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NY Commercial Leases Must Work For COVID, And Courts

By **Sophia Perna-Plank** (August 2, 2021)


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The body of case law concerning commercial rent defaults during the COVID-19 pandemic continues to grow.

This article discusses just some of those cases as they relate to commercial tenants' reliance on impossibility of performance as a defense to paying rent under their leases because of COVID-19-related economic downturns.

Take, for instance, Nassau County Supreme Court of New York Judge James McCormack's decision published last month in C&B Realty #3 LLC v. Sunstar Salon Services Inc.

The case covered a commercial landlord's motion for:

(1) Summary judgment on the issue of defendants' liability for breach of the lease; and

(2) Summary dismissal of the defendants' counterclaim for a judgment declaring that they were excused from their monetary obligations under the lease and guaranty based on the doctrine of impossibility of performance, among others, for the period March 2020 through the end of all restrictions on their operating capacity.

We remember that New York Gov. Andrew Cuomo's Executive Order 202.7 forced nonessential businesses, such as hair salons, like C&B Realty #3's tenant, Sunstar, to close, effective March 21, 2020.

It was not until June 2020 that the salon was authorized to reopen at a limited capacity, and with the added expense of extra cleaning and sanitizing protocols.

The salon made some partial payments after reopening but did not pay according to the terms of the lease.

Thus, in November 2020, C&B Realty #3 commenced its breach of contract action against the hair salon tenant and the personal guarantor of the lease based on the tenant's default on its obligations to pay rent since March 2020.

The landlord's motion followed.

Judge McCormack cited a December 2020 decision from the New York Supreme Court in Cab Bedford LLC v. Equinox Bedford Ave Inc. as the most relevant case the court could find, which involved a commercial landlord suing its gym tenant for breach of the parties' lease.

There, the gym argued, among other things, that the COVID-19 pandemic rendered it impossible for the gym to pay its rent obligations under the lease since they were shut down.

New York state Supreme Court Judge Arlene Bluth disagreed, finding that the doctrine of impossibility:

> [H]as no applicability here and does not raise an issue of fact. Defendants ran an "upscale gym" for many years prior to the Covid-19 pandemic and, after some painful months, are not permitted to operate (although at a limited capacity). The subject matter of the lease was not destroyed. At best, it was temporarily hindered. That there are more hurdles to running the business is not a basis to invoke the impossibility doctrine.

Judge McCormack discussed another decision reached by Judge Bluth on a December 2020 motion for summary judgment in 35 East 75th Street Corp. v. Christian Louboutin LLC.

In this case, Judge Bluth where she found that the subject matter of the contract, the physical location of the retail store, was still intact and the tenant, a retail store, was able to sell its products.

"The issue is that it cannot sell enough to pay the rent. That does not implicate the impossibility doctrine," Judge Bluth noted, adding that the lease contained a force majeure clause that specifically provided that the tenant would not be excused from having to pay rent, therefore contemplating financial disadvantage. Instead, it purported to extend the period of performance for whatever the delay may have been.

Still, Judge McCormack felt that the case before him was different from the cases before Judge Bluth. The C&B lease contained a provision that "Subject to the limitations herein set forth, the demised premises shall be used solely as a first class, high quality hair salon and for no other use or purpose whatsoever. "

In the court's view, this provision meant that the tenant did not just rent the space, but they rented the space with the requirement that it only run a hair salon out of it.

Due to the executive order's prohibition on operations, from March until June 2020, it was impossible for the tenant to operate its hair salon, which was the only permissible use of the space under the lease. However, once the tenant could operate the salon at 50% capacity in June 2020, its operations were no longer impossible, although they may have been extremely difficult and, "The impossibility of performance doctrine does not apply to 'extremely difficult.'"

Judge McCormack granted the landlord's motion for summary judgment on the issue of liability except for the months of March to June 2020. As to that period, Judge McCormack ruled that there were issues of fact requiring a trial as to the tenant's impossibility of performance defense.

Another case that comes to mind is Ten West Thirty Third Associates v. A Classic Time Watch Co., in which on a motion to dismiss Judge Bluth held that a decline in a tenant's business, a watch company, "does not constitute frustration of purpose or render its performance under the contract as impossible" and the court "cannot just rip up a contract because a tenant faced financial hardship due to the pandemic."

It also appears that Judge Bluth considered the impact of the pandemic on landlords in her decision, stating that:

> [t]he Court recognizes that the pandemic has decimated businesses around Manhattan and throughout the country. But that does not mean that the Court can ignore defendants' obligations. The Court must also consider the rights of the other contracting party, which must still maintain buildings and pay taxes even though the Tenant has not paid rent for months.

These decisions, as well as others, should continue to remind commercial landlords and tenants that the terms they negotiate as part of their lease are crucial to their legal rights and remedies. Further, in this new world, landlords and tenants alike should, moving forward, consider how to mitigate their damages and account for pandemics and stay-at- home orders in their leases.

However, this will come at a price and concessions will be needed on both sides. The parties to a lease should also keep in mind that the needs and concerns of landlords and tenants alike have changed.

Some tenants no longer need large footprints. Landlords and tenants are wary about entering into long term leases. Landlords need to catch up on mortgage payments.

So, what can commercial landlords and tenants do? They could consider shorter lease terms at a higher monthly rent rate with more renewal options.

Boilerplate and common lease clauses should be reconsidered. For example, since force majeure clauses are typically narrowly construed in New York, if specific terms like "pandemic," "public health crisis" and "stay-at-home orders issued by New York State or local governmental agencies as a result of a pandemic or public health crisis" are not in the clause, a party's performance of its obligations under the lease will be not excused or, depending on how the clause is drafted, delayed.

Additionally, landlords should really consider subleasing and assignment clauses and evaluate use and exclusive use clauses.

Should the time come again for the government to mandate closure of non-essential businesses, allowing a tenant to sublease or assign some, if not all, of the leased space to a business authorized to operate will allow the landlord to recoup rent.

Landlords should also require a security deposit as collateral for rent payments — yes, I have seen some commercial leases that do not require security deposits.

The parties could also consider including mechanics for drawing down on the security deposit in the event a tenant is unable to pay rent during a pandemic, public health crisis or government forced shutdown — and replenishing the security deposit at a later date.

Inclusion of a clause on automatic rent reduction for a specific period might even be an option. Regardless, landlords and tenants must consider the lessons learned because of the pandemic and prepare, as best they can, for the future.

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