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Seminar 19

Frustration, Impossibility and Force Majeure: A Litigator's View of Whether COVID-19 Can Be Invoked to Avoid Lease Obligations

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COVID-19 has unleashed a wave of litigation between landlords and retail tenants. In this seminar, experienced litigators will analyze whether courts have granted, will grant, and should grant tenants relief from rent and other lease obligations based on the pandemic. The speakers will discuss major pending cases, key court rulings, historical case precedents, and applicable statutes and government orders that will inform and predict future litigation decisions.

I. Introductions

II. Examples of lease obligations which have been affected by the pandemic

- A. Landlord's timely completion of "Landlord's Work."
- B. Tenant's timely completion of "Tenant's Work."
- C. Tenant's obligation to pay rent, including the commencement of that obligation.
- D. Tenant's obligation, if any, to open or operate.
- E. Tenant's right (if not in default) to exercise an option to extend the lease term.
- F. Tenant's right to reduce its rent obligation or terminate the lease if there is a failure to meet a co-tenancy requirement as a result of other stores not operating.

III. Possible defenses to lease obligations arising from the pandemic

A. Force Majeure

1. Many leases contain a force majeure provision in which the parties expressly agree that certain specified extraordinary events beyond the control of the parties will either excuse performance or extend the time to complete the performance.

2. The specific words used in the force majeure provision matter.
   a. Does the provision expressly cover a pandemic or a government order that requires the public to stay at home, prohibits construction activities, or requires retail businesses to close?

   b. Does the provision eliminate the performance obligation or just delay it until the force majeure event passes?

   c. Does the provision address how the existence of a force majeure event impacts the obligation to pay rent?
      i. Many leases provide that a force majeure event does not excuse the timely payment of rent.

      ii. If the lease is silent on whether a force majeure event excuses or delays the rent obligation, does the lease elsewhere reflect the parties' bargain that the tenant is, or is not, required to operate in the premises.

   d. To the extent the provision covers an "Act of God," is a pandemic an "Act of God?"

e. Many force majeure provisions contain a catchall provision like "and any other event which is beyond the control of the parties."
   i. Some courts limit such a provision to only those events that are similar in character to the specifically enumerated events.
   ii. Some courts interpret such a provision more broadly.

f. Does the provision require the party invoking force majeure to promptly notify the other party?

3. A sampling of relevant cases.
   a. *Kel Kim Corp. v. Central Markets, Inc.,* 524 N.Y.S.2d 384 (Ct. of App. 1987):
      i. Force majeure provision did not excuse tenant's inability to maintain insurance requirements in lease for a roller rink.
      ii. Court interpreted provision narrowly, finding no express reference to insurance interruptions and denying relief under catch-all provision for events beyond the parties' control
   b. *Kyocera Corporation v. Hemlock Semiconductor, LLC*, 313 Mich. App. 437 (2015):
      i. Narrowly construed a force majeure provision to the specifically identified events, holding that financial hardship or unprofitability of performance is not a force majeure event with respect to fixed price take or pay contract.
      ii. Relief denied because the contract allocated to the buyer the risk of the alleged force majeure event, a trade war which greatly lowered the market price for solar panels below the fixed price.
   c. *Bay City Realty, LLC v. Mattress Firm, Inc.,* Case No. 20-CV-11498 (E.D. Mich. Apr. 7, 2021):
      i. Rejecting landlord's expansive interpretation of force majeure language in lease provision on "hazardous materials", holding that language must be read in context and was intended to apply only to those regulations relating to "hazardous materials", which would not include COVID-19.
   d. *Palm Springs Mile Associates, Ltd. V. Kirkland's Stores, Inc*., 2020 WL 5411353 (S.D. Fl., Sept. 8, 2020):
      i. Rejecting application of force majeure provision based on "governmental laws" or "acts of God", to excuse non-payment of rent based on COVID restrictions, holding that tenant was required to establish that "a force majeure event *resulted* in its inability to pay its rent" and that the "restriction on non-essential activities and business operations must directly affect [the tenant's] ability to pay rent."

B. Frustration of Purpose

1. Restatement Contracts 2d § 265.
   a. Elements of defense.
      i. Contract is at least partially executory.
      ii. Frustrated party's purpose in making contract was known to both sides when contract made.
      iii. This purpose is frustrated by an event that was not reasonably foreseeable, that was not the fault of the frustrated party and the risk of this event was not assumed by the frustrated party in the contract.

2. A sampling of relevant cases.
   a. *Lloyd v. Murphy,* 25 Cal.2d 48 (1944):
      i. Auto dealer unsuccessfully claimed frustration of purpose to terminate his lease after US government restricted sales of new cars during WWII.
      ii. After balancing the equities, the court held that lessee was required to prove that the value of the lease had been "destroyed" as well as extreme hardship. It was insufficient that the performance of the lease obligations were unprofitable, difficult, or more expensive.

b. *UMNV 205-207 Newbury LLC v. Caffé Nero Americas Inc.,* 2084CV01493-BLS2 (Mass. Superior Ct., Feb. 8, 2021):

i. Finding frustration of purpose (allowing rent abatement) applicable where lease limited the permitted use of property to a single permitted use (restaurant operation) and that use was prohibited by COVID regulation.

ii. Rejected landlord's argument that the lease's force majeure provision (applying where a party was "prevented" from performing due to government regulation) allocated the risk of government restriction to tenant, holding that this provision did not preclude common law frustration of purpose.

c. *The Gap Inc. v. Ponte Gadea New York LLC,* Case No. 20-cv-4541, 2021 WL 861121 (S.D.N.Y., March 8, 2021):

i. Rejecting frustration of purpose defense in support of rescission/reformation of lease, holding that government regulation was foreseeable given lease's force majeure clause (which identified "governmental preemption of priorities or other controls in connection with a national or other public emergency").

ii. Concluding lease not frustrated since executive orders allowed for some in-store shopping, curbside pickup, and online order fulfillment, noting "no covenant in the lease in which [the landlord] made any guarantee regarding foot traffic, or the nature or demographic characteristics of the area of the Lexington Avenue store premises."

d. *East 75th Street Corp. v. Christian Louboutin L.L.C.,* No. 154883/2020, 2020 WL 7315470 (N.Y. Sup. Ct. Dec. 09, 2020):

i. Rejecting frustration of purpose, holding that it was inapplicable where the leasehold still exists and there was no prohibition on sale of product.

ii. Holding that tenant's "business model of attracting street traffic is no longer profitable because there are dramatically fewer people walking around due to the pandemic", but that changes to the retail market and unforeseen economic forces are insufficient to constitute frustration of purpose.

C. Impossibility a/k/a impracticability

1. Restatement Contracts 2d § 261.

a. When, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

b. Does not require absolute impossibility.

2. A sampling of relevant cases.

a. *Bush v. ProTravel Int'l, Inc.,* 746 N.Y.S.2d 790 (Civ. Ct. 2002).

i. New Yorker sought refund of her vacation deposit after the 9/11 terrorist attack, even though contract allowed the travel agency to keep the deposit unless the traveler canceled more than 60 days before departure.

ii. The vacationer's cancellation was untimely under the contract terms, but Court found the equitable circumstances created by 9/11 outweighed the contract language.

iii. Court held vacationer was entitled to a deposit refund if she could prove that the 9/11 emergency, near-lockdown conditions in New York made it temporarily impossible for her to contact the travel agency to cancel.

b. *267 Dev., LLC v Brooklyn Babies & Toddlers, LLC,* No. 510160/2020, 2021 BL 97086 (N.Y. Sup. Ct. Mar. 15, 2021):

i. Agreed with tenant that, since its business was closed by government regulation, tenant's performance under the lease was made objectively impossible.

ii. Discussing 9-11 jurisprudence, held that the scope of the COVID pandemic and the government's response was unprecedented and could not have been foreseen or built into the parties' contract.

c. *CAB Bedford LLC v. Equinox Bedford Ave Inc.,* 2020 WL 7629593 (N.Y. Supreme, Dec. 22, 2020):

i. Rejected impossibility defense asserted by gym tenant closed due to government regulation, holding that gym had been operated for many years prior to COVID and was able to operate after closure regulations ended.

ii. Court held that "The subject matter of the lease was not destroyed. At best, it was temporarily hindered. That there are more hurdles to running the business is not a basis to invoke the impossibility doctrine."

d. *In re: Cinemex USA Real Estate Holdings, Inc, et al.,* Case No. 20-14695, 2021 WL 564486 (U.S. Bankruptcy Court, S.D. Florida, Miami Div., Jan. 27, 2021):

i. In Chapter 11 bankruptcy, operator of dine-in movie theatre sought to excuse/delay rent payments due to frustration of purpose and impossibility.

ii. Held that it was impossible for tenant to operate due to government regulations and that this excused the obligation to pay rent during period of closure (and term extended for closure period) due to government regulations. However, this only applied during periods of forced closure, not periods of decreased profitability due to consumer reluctance to attend movies.

D. Operation of Law

1. *Industrial Development & Land Co. v. Goldschmidt,* 56 Cal.App. 507 (1922).
   a. Lessee terminated liquor store lease when prohibition went into effect
   b. Court upheld termination on grounds the lease limited the use of the premises to a liquor store, which use was now prohibited by law.

2. California Civil Code §1511(1): Excuses performance of a lease obligation when prevented or delayed "by operation of law" even if parties have contracted otherwise.

3. *Stasyszyn v. Sutton East Associates*, 555 N.Y.S.2d 297 (App. Div. 1st Dept. 1990)
   a. Residential landlord invoked operation of law defense to invalidate its obligation to renovate premises.
   b. Court granted tenant summary judgment, because landlord could not show it was unable to obtain permit for renovation.
   c. Landlord's showing that permit conditions were not economically feasible was insufficient to invoke defense.

E. Act of God

1. Act of God is defined in one federal statute as an "unanticipated grave natural disaster or other natural phenomenon of an exceptional, inevitable, and irresistible character, the effects of which could not have been prevented or avoided by the exercise of due care or foresight." - 42 U.S.C. section 9601 (CERCLA).

2. California Civil Code §1511(2): Excuses performance of a lease obligation when prevented or delayed "by an irresistible superhuman cause," ***unless*** parties have contracted otherwise

3. *Whole Foods Market v. Wical Ltd.* 2019 WL 5395739 (D.D.C. Oct. 22, 2019): rodent infestation is arguably an act of God, allowing expert testimony on the issue.

IV. Concluding Remarks – Lessons learned from latest court rulings and case precedents