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NY commercial lease update: Court permits drawdown on letter of credit and rejects tenant's impossibility of performance argument

By Richard J. Shore

Due to the ongoing moratorium imposed by Governor Andrew Cuomo's Executive Order on initiation of proceedings relating to nonpayment of rent and eviction (recently extended to September 4, 2020, by Executive Order 202.55), few courts have yet tested the enforcement of commercial leases and potential defenses tenants may raise in the COVID-19 pandemic era. In this context, the recent decision in *Backal Hospitality Group, LLC v. 627 West 42nd Retail LLC*[1] is of note for such future proceedings.

In *Backal Hospitality*, the Plaintiff-Tenant filed an Order to Show Cause seeking a Temporary Restraining Order and Preliminary Injunction preventing the Defendant-Landlord's drawdown of its $500,000 letter of credit and a determination that Tenant's surrender of premises (and Tenant's return and acceptance by Landlord of the keys of the premises) constitutes a termination of the lease and any of Tenant's ongoing payment obligations.

Tenant argued that Governor Cuomo's Executive Order 202.8, which required all non-essential businesses statewide to close in-office personnel functions, prevented Tenant from operating as an event space, and thus rendered it unable to pay future rent. In support for the injunctive relief sought, Tenant argued that it is likely to succeed on the merits since its surrender of the premises, combined with Landlord's acceptance of the keys, established that Landlord allowed Tenant to terminate the lease without any penalty.

The court rejected this argument looking to the terms of the lease, which specifically required that "[n]o agreement to accept a surrender of all or any part of the [premises] shall be valid unless in writing and signed by [Landlord]" and in this case Landlord did not accept the surrender by signed writing; instead Landlord responded to Tenant's attempt at surrender with a letter stating that it "in no way agreed to terminate the [l]ease" and that it reserved all of its rights pursuant to the lease and otherwise. As such, "[d]espite the fact that [tenant] vacated the premises, it was still liable to pay its

[1] *Backal Hospitality Group, LLC v. 627 West 42nd Retail LLC*, Index No. 154141/2020 (Sup. Ct. N.Y. Cnty. August 3, 2020) (Freed, J.)

arrears, as well as other amounts due under the lease, and [landlord] was permitted by the lease to draw down the [Letter of Credit] for this purpose."

Tenant also put forward an impossibility of performance argument "that they are likely to succeed on the merits because the [Executive Order 202.8] prohibiting large gatherings of people rendered it impossible for them to perform under the lease." Landlord argued that "the novel claim of impossibility of performance, which here is only temporary" is unsupported by applicable case law or the lease.

Interestingly, the court does not speak to the jurisprudence regarding the proposed invocation of impossibility of performance; instead the court once again looked to the terms of the lease, to a provision neither party actually cited, specifically that "[i]f the [rent] shall be or become uncollectible by virtue of … governmental order… Tenant shall enter into such agreement … to permit Landlord to collect the maximum [rent] … during the continuance of such legal rent restriction [that is] legally permissible." Once the government order restricting rent collection expires, (a) the lease rent "shall become payable under this Lease … for the period following such termination, and (b) Tenant shall pay to Landlord, if legally permissible, an amount equal to (i) the [rent] which would have been paid pursuant to this Lease, but for such rent restriction, less (ii) the [rent] paid by Tenant to Landlord during the period that such rent restriction was in effect."

The Court reasoned that the above provision reflects that the 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. Although the parties attempted in vain to negotiate a lease modification, [Tenant] nevertheless attempted to unilaterally terminate the lease in a manner violative of the terms thereof."

Conclusion

Absent government legislation or other intervention, it seems likely that courts will look specifically to the negotiated lease obligations where the COVID-19 pandemic and governmental restrictions prevent a tenant's business from operating. Additional jurisprudence will be forthcoming in the months and years ahead, but if the decision in *Backal Hospitality* is any indication, courts may shy away from relying on judicially created or inferred doctrine, and will instead focus on the terms of the particular lease to govern tenant obligations.

It should be noted, however, that Tenant did not raise many potential arguments that other tenants are and will likely raise in the coming months, including but not limited to frustration of purpose, applicability of its Force Majeure provision (which provision, like most New York commercial leases, did not excuse performance of payment obligations), and/or Real Property Law § 227.

Still, both tenants and landlords would be wise to closely read the provisions in their leases, and seek experienced counsel to assist in interpreting the applicability of relevant lease provisions (as well as any applicable judicial doctrines) that may be determinative of any commercial lease dispute.

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