



PROGRAM MATERIALS

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COVID-19 and the Commercial Landlord: Reacting to the Nonpaying Tenant in the COVID Era

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COVID-19 AND THE COMMERCIAL LANDLORD

Reacting to the Nonpaying Tenant
in the COVID Era

ABOUT US

J o s h u a W u r t z e l

- [Commercial litigator](#) with Manhattan litigation boutique [Schlam Stone & Dolan LLP](#)
- Former associate at Weil Gotshal & Manges LLP
- Schlam Stone runs the [Commercial Division Blog](#)
- Focus on aggressive representation in most cost-efficient way
- Published recent [article](#) in New York Law Journal about how landlords can deal with nonpaying commercial tenants
- Published recent [article](#) in NYSBA's NYLitigator about how commercial tenants can deal with their landlords



ABOUT US

J o n a t h a n H . G e r s t e i n

- Real-estate [transactional attorney](#) with
Manhattan boutique [Gerstein Strauss & Rinaldi](#)
[LLP](#)
- Former associate at Klehr Harrison Harvey
Branzburg LLP
- Focus on commercial leasing from landlord and
tenant side





COVID 19'S IMPACT ON COMMERCIAL LANDLORDS AND TENANTS

WORK-FROM-HOME CULTURE

- Cuomo shutdown orders caused many office workers to work from home
- Many office workers continue to work from home, and companies look to downsize office space
- The Zoom revolution
- Is the modern office place as we know it gone forever?



THE FALL OF RETAIL

- Cuomo shutdown orders temporarily closed many retail businesses, which were already suffering because of increasing preference for online shopping
- Other customer-facing business also temporarily shut (e.g., restaurants, gyms, movie theaters, art galleries)
- Retail and other customer-facing businesses continue to suffer from decreased foot traffic





A LANDLORD'S TOOLBOX

- Read the lease. Read the lease. Read the lease.
- Late charges.
- Default penalties.
- Terminate the lease and charge the tenant holdover use and occupancy.
- Sue the tenant.
- Sue the guarantor.
- Eviction, ejectment, and self help.
- Make a deal!!!





THE LANDLORD'S OBSTACLES

The background is a grayscale aerial photograph of a city with numerous skyscrapers. Overlaid on the left side is a graphic consisting of a green rectangle with a black L-shaped border. A white rectangle is positioned to the right of the green one, containing the text.

FORCE MAJEURE

MOST FORCE-MAJEURE CLAUSES DO NOT HELP TENANTS

- Most exclude payment of rent from their reach.
- Interpreted narrowly.
- Only if clause “specifically includes the event that actually prevents a party’s performance will that party be excused.” *Kel Kim Corp. v. Cent. Mkts., Inc.*, 70 N.Y.2d 900, 902–03 (1987).



BEWARE OF THE “CASUALTY” CLAUSE

- *188 Ave. A Take Out Food Corp. v. Lucky Jab Realty Corp.*, 2020 N.Y. Misc. LEXIS 10889, at *9 (Sup. Ct. N.Y. Cty. Dec. 21, 2020) (“plaintiffs have established that they are likely to succeed on their claim that the **COVID-19 epidemic, and the consequent state-mandated suspension of indoor dining at restaurants**, constituted a sudden, unexpected, unfortunate set of circumstances and, hence, a **"casualty"** within the meaning of the lease that rendered the premises unusable for a period of time, and thus **relieved the tenant of its obligation to pay rent**”).



PARTIAL ABATEMENT

- Court will ask whether tenant could use premises for any purpose
- *In re Hitz Rest. Grp.*, 616 B.R. 374, 379 (Bankr. N.D. Ill. 2020): restaurant tenant required to pay 25% of rent when it could still use 25% of space





COMMON-LAW DEFENSES

IMPOSSIBILITY

- Excuses performance when “**destruction of the subject matter of the contract or the means of performance**” by an “unanticipated event that could not have been foreseen or guarded against in the contract” makes performance “**objectively impossible.**” *Reed Found., Inc. v. Franklin D. Roosevelt Four Freedoms Park, LLC*, 108 A.D.3d 1, 7 (1st Dep’t 2013) (citation omitted).
- Doesn’t work, because “**financial disadvantage**” is “not a basis for reliance upon the impossibility of performance doctrine.” *Gen. Elec. Co. v. Metals Res. Grp. Ltd.*, 293 A.D.2d 417, 418 (1st Dep’t 2002).



FRUSTRATION OF PURPOSE

- Excuses performance when frustrated purpose is “so completely the basis of the contract that, as both parties understood, without it, the transaction would have made little sense.”
Jack Kelly Partners LLC v. Zegelstein, 140 A.D.3d 79, 85 (1st Dep’t 2016) (citation omitted).
- Has legs conceptually, but most courts have rejected it when premises not completely unusable.



DEVELOPING CASE LAW

- ***1140 Broadway LLC v. Bold Food LLC***, 2020 NYLJ LEXIS 1810, *4 (Sup. Ct. N.Y. Cty. Dec. 16, 2020) (frustration of purpose doctrine based on COVID-19 pandemic not a defense to landlord's claim for unpaid rent when "lease was for office space")
- ***35 E. 75th St. Corp. v. Christian Louboutin L.L.C.***, 2020 N.Y. Misc. LEXIS 10423, at *5 (Sup. Ct. N.Y. Cty. Dec. 9, 2020) (frustration of purpose doctrine based on COVID-19 pandemic not a defense to landlord's claim for unpaid rent when tenant operated a retail store, because "unforeseen economic forces, even the horrendous effects of a deadly virus, do not automatically permit the Court to simply rip up a contract signed between two sophisticated parties")



DEVELOPING CASE LAW (CONT.)

- ***Dr. Smood N.Y. LLC v. Orchard Hous., LLC***, 2020 N.Y. Misc. LEXIS 10087, at *6 (Sup. Ct. N.Y. Cty. Nov. 2, 2020) (New York shutdown orders did not excuse café's obligation to pay rent under frustration of purpose doctrine, since “partial frustration such as a diminution in business, where a tenant could continue to use the premises for an intended purpose, is insufficient to establish the defense as a matter of law,” and café “remain[ed] open for both counter service and pickup of orders submitted online”) (citation omitted)
- ***But see Gap, Inc. v. 170 Broadway Retail Owner, LLC***, 2020 N.Y. Misc. LEXIS 9794, at *6–7 (Sup. Ct. N.Y. Cty. Oct. 30, 2020) (retail tenant stated claims against landlord based on impossibility and frustration of purpose arising out of pandemic and shutdown orders when tenant alleged that its performance was made “objectively impossible, by an unanticipated event that could not have been foreseen or guarded against in the Lease, a credible description of the current worldwide pandemic, shutting down New York City ‘brick and mortar’ retail stores”)



THE LEASE CAN STILL SAVE YOU!

- ***Victoria's Secret Stores, LLC v. Herald Square Owner LLC***, 2021 N.Y. Misc. LEXIS 26, at *1 (Sup. Ct. N.Y. Cty. Jan. 7, 2021) (tenant is not “forgiven from its performance by virtue of a state law” when lease “allocate[d] the risk of tenant not being able to operate its business”)
- ***Backal Hosp. Grp. LLC v. 627 W. 42nd Retail LLC***, 2020 N.Y. Misc. LEXIS 4050, at *11–13 (Sup. Ct. N.Y. Cty. Aug. 3, 2020) (rejecting impossibility defense when lease “contemplated a scenario in which performance of the lease terms by plaintiffs might become prohibited by a governmental order, and agreed that, if such a situation arose, they would reach an agreement regarding the collection of rent at the conclusion of the governmental restriction”)





**LET'S (TRY TO)
MAKE A DEAL**

The background is a grayscale aerial photograph of a dense urban area with numerous skyscrapers. Overlaid on this is a graphic consisting of a green rectangle on the left and a white rectangle on the right, separated by a thick black L-shaped line. The text 'LEASE AMENDMENTS' is centered in the white rectangle.

LEASE AMENDMENTS

FAVORED BY LANDLORDS

- Difficulty finding new tenants
- Costs associated with new tenancy
 - Brokerage fees
 - Free rent
 - Work contributions
 - Landlord work costs



ARREARS PAYMENT AND FORGIVENESS

- Limit to billed but unpaid rent
- Avoid blanket release
- When possible, condition forgiveness on tenant's going forward compliance—at least for a period of time—which incentivizes tenant to pay going forward rent



ABATEMENT OF GOING FORWARD RENT

- When possible, space out and condition on tenant compliance
- This incentivizes tenant to pay going forward rent



APPLICATION OF SECURITY DEPOSIT

- If and to the extent possible, require replenishment
- Landlord replenishment acceleration right in the event of tenant non-compliance, which incentivizes tenant to pay going forward rent



DEFERRAL OF RENT

- Make clear that payment of deferred rent during the deferred-rent-payment period is in addition to tenant's rent obligations for such periods under the original lease
- Landlord acceleration right in the event of tenant non-compliance, which incentivizes tenant to pay going forward rent



EXTEND LEASE TERM

- Will lease term be extended in return for concessions



ESTOPPEL

- Underlying lease to govern representations made



CONFIDENTIALITY

- Prohibiting tenant from disclosing terms of agreement to other tenants or occupants of the building



RATIFICATION AND CONFIRMATION OF GUARANTY

- Should also include estoppel from Guarantor



LENDER CONSENT

- Whether required—often depends on terms of the amendment, whether the lease qualifies as a “major lease,” and the rental income generated by the building
- Security deposit might also need to be held in reserve with lender



BROKERS

- Importance of original brokerage agreement (e.g., commission paid up front vs. in installments over time)
- Whether installments of the commission have yet to become due
- Explore possibility of amending brokerage agreement
- Avoid payment of commission on abated rent



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SECURITY DEPOSIT APPLICATION WITHOUT AMENDMENT

FAVORED BY LANDLORDS

- No litigation required
- No lease amendment required



NOTICE AND REPLENISHMENT

- Notice to tenant often required under the lease before or after landlord applies the security
- Lease governs when must tenant replenish the applied portion of the deposit
- If lease doesn't require replenishment, then replenishment won't be required. *See 188 Ave. A Take Out Food Corp. v. Lucky Jab Realty Corp.*, 2020 N.Y. Misc. LEXIS 10889, at *12 (Sup. Ct. N.Y. Cty. Dec. 21, 2020) ("In the subject lease, there is no provision compelling the tenant to replenish a security deposit that the landlord drew down to cover allegedly unpaid rent. The plaintiffs correctly assert that such an obligation cannot be implied into the terms of the lease.")



LENDER CONSENT

- Requirement that deposit be held in reserve with the lender—check loan documents



FORM OF DEPOSIT

- Cash vs. letter of credit
- Bankruptcy ramifications



LANGUAGE IN LETTER OF CREDIT

- Draw down in accordance with lease without need to claim default
- Method of draw down (e.g., facsimile or overnight courier)
- Multiple partial drawings permitted
- Evergreen letter of credit with final expiry date at least two months after lease expiration date
- Fully transferrable with tenant to pay all transfer fees
- Issuer's obligations not conditioned on repayment
- Issuer to provide estoppel confirming letter of credit is in full force and the amount remaining available thereunder
- Issuer's financial wherewithal





WHEN PEACE TALKS BREAK DOWN



CHARGE, CHARGE, CHARGE THE TENANT

- While residential landlords may not demand or collect a “payment, fee or charge for late payment of rent” during a specified period throughout the pandemic, this restriction does not apply to commercial landlords.
- Late fees
- Interest
- Always compounded!
- Repayment of prior concessions
- Acceleration of deferrals
- Read the lease!!!

TERMINATE THE LEASE AND MAKE THE TENANT A HOLDOVER

- Confirm lease does not impose a duty to mitigate or limit tenant damages if lease terminated early
- Follow the lease to a T
- Get lender consent, if necessary
- Tenant then must choose between vacating but remaining liable for space it is not using or remaining in space and being liable for holdover use and occupancy at (usually) 150% or 200%
- Forces the tenant to come to the table
- No statutory of common-law duty to mitigate for commercial landlords, but keep eye on pending [bill](#) that would impose one





SUE THE TENANT

- Don't be afraid to sue—this is often necessary for negotiations!
- Fee shifting
- Keep an eye on pending [bill](#) to suspend rent payments for small-business commercial tenants for 90 days

SUE THE GUARANTOR

- Different types of guaranties
 - Absolute and unconditional and uncapped
 - Absolute and unconditioned but capped
 - Good-guy guaranties
 - Which obligations under the lease are covered (e.g., all rent or only fixed rent and recurring additional rent)?
 - What are the conditions to release of the guarantor (e.g., how much advance notice of surrender, whether restoration of the premises is required, and whether free rent must be repaid)?
- The devil is in the details of the guaranty and the ability of the guarantor to pay
- NYC Admin. Code 22-1005: eliminates liability for individual guarantors of certain tenants affected by shutdown orders from March 7, 2020 through March 31, 2021
 - Recently upheld against constitutional challenges. See *Melendez v. City of N.Y.*, 2020 U.S. Dist. LEXIS 222774, (S.D.N.Y. Nov. 25, 2020)





REMOVE THE TENANT

- Eviction
- Ejectment action
- Self help
 - Some caselaw allows it when done peaceably, but incredibly risky for landlord and we never advise landlords to use this

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SURRENDER AGREEMENTS

FAVORED BY LANDLORDS

- Allows landlord to get the premises back from tenant without need for eviction
- Often requires concessions





CONDITION OF THE PREMISES

- Free of liens and third-party occupancy rights

EARLY-TERMINATION FEE

- When and how paid
- Whether in addition to or in lieu of rent





SECURITY DEPOSIT

- Returned to tenant or forfeited
- If forfeited, whether in addition to or in lieu of rent

RELEASES

- Exclude third party claims, liens, and surrender agreement non-compliance





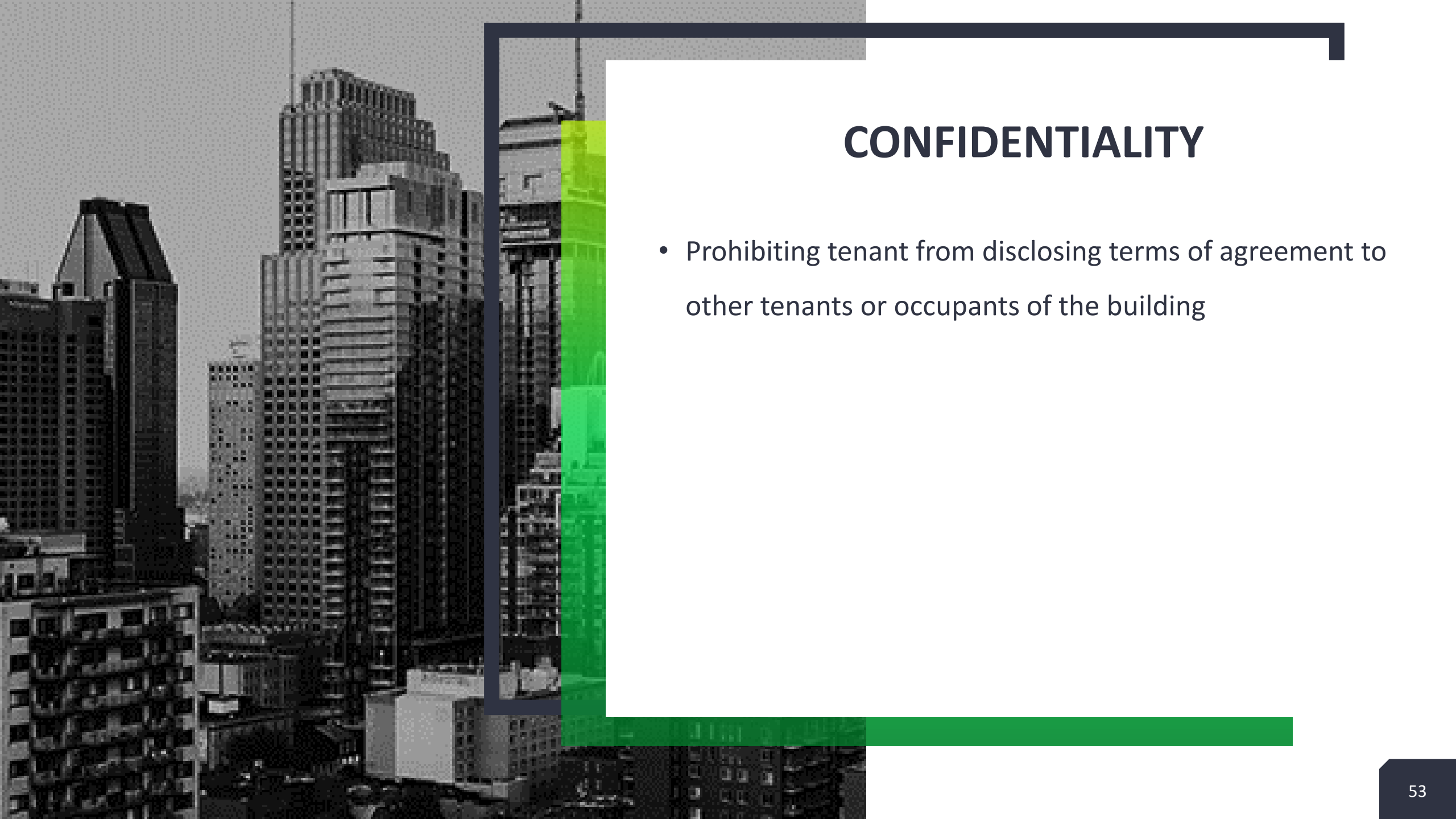
ESTOPPELS

- Underlying lease to govern representations made

HOLDOVER

- Holdover use and occupancy
- Tenant waivers in connection with holdover proceeding





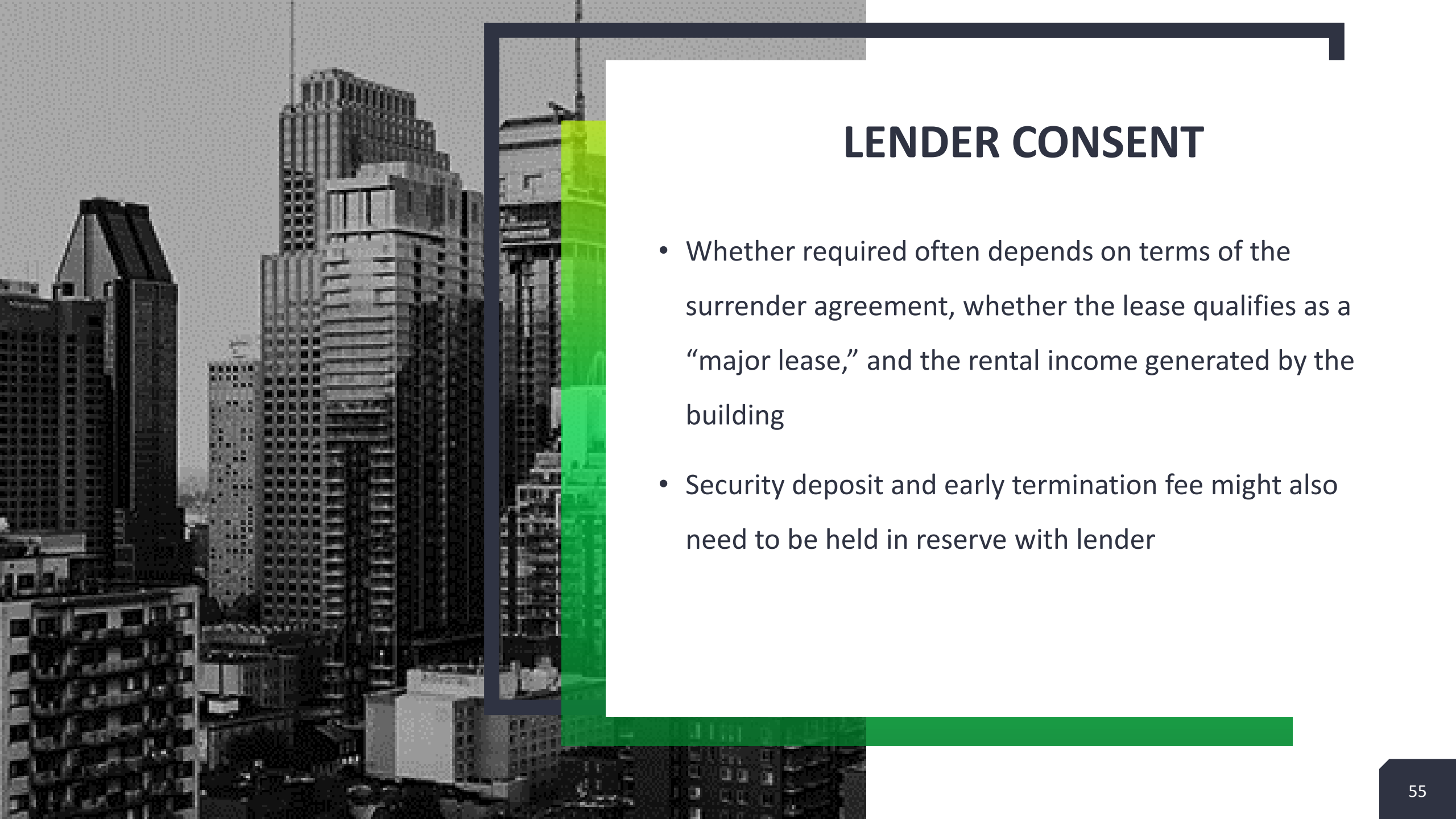
CONFIDENTIALITY

- Prohibiting tenant from disclosing terms of agreement to other tenants or occupants of the building

GUARANTOR ACCEPTANCE

- Any guarantor of the tenant's lease obligations to agree to terms of surrender agreement





LENDER CONSENT

- Whether required often depends on terms of the surrender agreement, whether the lease qualifies as a “major lease,” and the rental income generated by the building
- Security deposit and early termination fee might also need to be held in reserve with lender

BROKERS

- Importance of original brokerage agreement
- Lease terminated due to tenant default vs. in accordance with agreement of the parties
- Commission paid up front vs. in installments over time
- Whether installments of the commission have yet to become due



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PRACTICAL ADVICE

- Review lease carefully.
- Engage sophisticated counsel early on.
- Negotiate, but be ready to sue.
- Be aggressive, but know what you can and can't get.
- Keep an eye on changes in the law.



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