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Common Law Defenses May Favor Commercial Tenants in Covid-19 Disputes

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Many businesses are still struggling to recover after unprecedented government-ordered closures and health and safety restrictions due to the Covid-19 pandemic. While some state governments have enacted eviction moratoriums, little other help besides Payment Protection Program money has been granted to businesses working to make rent while operating at limited capacity—or not operating at all.

And while PPP money is now running out, new relief funds are more narrowly targeted for specific industries and have more stringent requirements. At the same time, courts around the country have begun to consider the various legal questions arising from the pandemic, in particular where businesses have left rent unpaid or have sought to rescind or terminate their lease due to the impact of the Covid-19 pandemic. This article focuses on recent case decisions in pandemic-era lease litigation, including a discussion of what these decisions may mean for the huge backlog of landlord-tenant litigation.

For businesses hoping to emerge from the pandemic downturn, and even for those that have permanently closed but still have a mountain of debt and liabilities, the stakes could not be higher. Landlords and tenants alike are waiting in worried anticipation for the judiciary in their state to tell them where the law will place the pandemic burden. Although these circumstances provide the quintessential facts under which the defenses of frustration of purpose, impossibility, and impracticability should apply, early cases have been mixed.

However, there is a growing trend among state court judges that suggests commercial tenants may be able to successfully argue that government shutdowns should excuse their obligation to pay rent. In March 2021 in a state court in Kings County, New York, a state with a growing divide amongst its state court judges on these issues, not only found in favor of a commercial tenant but affirmatively granted the tenant summary judgment. The court ruled that the tenant's rent was excused because, under the circumstances, performance was made impossible.

While New York courts have been fast out of the gate, issuing many of the first rulings in what are surely hundreds—if not thousands—of pending pandemic-era disputes between commercial tenants and their landlords, landlords should take notice that judicial sentiment is not trending in their favor.

Frustration of Purpose and Impossibility Distinguished

The primary defenses asserted by tenants in the pending cases are frustration of purpose and impossibility, which are often pled together. Frustration of purpose is related, but distinguishable, from the defense of impossibility. Frustration may be used as a defense when performance remains possible, but the purpose for which the tenant entered into the lease is “substantially frustrated.” By contrast, impossibility applies where the contracting parties assumed that something would continue to exist but performance becomes impossible, or impracticable, because the thing was destroyed through no fault of either party.

Typically, for the impossibility defense to be applicable in the context of a commercial lease, it is essential that the terms of the lease be made truly impossible to perform; by contrast, under frustration of purpose, performance is excused even though it is possible for the party to perform its contractual obligations, but the expected value of that performance has been destroyed by an unforeseeable event. That said, frustration of purpose and impossibility are often argued together, as the same facts may support both defenses and the relief sought is the same: tenants seek to use these common law doctrines to argue payment is excused or, depending on the circumstances, that the lease may be, and has been, terminated.

Depending on the jurisdiction, the difference between the frustration and impossibility may be further blurred, where the jurisdiction permits tenants to argue practical impossibility or “impracticability”—i.e., where the object of the contract could not be accomplished without commercially unacceptable costs and time input far beyond that contemplated in the contract.

Covid-19 and Frustration of Purpose/Impossibility

Frustration and impossibility tend to be narrowly construed by the courts, for the obvious reason that there cannot be many instances where a party is excused, or can walk away from, its contract. But amongst early pandemic-era litigation, courts have found that where a commercial tenant can plead facts showing that performance under a lease has been frustrated or made impossible due to government shut-downs and other pandemic restrictions, a tenant's duty to pay rent may be excused where the non-occurrence of these events was a basic assumption of the lease.

On March 15, 2021, in *267 Dev., LLC v Brooklyn Babies & Toddlers, LLC*, No. 510160/2020, [2021 BL 97086](#) (N.Y. Sup. Ct. Mar. 15, 2021), the New York state court in Kings County addressed cross-motions for summary judgment addressing, in part, the tenant's argument that rent was excused due to impossibility. The tenant, one of many businesses forced to close pursuant to Governor Andrew Cuomo's executive orders, argued that performance under its lease was made objectively impossible.

In one of a growing minority of cases favorable to commercial tenants in New York, the court reasoned that the "shutdown of [tenant's] business has precluded it from performing its contractual obligations," and the "government shutdown was unforeseeable and could not have been built into the contract." Under the circumstances presented the court found "that performance under the subject lease was made impossible." As such, the court granted tenant's motion, ruling that the landlord's action against the tenant was barred by the doctrine of impossibility.

In *UMNV 205-207 Newbury, LLC v. Caffé Nero Americas Inc.*, Case No. 2084CV01493, [2021 BL 90820](#) (Mass. Super. Ct., Feb. 8, 2021), Caffé Nero leased the plaintiff-landlord's premises for the sole purpose of operating a Caffé Nero-themed café. When Massachusetts barred restaurants from allowing on-premises consumption of food or beverages in March 2020, Caffé Nero closed its café and stopped paying rent. The landlord terminated its lease immediately and brought an eviction action, and Caffé Nero vacated in late October. The landlord then sued Caffé Nero for unpaid rent from April through October.

In another significant win for commercial tenants, the court granted Caffé Nero's motion for summary judgement, finding that payment of rent was excused due to frustration of purpose, for the period of time when indoor and outdoor dining were both prohibited and for any other time restaurants were closed by government order. More specifically, the court reasoned that where "government action bars the only permitted or possible use of the leased property, and there is no evidence that the lessor voluntarily assumed that risk, then 'the use of the leased property intended by the parties is frustrated.'"

In *Seoul Garden Bowery Inc. v. Ng*, 2020 NY Slip Op 31842(U), ¶15, [2020 BL 222324](#) (N.Y. Sup. Ct.) (June 8, 2020), the court similarly held that where the lease restricted use of the premises to operating a restaurant, and such use was not permitted due to government Covid-19 regulations issued for New York, the tenant had pled contractual impossibility sufficient to survive a motion to dismiss. Moreover, *Seoul Garden* further provides that, under the circumstances alleged, tenant had sufficiently pled a cause of action for rescission based upon impossibility of performance, as allegedly the leasehold use restriction prevented its performance.

But other courts have not engaged in such a broad reading of frustration, holding instead that only a complete prohibition of the operation of a business may constitute frustration.

In *RPH Hotels 51st St. Owner, LLC v. HJ Parking LLC*, 2021 NY Slip Op 30286(U), ¶¶ 3-5, [2021 BL 35062](#) (N.Y. Sup. Ct.) (Jan. 28, 2021), the court found that allowing a frustration of purpose defense for businesses that had been allowed to operate at limited capacity would expand the doctrine too far. Nonetheless, the court left the door open for certain tenants, finding that businesses "such as gyms, that were forced to close for months" may properly assert frustration as a defense.

Similarly, in *The Gap Inc. v. Ponte Gadea New York LLC*, No. 20 CV 4541-LTS-KHP, [2021 BL 81080](#) (S.D.N.Y. Mar. 8, 2021), the court held that The Gap could not assert a frustration of purpose defense because it had decided to close its doors, even though it was allowed to operate its business through curbside pickup and permitted to have limited capacity indoor shopping. Because the retailer had voluntarily closed, the defense did not apply.

Frustration of Purpose and Force Majeure Clauses

Force majeure provisions have also played an important role in commercial lease agreement disputes in the Covid-19 era, and many commercial tenants have attempted to escape leasehold obligations by invoking these well-known but rarely applicable clauses. But when a force majeure provision does not relieve commercial tenants of their leasehold obligations, the mere existence of a force majeure clause in a lease agreement does not necessarily preclude the common law frustration of purpose defense.

In *Rembrandt Enters. v. Dahmes Stainless, Inc.*, No. C15-4248-LTS, [2017 BL 314637](#) (N.D. Iowa Sep. 7, 2017), the court rejected the defendant's argument that the existence of a force majeure clause precluded the frustration of purpose defense, emphasizing the fact that no authority supported such a proposition. Similarly, the commercial tenants in *Caffé Nero* raised a viable frustration of purpose defense despite the existence of a force majeure clause.

While the mere existence of a force majeure provision clearly does not preclude the defense, whether a frustration of purpose defense will ultimately succeed depends on the express language of the provision. For example, in *Caffé Nero*, the specific language of the force majeure provision did not foreclose the frustration defense because the clause only contemplated performance becoming impossible. The provision did not address the distinct risk that performance could still be possible, even while the purpose of the lease was frustrated.

But in *The Gap* the court rejected tenant's pandemic-era frustration of purpose claim partially on the grounds that government-mandated closures were foreseeable in light of a force majeure clause that referenced government action in relation to public emergencies.

Covid-19 and Course of Dealing

The length of the pandemic, including the initial widely held belief that it would be short lived and certainly not more than a few months, led many tenants to negotiate short term agreements in an effort to address the impact of Covid-19 on their leases. Other tenants simply stopped paying or paid what they could, with landlords happy to receive any payment. As a result, the parties' course of dealing, including a tenant's divergence from the terms of its lease and landlord's express or implied acceptance, may be used to bind the landlord.

In *The Hatchett Firm v. Atlanta Life Financial Group, Inc.*, [2021 BL 71947](#) (Ga. Ct. App.) (Mar. 1, 2021), a tenant brought suit against a subtenant for failure to make full rent payments for 16 months. On appeal, the subtenant argued that the tenant waived its right to collect the rent because the tenant had not objected to the subtenant's partial- or non-payment of rent; therefore, the parties' mutual departure from the terms of the lease created a quasi-new agreement. The appellate court agreed, reversing summary judgment and holding that there was a genuine issue of material fact as to whether the parties' conduct created a quasi-new agreement, notwithstanding the sublease.

Conclusion

After more than a year of business closures, government mandates, and struggles to pay rent—and with a handful of early cases narrowing the window on tenants' use of common law defenses—commercial tenants can perhaps breathe a bit easier. Emerging litigation trends increasingly favor commercial tenants, and common law legal doctrines that were once only solutions to first-year law school hypotheticals are now viable theories upon which courts have granted commercial tenants judicial relief.