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LANDLORD TENANT LAW

Is It the Beginning of the End of the "COVID Defenses?"


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Over the past year, real estate practitioners have monitored the steady stream of court decisions concerning the COVID-19 pandemic's effect on commercial tenants' rental obligations. (Indeed, we discussed and summarized some of these rulings in our Dec. 2, 2020 and Feb. 2, 2021 columns.) As New York proceeds slowly but surely toward a semblance of pre-pandemic normalcy, the latest such decision signals that the era of COVID-related defenses to commercial rent nonpayment may soon become a thing of the past.

In a comprehensive May 19, 2021 decision and order issued in *A/R Retail LLC v. Hugo Boss Retail, Inc.* (Supreme Court, New York County, Index No. 158385/20) (the "order"), the court framed the overarching question as "whether the adverse financial impact of the COVID-19 pandemic on tenant's business, including government orders restricting consumer access to the retail store, should relieve tenant of the obligations under its lease with plaintiff" (order at 1).

Hugo Boss Retail, Inc. ("tenant") is the tenant of a two-floor retail store (the "premises") in the Shops at Columbus Circle, a luxury shopping mall in Manhattan (the "Shops"), pursuant to a 2012 lease (the "lease") providing for a current monthly rent approaching $700,000. Notably, tenant conceded that its store at the premises "loses millions of dollars a year even in the best of circumstances" and that the store's location at the Shops was intended in part to promote "visibility" for tenant's brand (order at 3).

Due to the pandemic, owner closed the Shops, including the premises, as of March 17, 2020 at 5 p.m. and restricted deliveries and employee access after that time. The following day, Governor Andrew Cuomo issued Executive Order 202.5, which, *inter alia*, ordered that "all indoor common portions of retail shopping malls…shall close and cease access to the public." Tenant paid April 2020 rent, but ceased paying rent thereafter. Owner reopened the Shops on Sept. 9, 2020, and tenant has operated its business at the premises since that time. Unsurprisingly, however, tenant's business declined precipitously and its rental arrears continued to balloon.

Owner (represented by Warren A. Estis and our colleague Howard W. Kingsley) commenced an action against tenant in Supreme Court seeking to recover, *inter alia*, millions of dollars in rent arrears under the lease and thereafter moved for summary judgment. By the order, the court (Joel M.

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Cohen, J.)—noting, *inter alia*, that the lease requires "[a]ll rent payable to landlord under the provisions of this lease [to] be paid to landlord…without deduction, set-off or counterclaim whatsoever" (order at 6)—granted owner's motion and rejected each and every one of tenant's defenses.

No "Casualty" or "Hazard"

The court held that the COVID-19 pandemic does not constitute a "casualty event" justifying termination of the lease. It found that "[t]he lease uses the term 'casualty' to denote *physical* damage to the premises," which it found was supported by other pandemic-era decisions to have considered the issue (order at 11-12 [emphasis supplied]). The court further found that even if the pandemic constituted a "casualty," tenant's remedy under the lease was to exercise its termination option, which it did not do (*id.* at 12-13).

Similarly, the court held that the pandemic is not a "hazard" justifying a rent abatement under Section 15.1(d) of the lease, which applies only "[i]f the premises are *completely or partially destroyed or so damaged by fire or other hazard* that the premises cannot be reasonably used by tenant or can only be partially used by tenant" (order at 13-14 [emphasis supplied]).

No Frustration of Purpose

Next, the court held that the lease should not be rescinded or reformed based on the "narrow" frustration of purpose doctrine (order at 15). Justice Cohen cited caselaw establishing that (1) frustration of purpose requires "complete destruction of the basis of the underlying contract" and that "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;" (2) "[i]t is not enough…that the transaction will be less profitable for an affected party or even that the party will sustain a loss;" and (3) frustration of purpose is unavailable "where the event which prevented performance was foreseeable and provision could have been made for its occurrence" (order at 15-16).

Notably, the court cited a number of recent decisions holding that "the temporary and evolving restrictions on a commercial tenant's business wrought by the public health emergency do not warrant rescission or other relief based on 'frustration of purpose'" (order at 17). Cohen found those decisions persuasive—especially in light of New York's slow but steady emergence from pandemic-related lockdowns:

> Tenant's core argument is that the pandemic-related restrictions on its use of the leased premises has 'entirely frustrated' the express purpose of the lease. However, the facts, which are largely undisputed, do not support that conclusion. The pandemic triggered several months of 'shutdown' followed by an evolving set of capacity restrictions that have reduced (but not eliminated) tenant's ability to generate revenue from its retail operation. While there are no guarantees, the path forward appears to be toward further relaxation or elimination of capacity restrictions…
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> [A]lthough the adverse economic effects of the pandemic undoubtedly are real and significant, they do not rise to the level of triggering an extra-contractual common law right to rescind a 13-year lease.
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> (*id.* at 18-19.)

Tenant also raised the lease's "force majeure" clause, which defined that term to include the "orders or regulations of or by any government authority," but carved out from that definition any "causes delaying the payment of money due and payable hereunder." Furthermore, the parties "except[ed] tenant's obligations to pay any sums of money due under the terms of this [lease]" from the lease's excusable delay provision. Thus, the court held that pandemic-related government closures and capacity restrictions were foreseeable and addressed in the lease—thereby precluding tenant's frustration of purpose argument (order at 20-22).

No Impossibility of Performance

The court also ruled against tenant on its impossibility of performance defense.

Justice Cohen cited several cases laying out the principles governing the impossibility of performance doctrine, including: (1) impossibility applies only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible; (2) financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy, is insufficient; (3) impossibility is unavailable where performance is possible, albeit unprofitable; and (4) the conditions causing impossibility must be unforeseeable and the risks associated with them could not have been built into the lease (order at 23).

Applying these principles, the court rejected tenant's impossibility defense and found that "the very text of the lease demonstrates that the conditions that [tenant] claims render performance impossible were foreseeable." The court further noted that tenant actually operated its store at the premises for at least part of the period for which it claimed impossibility, and that consequently, "[a]lthough its business was made difficult by the pandemic, tenant's performance under the lease was not objectively impossible" (order at 24-25).

No Basis to Reform Lease

Finally, the court rejected tenant's alternative argument that the lease should be reformed to reflect the parties' purported "true intent" that tenant would have no rent obligation in situations such as those that have existed during the pandemic. Aside from the claim being time-barred, the court noted, *inter alia*, that "[r]eformation is not granted for the purpose of alleviating a hard or oppressive bargain" (order at 26).

The court found tenant's claim to be "conclusory and entirely speculative" and, perhaps more importantly, "at odds with the lease provisions described above, including an unconditional obligation to pay rent and a force majeure provision that identifies the risk of government closures but does not provide for relief from obligations to pay rent" (*id.* at 27).

Conclusion

In summarizing the relevant issues, the court contrasted the transitory nature of the pandemic and related restrictions with the permanence of the relief sought by tenant, and also raised the inherent unfairness of foisting all COVID-related risks on commercial owners:

> The pandemic undoubtedly has taken a significant toll on tenant's business. But unlike the permanence of tenant's proposed remedies of rescission and reformation, government restrictions relating to the pandemic have evolved and eased considerably over time. . . [T]he parties provided in the lease for certain accommodations in the event performance of their respective obligations was impacted by government restrictions, but did not provide for termination of the lease or abatement of rent under those circumstances. A harsh result, to be sure, but so in its own way would be mass rescission of commercial leases, assigning all risk of the pandemic to property owners who face their own unrelenting expenses and economic burdens.
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> (order at 2.)

With the easing of pandemic restrictions, Justice Cohen's decision in *A/R Retail* may signal the beginning of a trend in which commercial tenants are unable to credibly allege COVID-related defenses to leasehold obligations. By the same token, with the increased economic activity that will inevitably accompany more "normal" times, commercial tenants with increased profits and cash flow may no longer feel compelled to assert such defenses.