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Takeaways From 4 NY Virus-Related Tenant Contract Rulings

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Over the past several months, many disputes have arisen over whether the COVID-19 pandemic or government responses to it provide, depending on the jurisdiction, an impossibility or impracticability defense for nonperformance under a contract. Now, we are beginning to see a flood of decisions addressing that defense.

We previously wrote about two recent decisions from New York that are instructive on the defense of impossibility — the relevant standard under New York law. We opined that these decisions showed it would often be difficult for parties to avoid performance on the ground of impossibility.

We added, however, that the outcome of COVID-19-related contract litigation would frequently be difficult to predict, due to, among other things: the potential availability of other, related defenses, such as the contract-based force majeure defense and the common law frustration of purpose defense; nuances among the laws of different jurisdictions; and the history of courts reaching divergent decisions in ostensibly similar impossibility cases.

Since then, New York courts have issued four additional decisions — all in the landlord-tenant context — that offer additional guidance for COVID-19-related contract disputes.

The first three decisions involved tenants that, to varying degrees, were unable to operate their business at their leased premises due to the pandemic and the government responses thereto.

The fourth decision involved an office space tenant whose primary business involved managing and consulting for a group of restaurants. The tenant claimed that the restaurant shutdown rendered its business model unprofitable, and therefore performing under the lease was impossible and any default excusable.

The first decision, BKNY1 Inc. v. 132 Capulet Holdings LLC, concerned a restaurant operator's obligation to pay rent for April and May — months during which New York Gov. Andrew Cuomo's Executive Order 202.3 prohibited restaurants from serving food and beverage on-premises.[1]

The restaurant operator argued that it should be excused from paying such rent either because the purpose of the contract had been frustrated or because performance was impossible.[2]

The court disagreed and ordered the payment of rent.

Addressing the frustration defense, the court emphasized that the restaurant had only been closed for two months of a nine-year lease term, and that the closure had occurred during the penultimate year of the lease.[3] Therefore, the court reasoned, the "temporary closure ... could not have frustrated [the lease's] overall purpose."[4]

If the closure had lasted for a more significant portion of the lease or started earlier in the lease, then the court might have reached a different conclusion. Indeed, that is what happened in Benderson Development Co. v. Commenco Corp., a New York decision holding that the purpose of a lease was frustrated where the tenant was unable to use the premises as a restaurant for almost three years after the lease was executed, due to the delayed completion of a public sewer.[5]

Turning to impossibility, the BKNY1 court held that the defense was inapplicable because the lease provided that the plaintiff's obligation to pay rent "shall in no wise be affected, impaired or excused because Owner is unable to fulfill any of its obligations under this lease ... by reason of ... governmental preemption or restrictions."[6]

That holding accords with New York's well-settled rule that the impossibility defense is available only where the impossibility was "produced by an unanticipated event that could not have been foreseen or guarded against in the contract."[7] It also resembles the holding in Backal Hospitality Group LLC v. 627 West 42nd Retail LLC, where the court suggested that the impossibility defense was unavailable because the parties had foreseen and contracted around the event underlying the defense.[8]

The outcome in the second decision, Dr. Smood New York LLC v. Orchard Houston LLC, was similar.[9] There, a café owner sought preliminary injunctive relief absolving its obligation to pay rent for two consecutive periods: April to July 6, when the rented premises were allegedly wholly unusable due to the pandemic and the related executive orders prohibiting in-person restaurant dining; and July 6 onward, when the premises were allegedly rendered partially unusable by the governor's executive order restricting in-person restaurant capacity.[10]

The café owner argued that it was likely to succeed on the merits for two reasons: (1) the pandemic and the government's orders had triggered a casualty provision in the lease; and (2) the purpose of the contract had been frustrated.

As to the casualty argument, the casualty provision of the lease provided for rent abatement "if the Premises [we]re damaged by fire or other casualty, or if the Building [wa]s damaged such that Tenant [wa]s deprived of reasonable access to the Premises."[11]

The court found that both arguments were unlikely to succeed and declined to issue the injunction. The court saw no merit to the plaintiff's claim that the pandemic constituted a casualty entitling it to a rent abatement because "there ha[d] been no physical harm to the demised premises and the lease [did] not provide for a rent abatement in such a case as plaintiff was required to obtain insurance to guarantee payment under said circumstances."[12]

And it held that the frustration argument failed as a matter of law because "the plaintiff ha[d] been operating out of the [] premises since at least July[] 2020," offering "both counter service and pickup of orders submitted online."[13]

Such partial frustration of the contract was insufficient to establish the defense, according to the court.[14] The court's holding on frustration suggests that the defense will only excuse tenants' obligations to pay rent if they were unable to derive any material benefit from their leased premises.

A retail tenant fared better in the third decision, involving a motion dismiss. In The Gap Inc. v. 170 Broadway Retail Owner LLC, a landlord moved to dismiss a tenant's claims for (1) a refund of rent paid for March 19 through March 31, and (2) a declaration that the retailer was excused from remitting rent after March 2020 under the impossibility doctrine.[15]

As to the first claim, the tenant alleged that it was entitled to a partial refund under the lease's casualty provision.[16] This casualty provision provided for an "abatement or reduction in Fixed Rent due to loss or use of all or a portion of the Demised Premises due to Casualty," but the lease did not define the word "casualty."[17]

As to the second claim, the retailer alleged that "its use of the premises as a retail store ... ha[d] been made objectively impossible, by an unanticipated event that could not have been foreseen or guarded against in the [l]ease ... shutting down New York City 'brick and mortar' retail stores."[18]

Emphasizing that precedent required the court to accept the tenant's allegations as true on a motion to dismiss and noting the sufficient pleading of the tenant's claims, the court declined to dismiss either claim.[19] Of course, the court did not rule on the merits of the tenant's claims. It therefore remains to be seen whether The Gap will be one of the rare cases in which an impossibility defense succeeds.

The fourth decision, 1140 Broadway LLC v. Bold Food LLC, did not involve a tenant that was shut down by any health directives.[20] Rather, it involved a landlord's claim for unpaid rent from an office tenant that provided services to restaurants and was "one step removed from the governor's public health orders relating to restaurants because [the tenant's] business assists restaurants," as well as the tenant's guarantor.[21]

The tenant argued that it should be excused from its default under the impossibility and frustration doctrines because "the shutdown of restaurants [had] render[ed] its business model unprofitable."[22]

The court disagreed, reaffirming that economic hardship, standing alone, cannot support a defense under either doctrine.[23] The court also denied the tenant's claim that the pandemic constituted a casualty that could entitle the tenant to a rent abatement, as the lease's casualty provision referred to physical damage, and did not address the failure of the tenant's business to retain its clients.[24]

Together, these decisions reaffirm that the outcomes in COVID-19-related contract disputes will be highly fact-dependent and, in some instances, difficult to predict.

The first three decisions reaffirm that businesses closed during the pandemic will face significant hurdles in establishing the impossibility defense, and that the availability of the defense will often turn on whether the claimed impossibility was produced by an event that could not have been foreseen or guarded against in the contract.

In this regard, it bears noting that courts might conclude that a pandemic and the government responses thereto were foreseeable, thus precluding the defense, even if the COVID-19 pandemic was not foreseeable in its particularities.

A business whose premises were closed should also consider two other potential obstacles.

First, even if a court finds that a pandemic-related closure was unforeseeable, it may require the business to show that it was impossible for it to meet its payment obligations, rather than a mere showing that the premises were inaccessible.

Also, a court might conclude that the inaccessibility of premises is not sufficient to establish impossibility if the premises were not physically destroyed. Indeed, that is what a New York court held in another recent landlord-tenant dispute, 35 East 75th St. Corp. v. Christian Louboutin LLC.[25]

These decisions also indicate that the availability of the frustration defense to closed businesses will frequently depend on the duration or scope of the closure. The defense likely will not apply where a business was closed only partially and for a short time near the end of a lengthy lease term.

By contrast, the defense should apply where a business recently rented a unique space for a specific purpose that can no longer serve that function at all, assuming the business can establish the other elements of the defense.[26]

Many cases will lie between these extremes, however, and the likely outcome of such disputes remains uncertain. Accordingly, many businesses whose premises were closed may be well-advised to negotiate a settlement, rather than submit to the risks of litigation.

The fourth decision reaffirms that a tenant's financial struggles, standing alone, will be insufficient to establish either an impossibility or frustration defense. Therefore, if a business's sole excuse for missing its payment obligations is a reduction in revenue, it should not expect to escape such obligations, unless the contract at issue expressly contemplated such an excuse.[27]

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[1] BKNY1, Inc. v. 132 Capulet Holdings, LLC, No. 508647/16, 2020 WL 5745631 (N.Y. Sup. Ct. Sep. 23, 2020).

[2] In New York, the impossibility defense requires that "the destruction of the subject matter of the contract or the means of performance ma[de] performance objectively impossible." Kel Kim Corp. v. Cent. Markets, Inc., 70 N.Y.2d 900, 902 (1987). "Moreover, the impossibility must [have] be[en] produced by an unanticipated event that could not have been foreseen or guarded against in the contract." Id. The frustration defense, meanwhile, excuses non-performance when a change in circumstances makes one party's performance virtually worthless to the other, frustrating its purpose in making the contract. PPF Safeguard, LLC v. BCR Safeguard Holding, LLC, 85 A.D.3d 506, 508 (N.Y. App. Div. 1st Dep't 2011).

[3] BKNY1, 2020 WL 5745631, at *2.

[4] Id. (emphasis added).

[5] Benderson Dev. Co. v. Commenco Corp.,44 A.D.2d 889, 889 (N.Y. App. Div. 4h Dep't 1974).

[6] BKNY1, 2020 WL 5745631, at *2. The court also noted that the restaurant operator had not offered evidence that it was unable to pay the April and May 2020 rent. Id. at *2 n.4.

[7] Kel Kim, 70 N.Y.2d at 902.

[8] Backal Hospitality Group LLC v. 627 West 42nd Retail LLC, No. 154141/2020, 2020 WL 4464323, at *4 (N.Y. Sup. Ct. Aug. 03, 2020); Muhammad Faridi and Timothy Smith, "2 NY Contract Cases Highlight Limits of Impossibility Defense," Law360 (September 24, 2020).

[9] Dr. Smood New York LLC v. Orchard Houston, LLC, No. 652812/2020, 2020 WL 6526996 (N.Y. Sup. Ct. Nov. 02, 2020).

[10] Id. at *1.

[11] Id. at *2.

[12] Id.

[13] Id.

[14] Id.

[15] The Gap, Inc. v. 170 Broadway Retail Owner, LLC, No. 652732/2020, 2020 WL 6435136 (N.Y. Sup. Ct. Oct. 30, 2020).

[16] Id. at *2.

[17] Id. at *2 & n.1.

[18] Id. at *2.

[19] Id. at *1–2.

[20] 1140 Broadway LLC v. Bold Food, LLC, No. 652674/2020 (N.Y. Sup. Ct. Dec. 3, 2020), Doc. No. 30.

[21] Id. at 4.

[22] Id. at 2.

[23] Id. at 3–4.

[24] Id. at 6.

[25] 35 East 75th Street Corp v. Christian Louboutin LLC, No. 154883/2020 (N.Y. Sup. Ct. Dec. 8, 2020), Doc. No. 25.

[26] New York law, for example, requires that the event causing the frustration was unforeseeable. A + E Television Networks, LLC v. Wish Factory Inc., 15-CV-1189 (DAB), 2016 WL 8136110, at *12–13 (S.D.N.Y. Mar. 11, 2016).

[27] See In re Old Carco LLC, 452 B.R. 100, 119 (Bankr. S.D.N.Y. 2011).