

## COMMERCIAL REAL ESTATE



GUEST COMMENTARY BY PHIL DIAMOND

## Mediation's value in a coronavirus economy

**Finding middle ground:  
Landowners want rent,  
tenants want relief**

In a properly functioning economy, there's a synergy between the three main components of commercial real estate: the lender typically provides most of the capital for the landlord to purchase the property; the landlord provides the physical space for the tenant to generate income; and the tenant produces the income that is used to pay rent for the landlord to service the loan and other expenses.

In the current coronavirus economy, which has deprived millions of commercial tenants of the ability to generate the income required to meet their rent obligations, the system has broken down.

The result?

Commercial tenants who can't pay their rent; commercial landlords who can't pay their mortgages; and commercial lenders faced with underperforming — or nonperforming — loans.

The solution?

Throughout the country, commercial landlords, tenants, and sometimes lenders as well, are entering into negotiations and agreements for lease and loan modifications to get through these difficult times. As a mediator, a real estate attorney, and a commercial landlord, it's clear to me that these times cry out for the application of the principles of mediation — and if necessary the process of mediation — in order for us to get through this crisis with as little collateral damage as possible.

Landlords, tenants, and lenders all come to the table with significant constraints on what they are financially able to do, now and for the foreseeable future.

Landlords are constrained by what they need to maintain their properties and service their debts. Tenants are constrained by the amount of income, if any, their businesses are still able to generate, and by the financial resources of any guarantors.

Lenders' constraints vary depending upon, for example, whether they are subject to loan regulators or committees, and whether the loans are held on the lender's own books or whether they have been packaged with other loans and sold to third-party investors as part of commercial mortgage-backed securities.

And all three are constrained by the current limitations on the judicial system if needed as a last resort, and by the fact that, at least for now, California courts are prohibited from issuing summonses in unlawful detainer actions (which means that non-performing tenants cannot be evicted).

As a result, viewing the process as a "zero-sum game" ("the more you get, the more I lose") is a recipe for disaster. Instead, the negotiating parties must bring a new mindset to the table — one that is based on flexibility, creativity, and transparency, and that recognizes that for all of us to get through this together, all players are going to have to be open to compromise.

And with that new mindset, the principles and process of mediation can be essential to resolving COVID-19 commercial lease dispute, without litigation.

Two key principles of mediation can be helpful in resolving COVID-19 commercial lease disputes. The first is comparing best- and worst-case potential outcomes if the dispute is not resolved, vs. what might be voluntarily achieved through negotiation. In the COVID-19 commercial lease setting, here are factors to consider in assessing best- and worst-case potential outcomes:

- Whether the tenant can "break the lease" either by a Force Majeure clause in the lease or by Civil Code Section 1511 or the common law doctrine of "commercial frustration of purpose."
- Whether the landlord can terminate the lease and sue for past and future lost rent (or, alternatively, keep the lease in effect and recover rent as it becomes due).
- How long, under the current circumstances, it would take the landlord to get relief from a court.
- Whether the landlord is prevented by law from evicting the tenant.
- Whether the tenant or any guarantors have sufficient assets to respond to a judgment for damages.
- How long it might reasonably take to replace a non-paying tenant.

The second principle of mediation that can be helpful in resolving COVID-19 commercial lease disputes is the principle of "Positions" vs. "Interests."

This principle focuses on the difference between what people say they want, and why they want it. What you say you want is your position; why you want it is your interest.

In the context of a COVID-19 commercial lease dispute, if the parties are willing to share with each other their underlying interests and not just their

positions, in the right situation there could be the foundation for a creative outcome beneficial to both sides.

For example, let's assume that the property is an old, single tenant building that is zoned for higher and better use as mixed-use multifamily, and the landlord would like to be able to develop it. Let's also assume that the non-paying, long-term commercial tenant has a few years left on his lease but would much prefer to just shut down the business and retire. The obvious solution? A negotiated lease buy-out.

### HOW A MEDIATOR HELPS RESOLVE CONFLICTS

Finally, there are some COVID-19 commercial lease disputes in which it can be beneficial not only to use mediation principles, but also to engage a mediator to shepherd the dispute through the resolution process. Here are some reasons why:

- The lease may require the parties to mediate before resorting to litigation or arbitration.
- Even if the lease doesn't require mediation, if the dispute is not resolved and ends up in court, at some point in the litigation process a judge is going to require the parties to mediate anyway. It's almost always more cost-effective to do so before investing the time, effort, and significant expense required in litigation.
- A mediator can assist the parties with better understanding and evaluating their risks and interests and facilitating the productive exchange of information and documents that the parties might otherwise be reluctant to share.

## COMMERCIAL REAL ESTATE

## ECONOMY

continued from page 10

- The entire mediation process, including materials prepared by the parties or their counsel in connection with the process, is confidential. This means that the parties are empowered to provide information to each other without the fear that something will be used against them in the event the dispute is not resolved through the mediation process.
- Because courts are working with skeleton crews due to the current pandemic, resolution of lease disputes may be achieved far more quickly — and far less expensively — through mediation than through the courts.
- In the mediation process, the parties are free to get as creative as they want, and to create a resolution in a way that neither side could ever achieve through litigation.
- One of a mediator's essential functions is to, as they say in the vernacular, "herd cats." Sometimes dispute resolution gets delayed or even derailed simply because the parties themselves are unable (due to the press of other matters or just procrastination), or in some cases unwilling, to keep the resolution ball moving forward. A mediator can assist by keeping the

process moving forward, and by coordinating a specific date for mediation, with counsel and all necessary decision-makers participating.

- Finally, using such platforms as Zoom and DocuSign, the entire mediation process can be handled remotely, which means that geographic distance between the mediator, the landlord, and the tenant is irrelevant, except to the extent of accommodating any time zone issues.

## REACHING RESOLUTION

These are difficult times for all of us, and commercial real estate has been hit hard. But by using mediation principles, and in the right situation the mediation process itself, COVID-19 commercial lease disputes can be resolved efficiently, without litigation, and with an outcome that is of the parties' own choosing.

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