

**CALIFORNIA BUSINESS PROPERTIES ASSOCIATION
LEGAL ISSUES AND ANALYSIS
SB 939 (WIENER) AS AMENDED MAY 29, 2020**

SB 939 (Weiner) has two main sections and according to our analysis, both are extremely problematic in the policy they set forth and the negative economic damage.

Section 1 allows all California-based commercial tenants in the state to pay no rent for an indeterminate amount of time.

Section 2 creates a special class of commercial renter (bars and restaurants and places of entertainment) and give them the right to nullify a lease contract. It allows certain tenants unilaterally walk away from a lease regardless of the investment put into a space by the building owner.

This bill creates new rights for tenants and removes existing rights from property owners. This imbalance will provide incentive for some tenants to use the full extent of this law and a health pandemic to force otherwise unreasonable demands onto a property owner.

We believe with these amendments the bill is unconstitutional and would trigger “takings” claims.

To follow is analysis and commentary on SB 939, followed by legal notes that back up the analysis.

SB 939 is Unconstitutional under the Contracts Clause

Our analysis determines that SB 939 would be found unconstitutional Under US Art. I, Sec. 10 and CA Art. I Sec. 9 - Contracts Clause.

This statute modifies and cancels private contracts between private parties clearly fails the two part Blaisdell test. *Is the interference substantial?* In this case “yes,” because substantial rights are terminated against the wishes and to the detriment of one party to the contract to the benefit of the other party. *If substantial, is it properly drawn?* In this case “no,” because the legislation is overly broad, contains no balancing of the rights of the parties, and is unnecessary to fulfill the state purpose. Other existing laws fulfill same purpose (contract law, bankruptcy).

Causes a “Taking” Requiring Compensation

When government action prevents a property owner from making economically viable use of their property, a taking occurs. See US v. Dickinson, 331 US 745 (1947); US v. Causby, 328 US 256 (1946).

The taking question is analyzed by considering the economic impact of the regulation, its interference with reasonable investment backed expectations and the character of the government action. See Kaiser Aetna v. US, 444 US 164 (1979).

This statute specifically bars commercial property owners from making economically viable use of their properties because it does not allow them to collect rent from tenants in the amount necessary to pay their mortgages, taxes, insurance and to pay the operating expenses which benefit the tenant. It interferes with all reasonable expectations and does so for an indefinite period of time. Therefore, whatever losses the owners suffer by reason of this statute must be paid by the State.

SB 939 suggests that all economic responsibility be placed only the property owner, giving new rights to tenants, and requiring no actions by the State of California to balance the harm done by the statewide shelter-in-place orders.

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All Leases Qualify - Commercial Foreclosures and Bankruptcy

Under the provisions of SB 939, every loan secured by commercial real property will be in put in real danger of going into default because of the impairment of its collateral and a statutory induced inability of the property owner to pay their mortgage. The rules put in place after the Great Recession will require lenders to place the properties in default and proceed with foreclosure if the property owner can meet revenue projections and pay the mortgage. Since those rules are Federal, the State cannot change the rules, though this bill will artificially accelerate foreclosures that could be avoided.

SB 939 excuses all commercial tenants operating primarily in California, regardless of size or type from any failure to pay rent from March 4, 2020, until three months after the end of the statewide Emergency Order. This is an open ended, indeterminate amount of time that property owners are being forced to forego basic operating income.

The bill additionally gives 12 months for the rent to be repaid and removes standard incentives for payment of debt.

As an example, if the Emergency Order is lifted by the end of the year, SB 939 mandates another three months of renter deferral (until April 2021) and full year to pay that debt (until Jan 2022).

The rent deferral is retroactive to early March 2020, so under the very realistic scenario where the emergency order is lifted by the end of this year, a full 13 months of rent could be withheld for 25 months. Non-payment of over a year's worth of revenue for two years will put many property owners into default and out of business.

In the meantime, section 2 of the bill allows certain tenants to break a lease, heaping even more debt on building owners that have invested capital in tenant improvements for those tenants that are allowed to walk away.

Under the bill's very generous definitions a vast majority of commercial renters will be eligible for what could easily be more than a year of deferred rent.

Anyone who can recall the Great Recession knows that when a massive number of properties fall to foreclosure or are returned to lenders in lieu of foreclosure the economy collapses.

The collapse of commercial real estate that would occur under SB 939 will be far reaching because it will also eliminate jobs and employers.

The Great Recession took four to eight years for the economy to recover. Recovery from this artificially created Great Recession, caused by turning all commercial property loans into the moral equivalent of subprime with the stroke of a pen, will take longer.

Even a Small Delay in Opening Equals Months of Deferred Revenue

The bill has a number of eligibility factors including any “*commercial tenant that was prevented from opening or required to **delay** opening its business because of the state of emergency.*” (Emphasis added).

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A grocery store that was merely delayed in opening because of a local shelter-in-place order for a few hours would be eligible for months of deferred rent.

Reduced Floorspace Also Equal Months of Deferred Revenue

Under SB 939, any leasee in which government requirements reduce capacity by 15% or more also become eligible for retroactive rent deferral.

This eligibility definition is absurd; even grocery stores whose sales are up by 200%, can claim a decline of fifteen percent or more of capacity, since all stores now must lower the number of customers and space out their lines.

Trades and Service Providers at Risk

All trades that support commercial real estate, including janitors, security guards, parking lot sweepers, maintenance trades, contractors, are at risk of reduction as property owners, with government mandated decreased revenue, will not be able to pay them at previous levels. This represents another large pool of workers who will become unemployed.

Without the artificial interference of SB 939 this may also happen at some properties – but the universal applicability of the bill will create unnecessary revenue problems at many properties as business renters use every advantage they can to lower their own business expenses.

Public agency pension funds at Risk

Public employee pension funds, such as CalPERS and CalSTRS, among others, rely on a substantial portfolio of commercial properties to provide steady value and income and to hedge against the volatility of equity markets with assets that have a better return than typical bond funds.

The cancellation of rents in this bill could cost CalPERS on the order of \$1 billion dollars or more.

Criminalization of Building Owners - Induced Lawsuits – Enabling “Bad Actors”

Under the provisions of SB 939, new fines and penalties are created that incentivize legal action by lessees.

SB 939 creates a new cause of action for any tenant that feels “harassed, intimidated or threatened” by their property owner. Such tenant may file a suit for \$2,000 per incident for the tenant, plus allows them to file a claim that this is an “unfair business practice,” which carries another fine of \$2,500 per incident.

Currently, unfair business practice claims require an actual loss of money or property. SB 939 would criminalize working with a tenant on a rent repayment.

The provisions/protections do not go both ways and do not allow a building owner to file a similar complaint against a lessee abusing this statute to force better business terms for themselves. SB 939 would provide an incentive for bad actors on the tenant side to threaten legal action and filing of an unfair business claim to force concessions from property owners.

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With the change in law proposed by SB 939, none of this will be covered by insurance any longer, which does not cover allegedly willful acts. Even if the property owner can defend themselves successfully, under SB 939 they do not get legal fees - only the tenant gets legal fees.

This is an outrageous imbalance designed to allow ruthless tenants the ability to intimidate property owners and extract unreasonable terms and settlements under an unfair and unbalanced law.

SB 939 Creates a Vicious Circle: Induces Conditions that Triggers Penalty Provisions

A property owner caught in the grip of SB 939 (i.e. a property that is getting no rent and/or has a tenant that walked away leaving debt behind) will be unable to avoid the penalty provisions and fees and penalties.

That property owner, with lack of revenue, will be forced to cut back on services that they can no longer afford to provide, and unscrupulous tenants can claim that the reduction of services was for the purpose of “harassing” them. Even if the property owner is doing nothing wrong but trying to survive with no revenue. Under these conditions, business renters can sue and get money from the property owner, who will most likely settle, because it will cost less to pay than to fight.

The bill creates a vicious circle for property owners – especially small property owners without fiscal and legal resources – in which it forces conditions for which the bill also creates new tools to sue for those conditions being present.

SB 939 by tipping the balance of what was heretofore a business-to-business contract, enables and encourages a “bad actor” tenant to shakedown their property owner.

Notification Requirement is Burdensome and Unreasonable – Will Cost the State of CA

SB 939 requires every lessor to send a notice to every leasee within thirty days of the effective date of this bill. That is millions upon millions of notifications the state is requiring of private industry with less than a month to complete. This makes no sense, is an expensive burden on companies that are also losing revenue under the bill and doesn’t even make logical sense.

Almost every commercial property lease requires that every notice be served on leasee in a specific manner. This is a business protection for both sides of the contract to assure that notices are not “lost in the mail.” Notice are typically required to be sent by personal service (\$35 to \$200 per notice), a recognized overnight carrier (\$8 to \$32 per notice), or by certified mail with a return receipt requested (\$7 per notice).

It is also unnecessary when the state could communicate about the law through its normal means and/or could just require that notice of the statute be included in the very notices that SB 939 is voiding.

This cost becomes millions when it is multiplied by every commercial leasee in California.

This will be a direct cost to the State of California as it will have to notify every tenant on state-controlled property within 30 days of a signature on the bill.

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Almost All Restaurant Tenants May Cancel Leases and Transfer Losses to the Property owner.

Section 2 allows almost any bar, restaurant, or “place of entertainment,” to cancel their lease, excluding only publicly traded companies and franchisees who hold franchises with publicly traded companies, even if they only own one location.

While there is some pretense language about it being a small business, definition does not align with any current standards and at 500 employees, is five times larger than the state of California’s definition of small business.

No small restaurant or bar has five hundred employees; according to the National Restaurant Association, 90% of restaurants employ fewer than fifty (50) workers. The number in the bill is outrageously high – even the current California definition is too high if the bill is truly trying to help small business restaurants.

Eligibility/Impacts Standard is So Minimal Virtually Every Establishment Will Qualify

Section 2 has a pretense of “eligibility/impact” that included applies to bars, restaurants, and places of entertainment and must meet just “one” of the criteria.

Any that was merely delayed in opening will qualify by a state or local shelter-in-place order. And for those that somehow never closed their doors, will qualify under the prospective 25% reduction in capacity due to government mandated social distancing requirements.

These thresholds are so low that they are rendered meaningless.

Under this bill, a restaurant with 500 employees that was delayed for a few hours in opening, but saw an increase in revenue, can claim full protections of the bill.

SB 939 Enables a Completely Unfair One-Sided Negotiation to the Benefit of the Lessee

While there is also some pretense language discussing the idea of negotiations, the tenant may cancel their lease and walk away for no payment other than three months’ rent plus back rent and with no collection allowed against any guarantor.

We already know that approximately thirty percent 60% - 80% of restaurants close in their first five years during normal times. Many will close whether this bill passes or not, and several large groups have already announced they will be closing.

This bill, instead of requiring those restaurant tenants to file bankruptcy and have their losses apportioned among all creditors, sets that fair process aside, and puts the greatest burden and losses on the property owner. Pro-rated tenant improvements will become the sole burden of the property owner.

This again is a tool to allow tenants to extort their property owners with the threat of walking away if the tenant doesn’t get what they want.

-- End Analysis and Commentary --

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Legal Notes for Revised SB 939 as Amended May 29, 2020

Concerns Endemic To Entire Legislation

1. Unconstitutional Under US Art. I, Sec. 10 and CA Art. I Sec. 9 - Contracts Clause
 - (a) Statute purports to modify and/or cancel private contracts between private parties
 - (b) Blaisdell two part test - Is the interference substantial?
 - (1) In this case yes because substantial rights are terminated against the wishes and to the detriment of one party to the contract to the benefit of the other party.
 - (c) Blaisdell two part test - If substantial, properly drawn?
 - (1) In this case no. The legislation is overly broad, contains no balancing of the rights of the parties, and is unnecessary to fulfill the purpose
 - (A) Other laws fulfill same purpose (contract law, bankruptcy)
 - (B) No determination of relative harms or rights
 - (d) Sveen is not on point to this
 - (1) Facts of Blaisdell match our situation, Sveen does not
 - (2) Sveen found interference was not substantial because the law was doing what the person who contracted most likely wanted done, so only dicta on second part of test.
2. Causes a Taking Requiring Compensation
 - (a) When government action prevents a property owner from making economically viable use of their property, a taking occurs. See US v. Dickinson, 331 US 745 (1947); US v. Causby, 328 US 256 (1946).
 - (b) The taking question is analyzed by considering the economic impact of the regulation, its interference with reasonable investment backed expectations and the character of the government action. See Kaiser Aetna v. US, 444 US 164 (1979)
 - (c) This statute specifically bars commercial property owners from making economically viable use of their properties because it does not allow them to collect rent from tenants in the amount necessary to pay their mortgages, taxes, insurance and to pay the operating expenses which benefit the tenant. It interferes with all reasonable expectations and does so for an indefinite period of time.
 - (d) Therefore, whatever losses the owners suffer by reason of this statute must be paid by the State.
3. Definition of Timing Unreasonable, Impossible of Definition and Extreme
 - (a) Legislation defines all triggers and dates from the end of the state of emergency declared by Governor on March 4, 2020
 - (b) States of emergency can exist for years and do not accurately measure the time during which tenants may be impacted.
 - (c) Timing not tied to actual impacts on specific businesses or sectors.
4. Section 1 applies to all tenants statewide; Section 2 applies to all tenants except publicly traded companies and franchisees.
 - (a) The limit in Section 1 is illusory. Since we already know that all businesses have been ordered to reduce their capacity, in some cases by as much as 75%, all businesses meet the capacity requirement of a decline of capacity by 15%.
 - (b) The limits in Section 2 are too broad. Ninety percent of restaurants employ less than fifty workers and this definition allows up to 500 workers and has no revenue definition component.
 - (c) Since all industries fit the impacted definition, all tenants in entire state will stop paying rent and hoard cash - entire economy collapses as property owners default on loans, cannot pay services to

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maintain properties or keep utilities going, cannot pay property taxes or insurance premiums - properties shut down - businesses shut down - property taxes fall - that's the ball game.

5. Collapse of Property Values, Property Taxes and State Budget/Foreclosures

(a) The postponement of rent out of the current calendar year and possibly as long as two years out will cause property values to drop precipitously and require property owners to write off the losses instead of carrying them as receivables

(b) Loss of Rents will lead to massive petitions for Prop 8 property tax reductions which will in turn lower revenues throughout state

(c) Loss of values will cause lenders to make capital calls as allowed under typical commercial loans and property owners will not be able to pay, leading to foreclosure of properties.

6. Problem of Unwinding - If and when found unconstitutional, cannot unwind a departed tenant, lost rent, etc.

7. No allowance made for property owners and tenants that already negotiated new terms between themselves unless those terms are more favorable than the statute, even though the parties already agreed.

Specific Concerns by Section - Section 1

1. Section 1(h) issue - Fails to Restrict Correctly - This right to bring a motion to have the Judgment set aside is not restricted as to ones issued based on the notice limitations set forth in the previous sections. It applies to all evictions and should be limited to parallel the scope of evictions above.

2. Section 1(i) - Since rents can never be basis for eviction, property owners will not get paid for at least two to three years - one year of waiting, twelve to twenty-four months going through court, then have to collect if you can still find the tenant after that long - will also be a component of the value of the taking.

3. Section 1(l) issue - This is cost prohibitive, impossible to regulate or enforce. Most property owners are not in a position to give legal notice to every tenant within thirty days - employees and property managers are on SIP and working remotely does not allow personal service, delivery to premises, or FedEx without leaving shelter - enormously expensive and unnecessary - notice could be required when any notice seeking forfeiture of a lease is given by requiring the inclusion of certain language, but demanding that every property owner send notice of this provision to every tenant in the state is entirely absurd and impossible.

4. Section 1(m) issue - Property owners and Tenants are currently suffering disastrously from a patchwork of overlying and contradictory rules from the State, Counties and Cities. If you are going to do anything in this area, it must be pre-emptive so that all parties understand their respective rights and duties.

5. Section 1(n) issue - Creates tort damages for contract dispute - against sound public policy to do this. It also awards double fines, one here and one in B&P 17200, cumulatively \$4,500 per individual violation, and allows tenants to extort property owners with one sided attorney's fees. Fundamental fairness requires prevailing party provisions to run both ways. It also punishes property owners when they are unable to continue to provide services to tenants when they run out of money, regardless of "intent."

Specific Concerns by Section - Sections 2 and 3

1. Section 2(a) Issues - Definitional Issues mentioned above. Almost all restaurants meet outrageous definition.

2. Section 2(b) Issues

(a) There are no limits on what a Tenant may demand. If they don't get what they want, they may cancel the lease. And modification may mean cancellation.

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- (b) There is no legal definition of "good faith" - there is a definition of commercially reasonable, but that is not used here and no tenant is required to be reasonable in the negotiations as there are no limits or standards operating against the tenant.
3. Section 2(c) Issues - No limits on what the tenant can ask for - no rent at all is permissible or only percentage rent or cut all operating expenses, or etc., so essentially all tenants can stop there from being a deal simply by making unreasonable or impossible demands.
4. Section 2(d) Issues
- (a) All tenants have the right to terminate and walk away and no property owner can stop them. The proposed damages will be taken into account in the calculation of the taking.
- (b) Termination takes effect even if the tenant never pays. The limitation is on the amount of damages, not requiring tenant to pay to effectuate cancellation, so tenant walks and then property owner has to sue for a limited amount of damages.
- (c) Damages do not take into account amount that property owner invested in space to get tenant into it, leasing commissions, condition of Premises or any other category of damages allowed to property owners under the Civil Code - illustrates inequitable and unnecessary extent of statute and unconstitutionality.
- (d) Section strips property owners of rights relative to guarantors for no reason, which are additional and substantive rights bargained for at the start of the relationship - usually given in lieu of additional security deposit or to convince property owner to take a tenant without solid financial history. Even if tenant doesn't pay termination fee, property owner can't collect it from guarantor.
- (e) No protection for small property owners relying on income to survive.
5. Section 2(f) issue - Multiple bites of apple - This implies that if the tenant gives the notice, no agreement is reached, but the tenant decides to stay, they can give this notice again and again during the pendency of this statute, forcing the property owner back to the table multiple times and with a new right to terminate each time. If you do this at all, then Tenant should only be able to give notice once and then, if no agreement, no right to keep doing it over and over.
6. Section 2(g) issue - This is to exclude franchisees and many franchisees are small business and many took SBA loans to buy and set up their franchises. There is no good reason to exclude these tenants if you are doing this for everyone else.
7. Section 2(h) issue - This time frame should be whichever is earlier, not whichever is later. If Tenants are going to use these rights, they should be prompt.
8. Section 3 issue - This is an inaccurate statement. Local agencies and school districts are property owners too in many instances, so the removal of their right to collect rents from existing leases with tenants will cost public agencies billions of dollars.