

COVID-19-Related Lease Modifications Raise New Issues of Liability for Unpaid Rent

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As pandemic-related shutdowns battered the retail and restaurant industry, many tenants avoided defaulting on their leases by negotiating a lease workout. These agreements often provided tenants some much-needed rent relief in exchange for extending the term of the lease.

However, commercial landlords should be aware that negotiating a lease workout/extension with a subtenant which modifies the term of the lease may relieve the original tenant of any obligation to pay rent should the subtenant default during the extension period.

Generally, when a tenant assigns or subleases its interest in a lease to another entity, the original tenant is still liable on the lease unless the lease provides that the original tenant is released from liability. Landlords often rely on the continuing liability of the tenant when consenting to an assignment or sublease.

If an assignee or subtenant extends the term of the lease pursuant to an extension or renewal option provided for in the lease, then the original tenant often remains liable for the extension or renewal term. However, if the assignee/subtenant extends the term of the lease beyond any extension or renewal options provided for in the original lease, this is considered a new lease, and the original tenant is released from liability.

As the California Court of Appeals noted in *Meredith v. Dardarian* (1978) 83 Cal. App. 3d 248:

[I]t has been recognized in several cases that if a lease contains an option in the tenant's favor to renew or extend the term which is binding on the landlord upon the tenant's election to exercise it, the tenant remains liable, under his covenant to pay rent, for rent during the extension or renewal, although he has assigned the lease and the option has been exercised by his assignee. Where an option to extend or renew is not automatically binding on the landlord at the election of the tenant, the tenant has been held not liable on his covenant to pay rent after renewal by his assignee.

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Thus, when commercial landlords are negotiating lease workouts with an assignee/subtenant, landlords should carefully consider whether modifying the term of the lease, outside of any renewal options provided for in the lease, is worth releasing the original tenant from liability. Astute landlords should require the original tenant to agree to be a guarantor on any lease amendment which extends the obligations beyond the term of the original lease.