

COVID-19 and Commercial Leases

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Client Advisory

March 31, 2020 by Macculloch M. Irving, Barbara B. Brown, Mark R. Zancolli, Jacob H. Nemon and Rocco M. Sainato

The COVID-19 pandemic has presented parties to commercial leases with legal issues that are rarely confronted in ordinary times. NYS Executive Order No. 202.8 has required non-essential businesses to reduce their on-site workforces by 100%, and has imposed a 90-day moratorium on residential and commercial evictions.[1] And the New York State Senate and Assembly are each considering legislation that would suspend rent payments for 90 days. Given this backdrop, and the continually evolving consequences of COVID-19, landlords and tenants are advised to review the provisions of their lease agreements and related guaranties (if any), with consideration given to the following issues and clauses in particular:

Background: Independence of Covenant

New York courts have ruled that the obligation to pay rent under a lease is independent of the parties' other lease obligations. Even in a situation where a landlord has breached its lease obligations, the tenant's obligation to pay rent continues unless there is an express lease provision to the contrary.[2] This is particularly true in a commercial context when each party was represented by counsel for lease negotiations.[3] This does not limit a tenant's right to bring a separate legal action against the landlord for damages.

Furthermore, absent a lease provision to the contrary, a tenant is unable to withhold rent if it remains in possession of its premises. The Court of Appeals has stated it is "inequitable for the tenant to claim substantial interference with the beneficial enjoyment of his property and remain in possession without payment of rent." [4]

The lease provisions that would affect the relationship of the landlord and the tenant with respect to the tenant's obligations to pay rent are therefore often exceptions to the independent covenant doctrine.

Force Majeure Most commercial leases contain a 'force majeure' provision excusing a party from performance of its contractual obligations when its performance is prevented by causes beyond its control. Issues raised by force majeure clauses include the following:

- Does the force majeure clause run in favor of both parties, or just the landlord?
 - If the force majeure clause runs in favor of both parties, does it contain an exception for performance of financial obligations, including payment of rent?
 - Does the force majeure clause specifically enumerate pandemics, epidemics, diseases or similar events?
 - Does the force majeure clause cover governmental actions of the sort that would be triggered by the NY Executive Order 202.8, which effectively required that 100% of a non-essential business's workforce be reduced from its offices from March 22, 2020
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through April 19, 2020? If so, did the governmental action in fact prevent performance under the lease in a manner that was outside the control of the parties?

Impossibility, Impracticability and Frustration of Purpose

Impossibility, impracticability, and frustration of purposes are different names used for the same general defenses/concepts. The U.S. District Court for the Southern District of New York has noted, "New York courts do not appear to recognize commercial impracticability as a separate defense to the doctrine of impossibility; rather, impracticability is treated as a type of impossibility and construed in the same restricted manner." [5]

Impossibility excuses a party's performance "when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible. Moreover, the impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract." [6]

Issues raised by the doctrines of impossibility, impracticability and frustration of purpose include the following:

- Have Governor Cuomo's Executive Orders rendered the use of the leased premises impossible?
- If so, has impossibility been occasioned only by financial difficulty or economic hardship? [7]

Rent Abatement Provisions

Commercial leases sometimes contain provisions expressly entitling tenants to rent abatements where, for example, services are not available to the leased premises for a specified number of days. Landlords and tenants should review their leases to see if they contain these clauses and, if so, should check for the following:

- Is the rent abatement available if services are suspended for any reason, or only if due to actions or inactions of the landlord?
- Is the rent available only if services are suspended, or is it also available if the leased premises become inaccessible? Have the leased premises become inaccessible?

Constructive Eviction and Quiet Enjoyment

Constructive eviction is a doctrine that allows a tenant to abate its rent when a wrongful act by its landlord deprives the tenant of the use of its premises even though there has been no physical eviction of the tenant. [8] In order to claim a constructive eviction, the tenant must abandon possession of the premises. [9] In order to bring a claim for a breach of the covenant of quiet enjoyment, a tenant must show actual or constructive eviction. [10] In considering a constructive eviction claim, parties must look at the following issues:

- Has there been a wrongful act by the landlord that has deprived the tenant of the beneficial enjoyment or actual possession of the tenant's premises?
- Does it matter whether or not the landlord has closed its building or stopped providing services (or both)?
- Has the landlord engaged in any other wrongful acts that would support a claim for actual or constructive eviction or breach of the covenant of quiet enjoyment?
- Does the lease contain a waiver of Section 227 of the New York Real Property Law? [11]

Conclusion

The facts and issues presented by the COVID-19 virus are constantly evolving. Commercial landlords and tenants will be required to carefully review the provisions of their commercial lease agreements in order to respond to these new and changing conditions and to engage in negotiations regarding their contractual arrangements. We are available to advise on the issues outlined above as well as other issues as this process unfolds.

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[1] E.O. 202.8 (March 20, 2020) (available at <https://www.governor.ny.gov/news/no-2028-continuing-temporary-suspension-and-modification-laws-relating-disaster-emergency>), provided in relevant part that through April 19, 2020: The provisions of Executive Order 202.6 are hereby modified to read as follows: Effective on March 22 at 8 p.m.: All businesses and not-for-profit entities in the state shall utilize, to the maximum extent possible, any telecommuting or work from home procedures that they can safely utilize. Each employer shall reduce the in-person workforce at any work locations by 100% no later than March 22 at 8 p.m. Any essential business or entity providing essential services or functions shall not be subject to the in-person restrictions. An entity providing essential services or functions whether to an essential business or a non-essential business shall not be subjected to the in-person work restriction, but may operate at the level necessary to provide such service or function. Any business violating the above order shall be subject to enforcement as if this were a violation of an order pursuant to section 12 of the Public Health Law.

[2] *Westchester County Indus. Dev. Agency v. Morris Indus. Builders*, 278 A.D.2d 232 (2d Dept. 2000).

[3] *Id.*

[4] *Barash v. Pennsylvania Terminal Real Estate Corp.*, 26 N.Y.2d 77, 83 (Ct. App. 1970).

[5] *Clarex Ltd. v. Natixis Sec. Ams. LLC*, 2014 U.S. Dist. LEXIS 121335, at *31-32 (S.D.N.Y. Aug. 29, 2014) (citing cases).

[6] *Kel Kim Corp. v. Cent. Mkts., Inc.*, 70 N.Y.2d 900, 902 (1987).

[7] "[W]here impossibility or difficulty of performance is occasioned only by financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy, performance of a contract is not excused." *407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp.*, 23 N.Y.2d 275, 281-82 (1968) (internal citations omitted).

[8] "[T]o be an eviction, constructive or actual, there must be a wrongful act by the landlord which deprives the tenant of the beneficial enjoyment or actual possession of the demised premises." *Barash v. Pennsylvania Term. Real Estate Corp.*, 26 NY2d 77, 82 (1970). "[T]he tenant must have been deprived of something to which he was entitled under or by virtue of the lease." *Id.*

[9] The "tenant ... must abandon possession in order to claim that there was a constructive eviction." See *Barash*, 26 NY2d at 83; *Manhattan Mansions v. Moe's Pizza*, 149 Misc2d 43, 45 (Civ. Ct. N.Y. Co. 1990).

[10] "To establish a breach of the covenant of quiet enjoyment, a tenant must show actual or constructive eviction." *34-35th Corp. v. 1-10 Industry Assocs., LLC*, 15 AD3d 579, 580 (2d Dep't 2005). "To make out a prima facie case of breach of the covenant of quiet enjoyment, a tenant must establish that the landlord's conduct substantially and materially deprived the tenant of the beneficial use and enjoyment of the premises." *Jackson v. Westminster House Owners Inc.*, 24 AD3d 249, 250 (1st Dep't 2005).

[11] RPL Sec. 227 provides as follows: "Where any building, which is leased or occupied, is destroyed or so injured by the elements, or any other cause as to be untenable, and unfit for occupancy, and no express agreement to the contrary has been made in writing, the lessee or occupant may, if the destruction or injury occurred without his or her fault or neglect, quit and surrender possession of the leasehold premises, and of the land so leased or occupied; and he or she is not liable to pay to the lessor or owner, rent for the time subsequent to the surrender. Any rent paid in advance or which may have accrued by the terms of a lease or any other hiring shall be adjusted to the date of such surrender."

Carter Ledyard has created a COVID-19 Response Group to monitor the evolving legal landscape, address client questions and ensure client compliance with the laws and regulations issued in response to the COVID-19 pandemic. The Carter Ledyard COVID-19 Response Group consists of Jeffery S. Boxer (212-238-8626, boxer@clm.com), Judith A. Lockhart (212-238-8603, lockhart@clm.com), Bryan J. Hall (212-238-8894, hall@clm.com), Alexander G. Malyshev (212-238-8618, malyshev@clm.com), Melissa J. Erwin (212-238-8622, erwin@clm.com), and Leonardo Trivigno (212-238-8724, trivigno@clm.com). Clients should contact the attorneys listed above or their regular CLM attorney for any questions concerning legal obligations arising from the COVID-19 pandemic.

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