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COVID in the courts: Trends in pandemic-era commercial real estate litigation - by Courtney Statfeld and Daniel Hendler

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Like crises before it, the COVID pandemic brings a wave of novel litigation that will shape industries for years to come. Since the pandemic began, stakeholders across CRE have filed COVID-related lawsuits, and if the 2007 Financial Crisis taught us anything, many more suits will follow in the pandemic's wake.

Tenants v. Landlords and Landlords v. Tenants

As governments across the country imposed lockdowns, many commercial tenants turned to the courts to seek relief from rent or rescind their leases altogether. Leases with “force majeure” or “Act of God” clauses may permit tenants to avoid their contractual obligations when an event outside their control makes performance impossible. Even tenants without explicit force majeure clauses may rely on the common law doctrines of impossibility of performance or frustration of purpose for similar relief. In June 2020, Victoria’s Secret sued its landlord to terminate the lease of its flagship Herald Square store, arguing the pandemic and government shutdowns frustrated the purpose of the lease.¹ Similar cases followed.² In addition to tenant-led litigation, landlords sued tenants for overdue rent.³ The tenants in those actions have responded with similar force majeure arguments. It is still too early to say where courts will ultimately fall on these force majeure questions, but it is unlikely that COVID will provide a blanket excuse for most tenants to avoid their leases.

Property Owners v. Lenders

Struggling landlords inevitably follow struggling tenants. Is it the calm before the foreclosure storm? State and Federal moratoriums have prevented foreclosure proceedings in many cases. To date, multifamily foreclosures are notably absent, as the CARES Act imposed a foreclosure moratorium on all GSE-backed loans. And in New York, Gov. Cuomo’s executive orders halted both commercial and residential foreclosures.⁴ However, on December 28, 2020, Governor Cuomo signed an extension of the moratorium for foreclosures on residential properties and landlords owning 10 or fewer dwelling units.⁵ Provided Governor Cuomo does not issue a similar executive order shortly impacting CRE, this would seem to pave the way for new evictions and foreclosure proceedings. Though some aggressive lenders have already pursued foreclosure where allowed,⁶ most banks appear to be taking a wait and see approach.⁷ As moratoriums lift and lenders seek cash, foreclosure litigation is likely to follow.

Property owners have not idly sat as they brought COVID cases against lenders in 2020 for violations of the CARES Act (mostly in class action form). These actions alleged that lenders failed to provide relief required by the CARES Act⁸ and those lenders granted forbearances to borrowers who didn’t request them, to the detriment of those borrowers’ credit ratings.⁹ Like other COVID litigation, most of these cases are working their way through the courts, though certain limited decisions have gone against property owners.¹⁰

Landlords and Tenants v. Insurers

To recoup lost revenues from the pandemic, landlords and tenants filed suits against insurers refusing to honor business interruption claims. The cases face mixed success depending upon the terms of actual insurance policies. As these cases are in their infancy, it is too early to tell how appellate courts will resolve the main issues at play.

CMBS litigation

The COVID pandemic has hit CMBS like no crisis before it by radically reduced demand for major CRE sectors – lodging and retail in particular. When CMBS loans are current, all stakeholders’ interests are aligned, but as CMBS loans go delinquent, conflicts of interest arise.

CMBS investors and trustees’ conflicts with special servicers over improper servicing of delinquent loans, failing to foreclose timely, appraisal reductions being applied to the detriment of particular investor classes, improperly disposing of REO property, and improperly calculating special servicer fees are all likely to result in contentious suits in 2021. As the economic stress of the pandemic exposes poorly underwritten loans, conflicts are also likely to arise between CMBS investors, trustees, or special servicers against CMBS sponsors, underwriters, and loan originators for breaches of

contract and fraud related to poor underwriting practices and misleading statements in CMBS offering materials.¹¹ Suits between CMBS investors regarding the allocation of limited cash flows may increase post-pandemic as well.¹²

REIT Investor Disputes

Similar to CMBS, financial stress can cause conflict between different REIT stakeholders. REIT managers' decisions about particular CRE assets may benefit specific stakeholders to the detriment of others. Investors may sue managers for self-dealing decisions or for decisions that benefit individual investor classes over others.

While COVID vaccine distribution may halt or reverse declines in certain CRE sectors, litigation tends to drag behind market events. RMBS litigation stemming from the 2007 financial crisis is still going on today, including new cases filed last year.

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1 Victoria's Secret Stores, v. Herald Square Owner LLC, No. 651833/2020 (N.Y. Sup. Ct. N.Y. Cty. 2020).

2 See, e.g., Valentino U.S.A., Inc. v. 693 Fifth Owner LLC, No. 652605/2020 (N.Y. Sup. Ct. N.Y. Cty. 2020).

3 See, e.g., Herald Center Dept. Stores of N.Y. LLC v. H&M No. 652174/2020 (N.Y. Sup. Ct. N.Y. Cty. 2020).

4 Exec. Order No. 202.66.

5 See https://nyassembly.gov/leg/?default_fld=&leg_video=&bn=S09114&term=2019&Summary=Y&Actions=Y&Memo=Y&Text=Y

6 See, e.g., D2Mark LLC v. Orei VI Investments LLC, No. 652259/2020 (N.Y. Sup. Ct. N.Y. Cty. 2020)

7 See Matthew Goldstein, Worried Lenders Pounce on Landlords Unable to Pay Their Loans N.Y. Times, Aug. 13, 2020, at <https://www.nytimes.com/2020/08/13/business/commercial-landlord-loan-foreclosure.html>.

8 See, e.g., Profiles Inc. v. Bank of America Corp. et al., No. 1:20-cv-00894 (D. Md. 2020).

9 See, e.g., Forsburg v. Wells Fargo & Co. et al., No. 5:20-CV-00046 (W.D. Va. 2020).

10 See, e.g., Profiles Inc., No. 1:20-cv-00894 (D. Md. 2020).

11 A shareholder class-action suit was recently brought against Wells Fargo for misstatements about its CLO and CMBS portfolios. Wood v. Wells Fargo & Co, et al., No. 3:20-cv-07997-RS (N.D. Cal. 2020).

12 See, e.g., In the Matter of Trusts, No. 17 CIV. 1998 (KPF), 2020 WL 1304400 (S.D.N.Y. Mar. 19, 2020).