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Practice Update

COVID-19 Impact on Commercial Leases in New York

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The COVID-19 pandemic and the United States' efforts to "flatten the curve" and slow the spread of the disease present considerable issues for commercial tenants and landlords. For instance, the Governors of New York, New Jersey, and Connecticut announced a ban, effective Tuesday, March 17, 2020, on gatherings of more than 50 people. San Francisco recently went so far as to order residents to "shelter in place," which is understood to mean that counties must shut down all but the most critical operations. Businesses that attract clusters of people, such as gyms, nightclubs or bars, have all closed down. Restaurants can serve only take-out or delivery orders. Hospitals, grocery stores, banks and pharmacies will remain open. The order calls for all "routine medical appointments" and elective procedures to be canceled or rescheduled. Most recently, Governor Andrew Cuomo ordered all non-essential retailers and businesses to close as of 8 p.m. on March 22, and for residents across New York state to stay home as much as possible in an effort to stop the spread of the novel coronavirus.

So what does this mean for commercial tenants and landlords in New York? As COVID-19 continues to spread throughout the United States and the world, commercials tenants and landlords will encounter challenges in meeting contractual obligations posed

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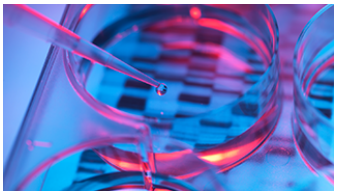

by the government's continuing and strengthened efforts at containment. COVID-19 has already and will continue to impact the ability of businesses in New York to continue operations and generate revenue. For instance, in New York (as well as many other states), restaurants were ordered to shut down all dine-in services and are relegated to delivery and take-out. For many restaurants, this reality is fatal. The restaurateur Alex Stupak commented, "[w]e went from a little money in the bank to bled dry. It was not a slow, steady decline — it was a straight drop." Without the ability to generate revenue, many of these businesses will no longer be able to pay the rent on their commercial spaces and will likely seek to be excused from performing their contractual obligations. Commercial landlords will be faced with the issue of whether to excuse their tenants' performance, enter into formal lease amendments, or pursue immediate defaults and associated judicial remedies.

Landlords that elect to pursue defaults and associated judicial remedies will undoubtedly be faced with the defenses of impossibility of performance, impracticability of performance and frustration of purpose on the part of the tenant given that most commercial and retail leases in New York obligate the tenant to continue to pay rent even during a force majeure event. In general, the doctrine of impossibility excuses a party's performance only when the subject matter of the contract or the means of performance renders performance objectively impossible. The impossibility must be the result of an unforeseen event that could not have been protected against in the contract. *Kel Kim Corp. v. Cent. Markets, Inc.,* 70 N.Y.2d 900, 902, 519 N.E.2d 295, 296 (1987); *Kolodin v. Valenti*, 115 A.D.3d 197, 198, 979 N.Y.S.2d 587 (2014); *Estates At Mountainview, Ltd. v. Nakazawa*, 38 A.D.3d 828, 829, 833 N.Y.S.2d 550 (2007). However, the financial difficulty or economic hardship of the promisor, even to the extent of insolvency or bankruptcy, does not establish impossibility sufficient to excuse performance of a contractual

obligation. *See, 407 E. 61st Garage v. Savoy Fifth Ave. Corp.,* 23 N.Y.2d 275, 281 (1968); *Stasyszyn v. Sutton E. Assocs.*, 161 A.D.2d 269, 271, 555 N.Y.S.2d 297 (1st Dep't 1990). The defense of impossibility is applied narrowly "due in part to judicial recognition that the purpose of contract law is to allocate the risks that might affect performance and that performance should be excused only in extreme circumstances such as when destruction of the subject matter of the contract by an act of God or by law makes performance objectively impossible. *See Kel Kim Corp. v. Cent. Markets, Inc.,* 70 N.Y.2d 900, 902, 519 N.E.2d 295, 296 (1987)); *see also 407 E. 61st Garage, Inc.*, 23 N.Y.2d at 281. New York courts have considered several factors to determine whether the impossibility doctrine is a viable defense, including "the foreseeability of the event occurring, the fault of the nonperforming party in causing or not providing protection against the event occurring, the severity of harm, and other circumstances affecting the just allocation of the risk." *D & A Structural Contractors Inc. v. Unger, 2*5 Misc. 3d 1211(A), 901 N.Y.S.2d 898 (Sup. Ct. 2009).

Similarly, financial difficulty or economic hardship is also not enough to establish the defense of impracticability*. See Urban Archaeology Ltd. v. 207 E. 57th St. LLC*, 34 Misc. 3d 1222(A), 951 N.Y.S.2d 84 (Sup. Ct.), *aff'd*, 68 A.D.3d 562, 891 N.Y.S.2d 63 (2009) (holding that defendant was not entitled to excuse its performance due to impracticability even where it sought a "reasonable extension during a time of severe economic crisis" because, if such argument prevailed, "every debtor in a country suffering economic distress could avoid its debts").

The defense of frustration of purpose, a related defense, "'applies when the frustrated purpose is so completely the basis of the contract that, as both parties understood, without it, the transaction would have made little sense.'" *Jack Kelly Partners LLC v. Zegelstein*, 140 A.D.3d 79, 85, 33 N.Y.S.3d 7, 10 (1st Dep't 2016), *leave to appeal dismissed*, 28 N.Y.3d 1103, 45 N.Y.S.3d 364, 68 N.E.3d 92 (2016) (where

lease provided that premises may only be used for commercial purposes and prohibited any use that violated Certificate of Occupancy and the Certificate of Occupancy prohibited commercial use, court held "without the ability to use the premises as an office, the transaction would have made no sense, and the inability to lawfully use the premises in that manner combined with defendants' alleged failure and refusal to correct the CO constitutes a frustration of purpose entitling plaintiff to terminate the lease.") Commentators have observed that the narrowness of the doctrines of impossibility and frustration of purpose, "underscores the need for counsel negotiating and drafting contracts to include contingency clauses providing for foreseeable possibilities—which are outside the scope of the impossibility doctrine—and language making clear the contract's purpose." Hall, Defenses of Impossibility of Performance and Frustration of Purpose, 10/19/2017 N.Y.L.J.

Commercial tenants and landlords should carefully review their leases in order to determine: (i) whether the failure to perform contractual obligations due to COVID-19 related causes constitutes a breach of contract or default, (ii) whether there is an exemption under contractual force majeure provisions for such pandemic causes, (iii) whether government-directed closures and shutdowns constitute an act of governmental authority covered by contractual force majeure provisions; (iv) whether government-directed closures and shut downs due to COVID-19 are covered by insurance (such as business interruption insurance), and (iv) whether events caused by or related to COVID-19 constitute a material adverse change under the terms of a contract.

As COVID-19 continues to spread and countries enact harsher measures to slow and contain the pandemic, courts will be faced with unique and novel questions in handling commercial lease disputes. All commercial landlords and tenants, no matter how big or small the business and in which

states they operate, are encouraged to look to their contractual provisions and applicable state law in order to determine the consequences of and available remedies for failure to perform contractual obligations due to the impacts of COVID-19.
