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LANDLORD TENANT LAW

Frustration and Impossibility: Viable Defenses Amid Pandemic?

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As the COVID-19 pandemic and its accompanying economic fallout continue to unfold, commercial tenants have increasingly come to rely on the common law doctrines of impossibility of performance and frustration of purpose as defenses to the nonpayment of rent.

The doctrine of impossibility of performance excuses a tenant's performance "only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible" (*Kel Kim Corp. v Cent. Markets, Inc.*, 70 NY2d 900, 902 [1987]). "[T]he impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract" (*id.*); notably, however, "an economic downturn" is not such an unanticipated event (*Urban Archaeology Ltd. v 207 E. 57th St. LLC*, 68 AD3d 562 [1st Dept 2009]). "[I]mpossibility occasioned by financial hardship does not excuse performance of a contract" (*id.*). Accordingly, "where performance is possible, albeit unprofitable, the legal excuse of impossibility is not available" (*Warner v Kaplan*, 71 AD3d 1, 6 [1st Dept 2009]).

The Appellate Division, First Department recently discussed the doctrine of frustration of purpose at length (although outside of the pandemic's context) in *Ctr. for Specialty Care, Inc. v CSC Acquisition I, LLC*:

> In order to invoke the doctrine of frustration of purpose, the frustrated purpose must be so completely the basis of the contract that, as both parties understood, without it, the transaction would have made little sense. Examples of a lease's purposes being declared frustrated have included situations where the tenant was unable to use the premises as a restaurant until a public sewer was completed, which took nearly three years after the lease was executed, and where a tenant who entered into a lease of premises for office space could not occupy the premises because the certificate of occupancy allowed only residential use and the landlord refused to correct it.
>
> However, frustration of purpose is not available where the event which prevented performance was foreseeable and provision could have been made for its occurrence.

(185 AD3d 34, 42-43 [1st Dept 2020] [citations, internal quotation marks and ellipses omitted]).

Two recently-reported decisions arising in the context of *Yellowstone* injunction applications (*see First Natl. Stores v Yellowstone Shopping Ctr.*, 21 NY2d 630 [1968]) demonstrate how lower courts are grappling with these doctrines during the pandemic. In *Rame, LLC v Metropolitan Realty Management, Inc.*, the court issued a *Yellowstone* injunction where the underlying default arose, in part, from unpaid rent allegedly caused by the pandemic (2020 WL 6290556, 2020 NY Slip Op 33538[U] [Sup Ct, New York County 2020]).

On the other hand, in *BKNY1, Inc. v 132 Capulet Holdings, LLC*, the court rejected the tenant's impossibility of performance and frustration of purpose defenses and ordered the tenant to pay rent due pursuant to the *Yellowstone* injunction order already in place, failing which the landlord could move to vacate the *Yellowstone* injunction (2020 WL 5745631, 2020 NY Slip Op 33144[U] [Sup Ct, Kings County 2020]).

In *Rame*, the landlord served a notice of default alleging that the tenant owed unpaid rent from December, 2017 through September, 2020 totaling over $1.8 million. The tenant asserted that (1) it operates numerous restaurants in the subject premises which all depend on in-person and indoor dining which, as of March 2020, were prohibited and/or severely curtailed by reason of Governor Cuomo's pandemic-related executive orders, (2) as a result, the tenant's business and profits declined and it was unable to pay rent, and (3) such inability to pay rent arose from the frustration of the lease's purpose and the impossibility of performance thereunder (2020 NY Slip Op 33538[U] at 2).

The tenant further asserted that it did not owe the amount of rent stated in the

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default notice, insofar as the lease permits a rent abatement if the tenant is unable to operate due to, *inter alia*, a national emergency or a governmental agency's order or rule (*id.* at 2-3).

For its part, the landlord argued that (1) while the governor's executive orders had long permitted takeout and outdoor dining services, the tenant had elected to stay completely closed since March, 2020 and availed itself of neither of these options, thus negating impossibility of performance and frustration of purpose as defenses, and (2) the lease requires rent to paid without any setoff or deduction whatsoever (*id.* at 3).

Notwithstanding the parties' disputes concerning the underlying merits, the tenant argued that it met the four-pronged *Yellowstone* test insofar as it held a commercial lease, it received a notice of default, the cure period had not yet expired, and it was willing and able to cure the alleged default (*id.* at 2). Justice Barbara Jaffe agreed, and issued a *Yellowstone* injunction in the tenant's favor:

> Whether plaintiff is entitled to an abatement of rent under the lease, *i.e.,* whether it will ultimately prevail in proving that it owes less than defendant asserts, is irrelevant to whether it is entitled to a *Yellowstone* injunction. Rather, the key issue is plaintiff's willingness and ability to cure its default, and it has indicated both.
> (*id.* at 5).

However, in light of the sizable rent arrears and the tenant's continued occupancy of the premises, Justice Jaffe also directed as a condition of the injunction that the tenant, notwithstanding its frustration and impossibility defenses, (1) pay rent on an ongoing basis, and (2) within 20 days, post an undertaking of nearly $1.1 million, representing 50 percent of the amount due as of Oct. 1, 2020 (*id.*).

In *BKNY1*, the court had previously issued a *Yellowstone* injunction conditioned on the tenant's continued payment of rent (2020 NY Slip Op 33144[U], at 2). The tenant, however, failed to pay rent for April and May, 2020, but asserted that the impossibility of performance and frustration of purpose doctrines excused its violations of the court's order (*id.* at 2-4).

Justice Lawrence Knipel rejected the tenant's arguments. First, Knipel held that "[t]he common-law doctrine of frustration of purpose is inapplicable under the circumstances" (*id.* at 3). After citing the general principles associated with such doctrine (discussed above), the court concluded: "Inasmuch as the initial term of the lease, as amended by the March 2012 rider, is for approximately nine years (November 2012 to September 2021), a temporary closure of plaintiff's business for two months (April and May 2020) in the penultimate year of its initial term could not have frustrated its overall purpose" (*id.*).

While the Appellate Division has not yet ruled on the applicability of the frustration of purpose and impossibility of performance doctrines to rent defaults during the pandemic, the 'Ram'e and 'BKNY1' decisions prompt several observations.

Justice Knipel similarly made short work of the tenant's impossibility of performance defense, holding that it was "[not] available to plaintiff in this case" (*id.* at 4). Citing *Stasyszyn v Sutton E. Assoc.* (161 AD2d 269, 271 [1st Dept 1990]), the court noted that "[a]bsent an express contingency clause in the agreement allowing a party to escape performance under certain specified circumstances, compliance is required" (2020 NY Slip Op 33144[U], at 4). Knipel found that the lease offered the tenant no relief, as a result of which the tenant's performance was required notwithstanding the pandemic and the governor's executive orders:

> Nothing in the lease at issue permits termination or suspension of plaintiff's obligation to pay rent in the event of the issuance of a governmental order restricting the use of the leased premises. To the contrary, the lease specifically provides that plaintiff's obligation to pay rent 'shall in no wise be affected, impaired or excused because Owner is unable to fulfill any of its obligations under this lease…by reason of…government preemption or restrictions,' which is the case here.
> (*id.*).

While the Appellate Division has not yet ruled on the applicability of the frustration of purpose and impossibility of performance doctrines to rent defaults during the pandemic, the *Rame* and *BKNY1* decisions prompt several observations. It appears that *Yellowstone* relief may remain available to commercial tenants where they have defaulted in paying rent by reason of the pandemic. However, a *Yellowstone* injunction is but a temporary reprieve, and a tenant must ultimately prevail on the merits if it hopes to defeat the landlord's rent claim.

The *Rame* court's order directing payment of ongoing rent and an undertaking as conditions for a *Yellowstone* injunction notwithstanding the tenant's impossibility and frustration defenses and the *BKNY1* court's outright rejection of the tenant's arguments suggest that these defenses will be construed very narrowly. Therefore, absent a specific lease clause providing rent relief, commercial tenants may have to look to other defenses against landlords' rent default claims.

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