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COVID-19 raises novel issues in commercial leases - by Richard Blumberg and James Rosenzweig

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The economic fallout from the COVID-19 Pandemic presents considerable issues for commercial landlords and tenants. Due to state mandated closures, many tenants cannot generate sales and, as a result, are unable to meet their ongoing rental obligations. The inability of these tenants to pay their rent raises the question: What legal rights do commercial landlords have to collect the outstanding arrears? The answer to this question will likely be found by reviewing the force majeure provision contained in the subject lease and by reviewing the common law doctrine of impossibility of performance.

“Force majeure” is a legal term, and generally provides one party an excuse from performing its obligations under a contract when such performance is impeded by an “Act of God” or other unforeseeable occurrence outside the party’s reasonable control. The concept does not arise under the common law, and is therefore present only when and if the parties negotiate and include such a provision in their written agreement. Many such provisions limit the time period for the allowed delay, or impose other restrictions on the claiming party, and most frequently provide that failure to pay rent is not excused by any force majeure type circumstances. Under New York law these provisions are narrowly construed. Reference must be made to the specific language of the contractual provision to determine its scope, including whether they will apply to the current COVID-19 situation that has led to closure orders. If the written force majeure clause refers to a pandemic, then further inquiry is required to determine whether or not it relieves the tenant from its obligation to pay rent and, if so, under what conditions. More likely, the clause will simply refer to an “Act of God” or other circumstance beyond the party’s reasonable control. It is still unknown whether the courts will interpret these more generic phrases to apply to the COVID-19 virus.

In addition to force majeure, landlords may also face arguments from their tenants based on the common law defense of frustration of purpose. This doctrine excuses performance where, after a contract is made, a party’s principal purpose is substantially frustrated without his fault by the occurrence of an event, the non-occurrence of which was a basic assumption on which the contract was made. In that case, the party’s remaining duties to render performance are discharged, unless the language or the circumstances indicate to the contrary. See generally Restatement (Second) of

Contracts, § 265. The purpose of a contract may be frustrated, among other things, by governmental order or regulation. Id. §264.

For a tenant to succeed with this defense, the underlying event must be substantial and must stem from an unforeseen circumstance. That raises the question as to whether pandemics are foreseeable. Similar to force majeure provisions, this defense is applied narrowly as courts are generally loath to relieve parties of their contractual obligations. Given the state of declared emergencies, courts may analogize to situations of wartime. For instance, a New York court during WWII rejected the claim by lessee of a roadside restaurant that wartime regulation caused a diminution in traffic, thereby frustrating the purpose of the lease. The court noted that the lessee was still able to operate the roadside establishment, even though the volume of business was decreased. However, the court also noted that if government acts had "completely frustrated" performance, then "payment of rent would be excused as a matter of law." Fisher v. Lohse, 42 N.Y.S.2d 121 (NYS Sup. Ct. Queens County 1943). Whether the current Executive Orders issued by New York's governor in response to the COVID-19 pandemic qualify for such complete frustration is still open and looks to be a highly litigated question.

Landlords and tenants should carefully review their leases and the latest case law in order to better understand their respective rights. However, as of the writing of this article, New York landlords have limited legal options against defaulting tenants. Currently, the courts are not accepting new landlord/tenant cases. In addition, the governor has instituted a moratorium suspending all evictions until August 20, 2020. Nevertheless, there is nothing that precludes landlords from serving statutory predicate notices, or default notices under the parties' leases. From a practical standpoint, given the novel set of circumstances resulting from COVID-19, landlords and tenants may find it in their best interests to negotiate reasonable rent deferral agreements to allocate losses resulting from the virus' impact on business.

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