New York Law Journal
Real Estate Trends
WWW.NYLJ.COM
An ALM Publication
TUESDAY, FEBRUARY 2, 2021

LANDLORD TENANT LAW

COVID-19 Defenses: Case Law Update

By **Warren A. Estis**

In their last column, Warren A. Estis and Alexander Lycoyannis discussed the COVID defenses of impossibility and frustration of purpose and analyzed two of the first known decisions applying them in commercial landlord-tenant disputes during the pandemic. Here, they summarize four recent lower court rulings applying the COVID defenses in commercial landlord-tenant cases.

As we (incredibly) close in on one year since the COVID-19 pandemic hit U.S. shores, the manner in which courts interpret the doctrines of frustration of purpose and impossibility of performance (the "COVID defenses") remains top-of-mind for most in the New York real estate industry.

In our last column, we discussed the COVID defenses and analyzed two of the first known decisions applying them in commercial landlord-tenant disputes during the pandemic. Since then, we have been made aware of several additional lower court rulings on the topic. Most courts have held that absent a specific lease clause providing relief, the COVID defenses do not relieve commercial tenants of the obligation to pay rent or otherwise comply with their leases. Other courts, however, have held to the contrary.

Below, we summarize a representative sampling of four recent lower court rulings applying the COVID defenses in commercial landlord-tenant cases—two of which were in the owner's favor, with the tenant prevailing in the other two—and give our thoughts as to what comes next.

Where Owners Prevailed

In *Dr. Smood New York LLC v. Orchard Houston*, Justice Laurence Love denied the tenant's motion for a preliminary injunction enjoining the owner from terminating the lease and seeking to recover possession of the premises, finding that the tenant failed to establish a likelihood of success on the merits of its claims (2020 NY Slip Op 33707[U] [Sup Ct, New York County 2020]).

The court noted that "for a party to avail itself of the frustration of purpose defense, there must be complete destruction of the basis of the underlying contract; partial frustration such as a diminution in business, where a tenant could continue to use the premises for an intended purpose, is insufficient to establish the defense as a matter of law" (*id.* at 4 [*citing Robitzek Inv. Co. v. Colonial Beacon Oil Co.*, 265 AD 749, 753 [1st Dept 1943]). Utilizing this standard, Justice Love rejected the frustration of purpose argument because the Governor's executive orders only prevented tenant from operating indoor dining services, while "the premises remain open for both counter service and pickup of orders submitted online" (*id.*).

The court also found the tenant's attempt to invoke the lease's casualty clause to be "entirely without merit as there has been no physical harm to the demised premises and the lease does not provide for a rent abatement" by reason of the pandemic (*id.* at 4). As a result, "[the tenant's] obligation to pay rent and taxes pursuant to the lease continue[d] unabated" (*id.* at 5).

In *35 E. 75th St. Corp. v. Christian Louboutin L.L.C.*, Justice Arlene Bluth granted summary judgment to an owner against its luxury retail tenant for, *inter alia*, rent and additional rent accruing since March, 2020 (2020 NY Slip Op 34063[U] [Sup Ct, New York County 2020]). The tenant asserted that the COVID defenses absolved it of the obligation to pay rent in that (1) "when it signed the lease in 2013 no one could have predicted that there would be an infectious disease that would shut down the vast majority of businesses;" (2) "its entire business was built on a highly visible and well trafficked retail location on the Upper East Side;" and (3) "the lack of customer traffic has decimated the store's revenues" (*id.* at 1-2).

WARREN A. ESTIS *is a founding member at Rosenberg & Estis.* ALEXANDER LYCOYANNIS *is a (former member) at the firm.*

Justice Bluth disagreed, holding that the frustration of purpose doctrine "has no applicability" because "[t]his is not a case where the retail space defendant leased no longer exists, nor is it even prohibited from selling its products" (*id.* at 4). While "[the tenant]'s business model of attracting street traffic is no longer profitable because there are dramatically fewer people walking around due to the pandemic…unforeseen economic forces, even the horrendous effects of a deadly virus, do not automatically permit the Court to simply rip up a contract signed between two sophisticated parties" (*id.*).

As for impossibility of performance, the court found that "[t]he subject matter of the contract—the physical location of the retail store—is still intact" and that the tenant "is permitted to sell its products. The issue is that it cannot sell enough to pay the rent. That does not implicate the impossibility doctrine" (*id.* at 5).

Where Tenants Prevailed

By contrast, in *The Gap, Inc. v. 170 Broadway Retail Owner, LLC*, Justice Debra James denied the owner's pre-answer motion to dismiss the tenant's causes of action relating to, *inter alia*, the COVID defenses (2020 NY Slip Op 33623[U] [Sup Ct, New York County 2020]). In contrast to Justice Love's ruling in *Dr. Smood*, Justice James held that the tenant, a retail clothing store, stated a valid claim under the lease's casualty clause because "plaintiff could not lawfully use the premises in the manner set forth in the lease" by reason of the governor's order directing the closure of non-essential businesses (*id.* at 4).

The court also held that the tenant stated viable frustration of purpose and impossibility of performance causes of action, insofar as the complaint "alleges in some factual detail, that…performance [under the lease] has been made objectively impossible, by an unanticipated event that could not have been foreseen or guarded against in the Lease, a credible description of the current worldwide pandemic, shutting down New York City 'brick and mortar' retail stores" (*id.* at 6).

And, in *International Plaza Assoc. L.P. v. Amorepacific US, Inc.*, Justice Carol Feinman denied summary judgment to an owner seeking rent arrears of over $300,000 from a cosmetics and beauty supply retail store based on the COVID defenses (2020 WL 7416600 [Sup Ct, New York County 2020]). The court found that the frustration of purpose doctrine justified the denial of summary judgment because "the shutdown of the defendant's shop from March, 2020 to June, 2020 and the continuing restrictions made it almost impossible for defendant to fulfill its function for which it signed a lease with plaintiff" (*id.*).

The court found it significant that "part of [the tenant's] business includes allowing customers to test the [cosmetic] product[s]," which "is limited [due to] the important requirement that people who walk into the store must wear a face mask and that they keep a six foot distance from each other" (*id.*). Thus, Justice Feinman denied summary judgment and permitted the tenant to conduct discovery in order to "present facts on how it has attempted to conduct its business and its alleged failure to do so for a reason never imagined let alone foreseen by either defendant or plaintiff," which "cannot be shown by legal memoranda or oral arguments alone" (*id.*).

Conclusion

Practitioners and real estate industry participants seeking guidance as to their own conduct and legal strategy will have considerable difficulty drawing principled distinctions from these cases. On one hand, the *Dr. Smood* and *Christian Louboutin* rulings are consistent with the pre-pandemic understanding of the COVID defenses (discussed in our December column). Indeed, as a general matter, New York's courts will hold counseled, sophisticated businesspeople to their bargain (*see e.g. Matter of Part 60 Put-Back Litig.*, 2020 NY Slip Op 07687, at 5 [Ct App Dec. 22, 2020]).

For these reasons, we believe that the Appellate Division is ultimately more likely to agree with the rulings in *Dr. Smood* and *Christian Louboutin* than those in *The Gap* and *International Plaza*. On the other hand, a business deemed "essential" and which has been permitted to operate in at least some capacity throughout the pandemic, such as the restaurant tenant in *Dr. Smood*, has consistently had the opportunity to generate revenue and pay rent, in contrast to retailers forced to close their doors for at least part of the pandemic—thus perhaps leading the courts in *The Gap* and *International Plaza* to rule as they did.

The bottom line is that until the Appellate Division issues a definitive ruling on the COVID defenses' applicability during the pandemic, both owners and tenants litigating pandemic-related nonpayment issues can rely on multiple reported decisions to support their respective legal positions.