not fully constructed were not included in the "Shopping Center" for purposes of the condition Thus, Landlord argued that more than sixty percent of buildings that had been fully constructed were open and operating at the time plaintiff opened for business. The Landlord moved to dismiss Best Buy's complaint. The District Court denied the motion to dismiss because it determined there were potential conflicting definitions for "gross leasable area" and "shopping center" in the lease.

The District Court reasoned that under plaintiff's interpretation, the "gross leasable area" of the shopping center could be interpreted to refer to the amount of leasable area included in the site plan, stating "[i]t is therefore plausible that the gross leasable area of the Shopping Center was meant to be defined as a static number based on the amount of leasable area available in the proposed buildings in the Site Plan." And, under defendant's interpretation, "gross leasable area" could refer to a number that can only be calculated after a building is constructed based on an article in the lease that provided: "For the purpose of this lease, the leasable area of the Premises shall be measured from the center of all common walls and the outside of all exterior walls of the Premises." The District Court also found two plausible meanings for Shopping Center either being the building on the site plan or those already constructed, based on the definition in the lease:

> The premises and improvements and appurtenances constructed and to be constructed thereto (the "Premises") located at the SE corner of State Highway Route # 120 and South Union, in Manteca, California (the "Shopping Center"). The legal description of the Shopping Center is attached hereto as *Exhibit A* and made a part hereof, and the Shopping Center is outlined in red on the site plan attached hereto as *Exhibit B* and made a part hereof . . . Nothing contained in this Lease will prohibit Landlord from constructing the Shopping Center at various times, and in various phases or sections . . . The buildings located within phases or sections constructed after the date of execution of this Lease will be deemed to be included within the defined Shopping Center for all purposes of this Lease as of the date that the buildings are fully constructed . . . .

The District Court, therefore, concluded at the motion to dismiss stage: "Because plaintiff has alleged a reasonable interpretation of the contract and plead that defendant breached its terms, the court cannot grant defendant's motion to dismiss when no evidence evincing the intent of the parties is before it.

Another example of the import of a site plan was in *Chesterfield Exchange, LLC v. Sportsman's Warehouse, Inc.*, 572 F. Supp. 2d 856 (E.D. Mich. 2008). In this case, Sportsman's was found to have a right to rescind its lease after Sam's Club, a key tenant for Sportsman's moving into the shopping center, failed to enter into lease in the shopping center. After protracted negotiation, which included Sportsman's relocating its proposed space for the planned building of a Sam's Club, Sportsman's ultimately agreed to sign a lease with Chesterfield. Although the executed lease did not contain any provision conditioning the lease on the opening of Sam's Club, the Lease contained an Exhibit B styled "Depiction of *Shopping Center* and Premises," The box showing Sam's Club still described it as "proposed." In addition, the legend contained a disclaimer, which read:

> "This drawing is for general information purposes only. Any and all features, matters and other information depicted hereon or contained herein are for illustrative marketing purposes only, are subject to modification without notice, are not intended to be relied upon by any party and are not intended to constitute representations or warranties as to the ownership of the real property depicted hereon, the size and the nature of improvements to be constructed (or that any improvements will be constructed) or the identity or nature of any occupants thereof."

The lease also contained an integration clause, which read as follows: "This Lease contains all of the agreements made between the parties regarding the subject matter hereof, and may not be modified or amended in any
manner, except by an agreement in writing signed by all of the parties hereto, or their respective successors in interest."

Sportsman's sought to rescind the lease and for money damages for the planned location of its store. Landlord Chesterfield relied on the integration clause and the fact that the lease did not contain a requirement that the lease was conditioned on a Sam's Club. The District Court agreed that the integration clause applied therefore binding the parties to the lease including the exhibits as the complete expression of the agreement. To try and vitiate the integration clause, Sportsman's argued it was a victim of fraud in the inducement to sign the lease or, at least, negligent or innocent misrepresentation, and therefore parol evidence should be allowed to show that it was duped into signing the lease by the promise of a Sam's Club store as a cotenant. The court disagreed, finding that, at the time Sportsman's signed the lease, there was no fraudulent or negligent misrepresentation. Rather, the court allowed parol evidence to clear up an ambiguity as to the word proposed on the site plan attached as exhibit to the lease. The court had previously found that the disclaimer language was illegible and had no legal effect. As to the word "proposed" on the site plan, the court found it ambiguous because it could mean "possible" or "likely," but it also has been construed to mean "planned" or "intended". The court found that based on the undisputed evidence in the case, the word "proposed" meant "intended" because the conduct of the parties pointed in that direction. The court found that it was the fact of forthcoming Sam's Club that rekindled the lease negotiations and caused Sportsman's to be willing to incur the cost of relocating and redesigning the building to accommodate that inclusion. However, the court also required Sportsman to prove that its reliance on a future Sam's Club was so substantial of an unfulfilled term that rescission of the lease could be allowed. The court found that Sportsman's met that burden stating: "In this case, there is no doubt that a major consideration propelling Sportsman's to commit to space in the plaintiff's shopping center was the presence of a big box anchor tenant. In fact, all the evidence suggests that the promise of a pending Sam's Club was material to Sportsman's decision to sign the lease." The court, therefore, concluded that "when it was clear that the Sam's Club was not going to be built, Sportsman's had the option to rescind the lease."

Finally, in *Eastern Shore Markets v. J.D. Associates Limited Partnership*, 312 F.3d 175 (4th Cir. 2000), the United States Court of Appeals for the Fourth Circuit, applying Maryland law recognized the potential for a claim based on an alleged breach of the implied covenant to refrain from engaging in destructive competition. (*See Sec. III.A supra* for a full description of the factual background). On appeal, the Court of Appeals for the Fourth Circuit reversed the dismissal, stating that, "under Maryland law, the intentions of parties as expressed in the lease providing for rent calculated in part as a percentage of sales, combined with the circumstances surrounding the lease's formation, may give rise to an implied covenant to refrain from competition that is destructive to the mutual benefit of the contracting parties." The court focused on the "circumstances

surrounding the lease's formation," including a "shopping-center site plan, which was made part of the lease, and its inclusion of [the plaintiff's] store as the only grocery store in the shopping center," which was attached to the plaintiff's complaint. Significantly, the appellate court rejected the argument that the terms of the lease and site plan demonstrated that the parties understood that the plaintiff would be the only grocery store and, therefore, created an implied covenant of exclusivity based on the implied covenant of good faith and fair dealing, as that covenant must be bargained for and written in the agreement. Rather, the court found that an enforceable promise to refrain from destructive competition arose because the shopping center site plan, which apparently limited competition, was incorporated into the lease.

2. Implied Easements

Other rights are implied from the use of the shopping center, such as easement rights. In *South Beaver Historic Bldg. Group, L.L.C v. Harton*, 2007 Ariz. App. Unpub. LEXIS 211 (2007), the Arizona Court of Appeals affirmed the lower court's summary judgment finding an implied easement based on prior use for the operators of one parcel that operated businesses for over 25 years as tenants in the North property to use the back entrance of their stores that intersected with the parking lot of the adjacent South property, which exceeded the boundaries of a recorded easement. The court recognized that the undisputed evidence showed that the operators needed truck access directly to their back doors for deliveries, garbage pickup, and repairs and the only feasible way to do that was to have access beyond the express rectangular easement. In explaining the elements for an implied easement, the court found that the third element of the easement being essential to the enjoyment of the parcel to be benefitted, [13] "only reasonable necessity is required for an implied easement 'such as will contribute to the convenient enjoyment of the property'." The undisputed facts evidence that the alternative means would have blocked the operators' front entrances as the court found that " [t]he need for direct access to the back of the North Property without going through the front of the South Beaver businesses, disrupting their customers by blocking the entrances and making the customers eat alongside garbage cans, and making service personnel block a public street and extend long equipment to clean filters in the rear of the businesses, meets this test." *See also Granite Properties Ltd. P'ship v. Manns*, 117 Ill.2d 425, 512 N.E.2d 1230 (1987) (*implied* easement found to *use* driveway at rear of *shopping center* for deliveries when it would have been difficult and disruptive for semi-trailer trucks to make deliveries in different manner).

3. Implied Use

As discussed and cited above, in *Downtown Barre Development v. C & S Wholesale Grocers, Inc.,* the Vermont Supreme Court overruled the Superior Court's finding that the former and assigning tenant could not change the use of the space at a shopping center to a different retail use. While acknowledging that specific provisions of the lease unambiguously permitted any lawful use of the space, the superior court determined that the lease as a whole reasonably and necessarily implied a condition that the premises be operated as a single unified supermarket or comparable store. In recognizing that Vermont law recognizes that lease terms may be implied where necessary to effectuate the purpose underlying the stated terms of a lease, the Superior Court found that:

> The language of "any other lawful use" does not negate the importance of these references, as it is reasonable that the parties intended some flexibility in the evolution of Grand Union's business over a period of up to 40 years, while fundamentally relying on an implied understanding that Grand Union would continue in the supermarket business. In addition, the course of dealing shows that the parties did not think "any other lawful use" included a pharmacy, because when Grand Union wanted to incorporate one in its store, DBD objected in order to preserve the distinction between the supermarket and specialty minor stores, and its position prevailed between the parties.

The Superior Court, therefore, concluded that "taking into account the specifically stated terms of the lease and the necessary implied covenants that are based on those stated terms, the court concludes that DBD is entitled under the lease to prohibit a tenant from demising the former Grand Union space into two spaces and from

[13] The other two elements to find an implied easement by prior use include (1) the existence of single tract of land so arranged that one portion of it derives a benefit from the other, the division thereof by a single owner into two or more parcels, and the separation for title, and (2) before separation occurs, the use must have been long, continued, obvious or manifest, to a degree which shows permanency

using the space for purposes other than as a supermarket or other type of anchor store with reasonably comparable characteristics."

The Vermont Supreme Court reversed the Superior Court finding that the lease provisions allowed the assigning tenant to purchase the rights and obligations of the tenant under the lease and to alter the premises for use as a pharmacy and other retail business. The court noted:

> First, the lease allows the tenant to assign or sublet the premises, or any part of it, "for any lawful use," and the landlord can terminate the lease based on any such assignment or subletting only if the tenant notifies the landlord that it intends to disclaim its liability under the lease. Second, the lease allows the tenant to operate the premises "for the sale of goods and any other lawful use including without limitation, a use as [a] supermarket." Thus, although the parties undoubtedly expected the tenant to use the premises, at least initially, as a supermarket, the lease explicitly allows other lawful uses.

The Supreme Court also observed that "[t]he parties could have drafted this provision to restrict use of the premises to the operation of a supermarket, as evidenced by another provision in the lease prohibiting the landlord from using the premises as a supermarket for three years in the event it failed to deliver the premises to Grand Union". The parties, however, chose to allow any lawful use of the premises. Therefore, the Court concluded that "the lease's expansive use provision permits any reasonable, lawful use of the premises, including its use as a Brooks Pharmacy or other reputable retail establishment."

Conclusion

This article discusses numerous cases in which implied covenants were found. The existence of these cases are what gives parties pause and reason for negotiation of disputes. These cases and many others create uncertainty in regard to the outcome of litigation. We could find no study that quantifies the number of cases where efforts to impose implied covenants were successful compared to the number of cases that may have been disposed of on motion (even before discovery). It is the reported decision in a case that successfully imposes an obligation not expressly stated that gains the notoriety. It is the law of implied covenants that turns the "should haves, could haves and would haves" in negotiations into weapons in litigation. Whenever there is an occurrence or situation that cannot be said to be fully addressed in the contract or there is ambiguity, the law may imply a covenant to address the situation, evaluate the performance or interpret the obligations. It is important to understand the law governing the contract when drafting and when litigating as not all states are alike.