A Commercial Tenant Cannot Pay Its Rent: Now What? The Latest in New York Force Majeure Litigation

By Stephanie L. Denker and Christie R. McGuinness

March 2021 marked one year since the COVID-19 pandemic became the focal point of nearly all conversations in America, since many people began working remotely and since many businesses halted or limited in-person operations. One looming question has been who will prevail in commercial lease disputes: the tenants or the landlords.

Stephanie L. Denker

New York federal and state courts have answered this question in a series of cases. They balanced the real impact that the pandemic has had on businesses with the terms of the leases that these businesses entered. Although tenants have propounded various creative arguments, it has become apparent that New York courts will continue to enforce contractual terms as written without regard to the financial hardship that it may cause a business.

This article will summarize some arguments set forth by commercial tenants and whether New York courts have found them to be persuasive.[1]

Stephanie L. Denker is s a litigation associate in Saul Ewing Arnstein & Lehr's New York office, who focuses on complex commercial litigation. Her practice includes representing individuals and companies in FINRA arbitrations, and state and federal lawsuits. She also represents companies in lawsuits concerning trademark and copyright infringement, unfair competition, unfair business practices, and misappropriation of trade secrets. Her email is stephanie.denker@saul.com.

Christie R. McGuinness is a litigation associate in Saul Ewing Arnstein & Lehr's New York office. Christie works on complex litigation, focusing on managing day-to-day developments for matters, taking and defending depositions, and overseeing the discovery process. Her email is christie.mcguinness@saul.com.

Christie R. McGuinness

New York Courts Have Split as to Whether the COVID-19 Pandemic Constitutes a "Casualty" Under Commercial Leases

Although some New York courts have found that COVID-19 is not a "casualty" as that term is generally used in commercial leases, others have found the opposite.

For example, in *Gap Inc. v. Ponte Gadea N.Y. LLC*,[2] the court was not persuaded by the tenant's argument that it was entitled to rent abatement because the pandemic constituted a "casualty" under the lease's terms. The court analyzed the lease and found "that 'casualty' refers to singular incidents, like fire, which have a physical impact in or to the premises—and does not encompass a pandemic, occurring over a period of time, outside the property, or the government lockdowns resulting from it." The court also found that its interpretation was consistent with Black's Law Dictionary, which defines the term as "serious or fatal accident" or "person or thing injured, lost or destroyed."[3]

However, another court that applied the ordinary meaning of "casualty" as used in a commercial lease came to a different conclusion. In *188 Ave. A. Take Out Food Corp. v. Lucky Jab Realty Corp*., the court entered a preliminary injunction prohibiting the landlord from terminating the lease or evicting the tenant during the pendency of the lawsuit even though the tenant stopped paying rent in March 2020.[4] The court concluded that "casualty" means "an 'accident' or 'unfortunate occurrence,' that is, something other than a 'common occurrence' constituting a 'sudden or unexpected' series of events." The court ultimately found:

> The plaintiffs have established that they are likely to succeed on their claim that the COVID-19 epidemic, and the consequent state-mandated suspension of indoor dining at restaurants, constituted a sudden, unexpected, unfortunate set of circumstances, and hence a "casualty" within the meaning of the lease that rendered the premises unusable for a period

> of time, and thus relieved the tenant of its obligation to pay rent.[5]

Although this is not a final determination, the court was persuaded by the tenant's argument that it did not owe rent because the pandemic rendered the restaurant partially unusable.

Financial Hardship Is Not Grounds for Avoiding Contractual Obligations

"[F]inancial hardship is not grounds for avoiding performance under a contract."[6] Likewise, "where performance is possible, albeit unprofitable, the legal excuse of impossibility is not available."[7] Despite this well-settled law, commercial tenants have argued that they should be excused from paying rent in light of the economic changes caused by the pandemic. New York courts have generally found this argument unpersuasive.

Indeed, the *Gap Inc.* court stated: "[t]he fact that its continued performance may be burdensome, even to the extent of insolvency or bankruptcy, does not render Gap's performance objectively impossible under New York law."[8] Another court stated: "unforeseen economic forces, even the horrendous effects of a deadly virus, do not automatically permit the Court to simply rip up a contract signed between two sophisticated parties."[9]

The Pandemic Must Have "So Completely" Frustrated the Purpose of the Commercial Lease That the Transaction Made Little Sense

"[F]or a party to avail itself of the frustration of purpose defense, there must be complete destruction of the basis of the underlying contract."[10] New York courts have found that government directives closing a business for a small portion of the lease term did not frustrate the leases' purpose.[11] They have also found that the ability to partially operate a store, such as for counter service or picking up orders, is insufficient grounds to be excused from paying rent under the frustration of purpose doctrine.[12]

Foreseeability Can Be Determinative

Because parties to contracts can allocate foreseeable risks, for a party to be excused from performance under the doctrines of frustration of purpose or impossibility, the event must have been truly unforeseeable. Although COVID-19 in and of itself was unforeseeable, some New York courts have found its resultant effects were foreseeable, precluding the application of these doctrines.

For example, the *Gap Inc.* court granted the landlord's motion for summary judgment as to liability because "the very text of the Lease demonstrates that the conditions that Gap claims render performance impossible were foreseeable."[13]

However, in *International Plaza Associates L.P. v. Amorepacific US, Inc.*, the court denied the landlord's motion for summary judgment as premature.[14] The tenant, whose business included allowing customers to test products, which is limited when wearing face masks and social distancing, argued that there were factual issues as to whether the COVID-19 pandemic was foreseeable and what role the government orders played in the tenant's ability to sell its products. The court found that discovery was required concerning how the defendant "attempted to conduct its business and its alleged failure to do so for a reason never imagined let alone foreseen by either defendant or plaintiff."

Takeaways

Businesses should carefully analyze their commercial leases and understand their rights and obligations under those contracts in light of New York courts' seeming reluctance to apply common law defenses. Further, when entering into new leases, businesses should allocate the risk of non-payment of rent as a result of a pandemic or closure of in-person business operations. The COVID-19 pandemic has made clear that it is prudent for businesses to spend time and resources cautiously drafting and negotiating commercial leases before they are executed.

Endnotes

1. This is not meant to be an exhaustive list of arguments made in cases arising from the pandemic, but instead an illustration of the trends seen in multiple cases.
2. No. 20-cv-4541, 2021 WL 861121 (S.D.N.Y. March 8, 2021).
3. *Id*. at *7.
4. No. 653967/2020, 2020 WL 7629597 (Sup. Ct. N.Y. Cnty Dec. 21, 2020).
5. *Id*. at *3.
6. *Macalloy Corp. v. Metallurg, Inc.*, 284 A.D.2d 227, 227 (1st Dep't 2001).
7. *Warner v. Kaplan*, 71 A.D.3d 1, 5–6 (1st Dep't 2009).
8. 2021 WL 861121, at *9-10 ("the COVID-19 pandemic has [also] not amounted to a frustration of the Lease's purpose" because "the evidence suggests that Gap has made a business decision to close its stores at 59th and Lexington, perhaps due to the pandemic's greater financial impact on those stores than on its other stores."). See also *Atlantic Garage Management LLC v. Boerum Commercial LLC*, No. 512250/2020, Doc. 70 (Sup. Ct. Kings Cnty Dec. 2, 2020).
9. *35 E. 75th St. Corp. v. Christian Louboutin L.L.C.*, No. 154883/2020, 2020 WL 7315470, at *2 (Sup. Ct. N.Y. Cnty Dec. 9, 2020) ("This is not a case where the retail space defendant leased no longer exists, nor is it even prohibited from selling its products. Instead, defendant's business model of attracting street traffic is no longer profitable because there are dramatically fewer people walking around due to the pandemic.").
10. *Dr. Smood N.Y. LLC v. Orchard Houston, LLC*, No. 652812/2020, 2020 WL 6526996, at *2 (Sup. Ct. N.Y. Cnty Nov. 2, 2020).
11. *See, e.g. Greater New York Automobile Dealers Assn, Inc. v. City Spec, LLC*, No. LT-053560-20/QU, 2020 WL 8173082, at *9 (N.Y. Civ. Ct. Dec. 29, 2020) (finding a four-month closure out of a five-year lease caused by an Executive Order that closed in-person operations did not frustrate the lease's overall purpose); *BKNY1, Inc. v. 132 Capulet Holdings, LLC*, No. 508647-2016, 2020 WL 5745631 (Sup. Ct. Kings Cnty. Oct. 21, 2020) (holding a nine-year restaurant lease was not frustrated by a two-month state-mandated closure).
12. *See, e.g., Dr. Smood*, 2020 WL 6526996, at *2; Gap, 2021 WL 861121, at *8-9.
13. 2021 WL 861121 at *10 (relying on the lease's "Force Majeure Event definition" because it "demonstrate[d] that the parties foresaw, and apportioned the risk associated with, the possibility that government measures in the event of a public emergency could affect performance under the Lease").
14. No. 155158/2020, Doc. No. 26 (Sup. Ct. N.Y. Cnty Dec. 14, 2020). *See also 1877 Webster Ave. Inc., v. Tremont Center, LLC*, No. 29239/2020E, 2021 WL 1621431, at *3 (Sup. Ct. Bronx Cnty Mar. 29, 2021) (declining to dismiss the frustration of purpose claim because "[t]he parties' conflicting arguments regarding the foreseeability of the impact of the Covid pandemic create genuine issues of fact on this record" and noting the lease does not resolve the factual dispute at the motion to dismiss stage).