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The 'COVID Defenses': An Appellate Update

By **Warren A. Estis**

Since the onset of the COVID-19 pandemic, we have analyzed some of the many cases involving the "COVID defenses," *i.e.* defenses to commercial rent nonpayment predicated in some manner on the pandemic (*see* our columns of Dec. 2, 2020, Feb. 2, 2021 and June 1, 2021). In our June 1, 2021 column, we stated: "As New York proceeds slowly but surely toward a semblance of pre-pandemic normalcy…the era of COVID-related defenses to commercial rent nonpayment may soon become a thing of the past."

Two recent rulings from the Appellate Division, First Department bear directly on this issue. In *Valentino U.S.A., Inc., v. 693 Fifth Owner LLC* (160 NYS3d 858, 2022 NY Slip Op 01431 [1st Dept. 2022]), the Appellate Division affirmed that doctrines such as frustration of purpose and impossibility of performance are, indeed, generally unavailable to relieve commercial tenants from the consequences of COVID-related rent nonpayment. However, in *Schulte Roth & Zabel v. Metropolitan 919 3rd Avenue LLC, et. al.* (202 AD3d 641 [1st Dept. 2022]), the court also affirmed that, above all, commercial lease terms negotiated by sophisticated parties will govern COVID-related rent disputes.

'Valentino'

In *Valentino U.S.A., Inc., v. 693 Fifth Owner LLC*, the Appellate Division affirmed the lower court's ruling that the plaintiff-tenant's complaint asserting the COVID defenses failed to state a cause of action.

Relying on its ruling in *Crown IT Servs., Inc. v. Koval-Olsen* (11 AD3d 263, 265 [1st Dept 2004]), the Appellate Division held first that "the narrow doctrine of frustration of purpose is inapplicable here, where the purpose of the contract has not been completely thwarted" (160 NYS3d at 859 [internal quotation marks omitted]). The court explained:

> Contrary to plaintiff's contention, frustration of purpose is not implicated by temporary governmental restrictions on in-person operations, as the parties' respective duties were to pay rent in exchange for occupying the leased premises, and plaintiff acknowledged that it was open for curbside retail services as of June 4, 2020 and services by appointment as of June 22, 2020. (*id.*)

The Appellate Division similarly rejected the plaintiff's impossibility of performance claim, noting that impossibility "excuses a party's performance only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible" (160 NYS3d at 859 [citing *Kel Kim Corp. v. Central Mkts.*, 70 NY2d 900, 902 [1987]). The court held that the COVID-19 pandemic failed to satisfy this very high standard:

> Here, the pandemic, while continuing to be "disruptive for many businesses," did not render plaintiff's performance impossible, even if its ability to provide a luxury experience was rendered more difficult, because the leased premises were not destroyed (see 558 Seventh Ave. Corp. v. Times Sq. Photo Inc., 194 AD3d 561, 562 [1st Dept 2021],

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appeal dismissed 37 NY3d 1040 [2021]).

(*id.*)

Finally, the Appellate Division rejected the plaintiff's constructive eviction claim, noting that the "complaint alleges that the pandemic is to blame for plaintiff's temporary inability to operate," and not "any act by defendant that interfered with [the plaintiff's] use or enjoyment" of the leased premises (*id.*).

'Schulte Roth & Zabel'

While *Valentino* has cemented the notion that commercial tenants relying solely on the COVID defenses face an uphill battle in defeating an owner's rent claims, the Appellate Division's ruling in *Schulte Roth & Zabel v. Metropolitan 919 3rd Avenue LLC, et. al.* establishes the primacy of a commercial lease's language in deciding a COVID-related rent dispute.

In *Schulte Roth & Zabel,* the plaintiff-tenant sought a rent abatement for a period during which most of its employees were working remotely. The plaintiff relied on Section 5.4 of the lease, which provides, in relevant part, that the plaintiff is entitled to a rent abatement if:

> Tenant is unable to use the Premises,…due to Landlord's breach of an obligation under this Lease to provide services, perform repairs, or comply with Legal Requirements… other than as a result of Unavoidable Delays or Tenant Delays (or, if Tenant's inability to use the Premises…results, in whole or in part, from Unavoidable Delays and such condition continues for a period in excess of fifteen (15) consecutive Business Days).

(202 AD3d at 642.)

The Appellate Division affirmed the lower court's denial of the defendant-owner's motion to dismiss the complaint because Section 5.4 of the lease is ambiguous, *i.e.* "on its face" it is "reasonably susceptible of more than one interpretation" (202 AD3d at 641 [citations omitted]). The court explained:

> On the one hand, section 5.4 can be reasonably interpreted to mean that plaintiff will be entitled to a rent abatement only if plaintiff's inability to use the premises is a result of defendant's breach of its obligations under the lease. Pursuant to this interpretation, the condition within the parentheses is directly connected to the condition that comes before the parenthesis and means that the plaintiff would be entitled to a rent abatement if the plaintiff is unable to use the leased premises because the landlord breached an obligation under the lease, and the breach is caused, in whole or in part, by an Unavoidable Delay, as defined in the lease, if the Unavoidable Delay continues for more than 15 business days.
>
> On the other hand, section 5.4 can also be reasonably interpreted to mean that plaintiff will be entitled to a rent abatement if one of two conditions occur. Specifically, the plaintiff would be entitled to a rent abatement if it is unable to use the leased premises, which is caused by either (i) landlord's breach of an obligation under the lease, or (ii) Unavoidable Delays that continue for more than 15 business days. Pursuant to this interpretation, the use of the disjunctive 'or' at the beginning of the parenthetical clause distinguishes the second condition within the parenthetical as a separate and alternative condition to the first condition, which comes before the parenthesis. Moreover, as a separate condition, it does not require that the landlord breach an obligation under the lease in order for the plaintiff to be entitled to a rent abatement.

(*id.* at 642)

Standing alone, the legal doctrines of frustration of purpose and impossibility of performance will usually not excuse a commercial tenant's nonpayment of rent, even if COVID rendered the tenant's performance difficult.

Accordingly, the Appellate Division directed the matter to proceed to discovery because "extrinsic evidence will be necessary to resolve the ambiguity" (*id.*).

Conclusion

As the foregoing decisions illustrate, it is now clear that over two years after the pandemic's onset, (1) standing alone, the legal doctrines of frustration of purpose and impossibility of performance will usually not excuse a commercial tenant's nonpayment of rent, even if COVID rendered the tenant's performance difficult, and (2) a COVID-related defense to nonpayment of rent stands on firmer legal footing if the defense is based on the lease's language.