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575 Lexington Avenue, New York, NY 10022 | (212) 984-7700 | www.wbny.com | @warshawburstein | Warshaw

Negotiating Requests for Commercial Rent Reductions, Deferrals or Abatements

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The shutdown of all "non-essential" businesses by the New York State and New York City governments due to the global coronavirus (COVID-19) pandemic has created an acute financial crisis for both commercial landlords and tenants. Tenants whose businesses (including stores, bars and restaurants) have been closed for weeks, may be having difficulty paying rent, salaries, utilities and other expenses. Likewise, with diminished rental income, landlords may be having difficulty covering their own expenses, such as debt service on the property, real estate taxes, water and sewer charges and insurance.

What should commercial landlords and tenants do during these most trying times?

A. Review the Lease

Before taking any action, landlords and tenants should read their leases carefully and consult an attorney if they have any questions. Some relevant provisions to review include those concerning the payment of rent and any so-called "force majeure" clause.

i. The Rent Clause

Commercial leases, including and especially "triple net" leases, typically provide that the payment of rent is absolute and without any setoffs, reductions, or deductions. The payment of rent provision, however, may be subject to other provisions of the lease, including "force majeure" clauses.

ii. The Force Majeure Clause

A force majeure clause, also known as an "Act of God" clause, typically lists events beyond the control of the parties, such as war, civil unrest, labor strikes, natural disasters, and national emergencies that either suspend or excuse the performance of a party's obligations under a contract, such as a lease. Force majeure clauses include, but are not limited to, "Acts of God," so it is important to read the lease to make sure that it covers the current situation. Terms such as a

shutdown due to disease, infection, pandemic, quarantine, or a governmental act or prohibition probably would need to be specifically mentioned in the provision, as leases are enforced according to the "plain meaning" of their terms.[1] Moreover, New York courts narrowly construe force majeure provisions in leases and other agreements.[2]

Some leases contain force majeure clauses that expressly exclude the tenant's performance of monetary obligations (i.e., payment of rent and additional rent), meaning, that even during a covered event, the tenant, nonetheless, must continue to pay rent and additional rent. Some leases excuse a tenant's performance of only non-monetary obligations, and only during the time that the event occurred. The most pro-landlord leases contain provisions that even in the event of a force majeure, the tenant must continue to pay rent and additional rent.

B. Impossibility of Performance and Frustration of Purpose

In addition to the terms of the lease, parties should be aware of two common-law doctrines that may be invoked to excuse a tenant's performance: impossibility of performance and frustration of purpose.

Courts have held 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." Moreover, the impossibility must be caused by an unanticipated event that could not have been foreseen or guarded against in the contract."[3] Courts also have held that the doctrine of impossibility of performance "occasioned by financial hardship does not excuse performance of a contract."[4] Assuming that this governmental closure is short-lived and the tenant is able to resume its business within a relatively short period of time, it might be difficult for such tenant to argue that its performance is "objectively impossible," even if the event itself could not have been anticipated. Moreover, depending on the language of the force majeure clause in the lease, the parties may have foreseen or guarded against such event.

The doctrine of frustration of purpose, on the other hand, is extremely narrow and does not apply "unless the frustration is substantial."[5] To invoke this defense, the frustrated purpose must go so completely to the basis of the contract as understood by both parties, that without it the transaction would have made little sense.[6] Notably, this defense is not available when the event preventing performance was "foreseeable."[7] As with the doctrine of impossibility, the viability of

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[1] See Greenfield v. Philles Records, Inc., 98 N.Y.2d 562, 569 (2002); Vermont Teddy Bear Co. v. 538 Madison Realty Co., 1 N.Y.3d 470, 475 (2004) (holding that a writing must be enforced according to its terms.

[2] See Duane Reade v. Stoneybrook Realty, LLC, 63 A.D.3d 433, 434, 882 N.Y.S.2d 8 (1st Dep't 2009) ("[i]nterpretation of force majeure clauses is to be narrowly construed and 'only if the force majeure callus specifically includes the event that actually prevents a party's performance will that party be excused,'" quoting Kel Kim Corp. v. Central Mkts, 70 N.Y.2d 900, 902-903 [1987]).

[3] Kel Kim, 70 N.Y.2d at 902 (19870: Warner v. Kaplan, 71 A.D.3d 1, 5, (1st Dep't 2009).

[4] Urban Archaeology Ltd v. 207 E. 57th St. LLC, 68 A.D.3d 562, 562 (1st Dep't 2009), citing 407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp., 23 N.Y.2d 275, 281-82 (1968).

[5] Rockland Dev. Assoc. v. Richlou Auto Body, 173 A.D.2d 690, 691 (2d Dep't 1991).

[6] See Crown IT Servs. v. Koval-Olsen, 11 A.D.3d 263, 265 (1st Dep't 2004).

[7] See Warner v. Kaplan, 71 A.D.3d 1, 6 (1st Dep't 2009), lv. denied, 14 N.Y.3d 706 (2010).

this defense might depend upon, among other factors, how long the governmental closure lasts, even if neither party could have foreseen that, in 2020, a virus would shut down not only businesses in the City of New York, but worldwide.

In addition to these doctrines, courts also may fashion such other equitable relief as may be necessary to prevent the termination of commercial leases under the well-established doctrine that "equity abhors forfeiture of valuable leasehold interests."[8]

C. Practical Solutions

Relying on courts to resolve lease disputes is not a viable option at this point given, among other things, the restrictions on judicial proceedings and the 90-day moratorium on commercial evictions in the State (which extends through June 20, 2020). While commercial tenants still are legally and contractually obligated to pay, landlords presently are barred from commencing eviction proceedings or taking any legal action to execute warrants of eviction and judgments of possession. Landlords, however, still may issue default notices, and tenants, if necessary, may file emergency applications for *Yellowstone* and/or injunctive relief to avoid the termination of their commercial leases.

During these difficult times, it would behoove landlords and tenants to be reasonable and flexible in negotiating compromises. If the lease term has many years to run and prior to the current crisis the tenant had been current on its obligations, there could be value in preserving the long-term relationship by making short-term compromises, assuming that the stay-in-place orders are lifted soon.

The process usually starts with tenants seeking concessions by requesting that landlords agree to reduce or abate the payment of rent or additional rent, such as common area maintenance charges (CAM), real estate taxes, insurance, etc., for a period of time. Alternatively, tenants may request that landlords agree to defer the payment of rent or additional rent for a short period of time, with the deferred amount to be repaid over an extended period of time.

It is important for landlords to understand that a tenant's request for rent relief usually is the "first offer," and that there may be room for negotiation. Thus, instead of a rent reduction or abatement, a landlord may offer to defer the payment of rent or additional rent for a limited period of time, without penalty or interest, in exchange for a tenant agreeing to pay the deferred rent in equal monthly installments over an extended period of time. Sometimes, landlords may have no practical alternative but to consider a rent reduction. However, this concession may be mitigated, for example, by extending the term of the lease, or perhaps obtaining a stronger or better personal or corporate guaranty. As each lease is different, many different solutions might be employed.

Commercial landlords and tenants also may be eligible for relief, including loans and grants, under the recently enacted Coronavirus Aid, Relief, and Economic Security Action ("CARES Act"), a $2.2 trillion stimulus package designed to mitigate the financial impact of COVID-19.

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[8] Zaid Theatre Corp. v. Sona Realty Co., 18 A.D.3d 352, 355 (1st Dep't 2005), quoting Metropolitan Trans. Auth. v. Cosmopolitan Aviation Corp., 99 A.D.3d 767, 768 (2d Dep't 1984), aff'd, 64 N.Y.2d 623 (1984).

The key is not to panic (although it is much easier said than done during a "pandemic"), but to use your business judgment, be creative, and consult competent real estate counsel to assist you.

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If you have any questions regarding your lease, please contact Slava Hazin, any of the undersigned, or your regular attorney at Warshaw Burstein, LLP, a full-service law firm with attorneys ready to assist you.

Maxwell Breed	mbreed@wbny.com	(212) 984-7747
Ally Hack	ahack@wbny.com	(212) 984-7732
Slava Hazin	shazin@wbny.com	(212) 984-7810
Harvey Krasner	hkrasner@wbny.com	(212) 984-7828
Lisa Liu	lliu@wbny.com	(212) 984-7793
Bruce Wiener	bwiener@wbny.com	(212) 984-7878