Frustration of Purpose in New York Commercial Lease Disputes – What We Can Learn From Past Disasters

Legal Alert
April 15, 2020

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As a result of the current COVID-19 pandemic, New York commercial landlords are already hearing from tenants claiming that, on account of an executive order from Governor Andrew Cuomo shutting non-essential businesses, they should no longer have to pay rent under their leases, at least for some time. Unless tenants can cite a provision in the lease excusing payment, which is highly unlikely in view of the universal prevalence of landlord-friendly lease formats, they will have to rely primarily on the common law "frustration of purpose" defense. As a general matter, the defense of frustration of purpose under New York law

"focuses on events which materially affect the consideration received by one party for his performance. Both parties can perform, but as a result of unforeseeable events, performance by party X would no longer give party Y what induced him to make the bargain in the first place." [1]

The doctrine excuses performance when a "virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party." [2]

The current COVID-19 pandemic is not the first time the New York courts have encountered arguments that commercial leases should not be enforced or should be terminated or rescinded, because of a man-made or natural disaster. During and after World War II, the New York courts were asked to opine on whether a host of government edicts gave rise to a frustration of purpose. The outcomes of these cases varied based on their underlying facts.

In a number of cases, the New York courts found that a government action did, indeed, provide the tenant with a defense. For example, a landlord's motion for summary judgment

was denied where a retailer contended that the government's banning of the manufacture of radios, radio equipment, electrical equipment, refrigerators and other consumer goods "destroyed the subject matter" of the lease since the tenant could no longer obtain those goods for sale. While the court noted that if the tenant can continue in the business at the premises within the confines of the lease, although not as profitably, this would amount to frustration of purpose. As a result, the court decided to grant the tenant "his day in court" to show that he could no longer conduct business because he could not obtain inventory. [3] While the text of the case does not tell us what the end result was, the court clearly implied that if the tenant was able to demonstrate at trial that he could not obtain any goods for sale on account of the government restrictions, he would prevail and the lease could be terminated. In a separate case, a 1942 act of Congress banning the sale of passenger automobiles was held to have deprived the tenant, the operator of an automobile showroom of the beneficial use of the leased premises and found the lease to have "although other incidental uses might still be made of it." [4]

In two other New York cases, the courts found the defense of frustration of purpose inapplicable. In 1942, the War Production Board (the "WPB") restricted the manufacture of pianos. Since the WPB did not restrict the sale of pianos and did not make the use of retail space to sell pianos unlawful, a court found in favor of a landlord seeking to enforce a lease against a piano dealer. [5] Another tenant claimed that the government's food rationing program made it impossible to operate a refreshment stand. There, the court found that while the volume of the tenant's business was substantially reduced, the performance of the lease was not rendered completely impossible by a governmental act. [6]

The question in all of the commercial lease cases cited above was whether the lease at issue *in toto* should be rendered unenforceable or terminated. Commercial leases of today have become much more detailed, lengthy and compartmentalized. For example, office space leases may impose escalations requiring a tenant to pay extra for sub-metered electricity. In the current environment, where the tenant has been forced to shutter its business and no longer uses electricity resulting in lower electricity use by the landlord, a tenant might argue that while the lease arguably still requires the payment of base rent, the escalation clause should not be enforced because of a frustration of purpose.

New York case law does not offer specific guidance as to whether a particular clause can be "severed" from a lease and not enforced even temporarily, on account of a frustration of purpose. The Restatement (Second) of Contracts indicates that the answer should preferably be yes. [7] A 1971 decision from New York's highest court seems to suggest that the New York Courts are free to adopt the Restatement rule. [8] Accordingly, although the New York courts have not been presented with this issue – yet – one can expect that they will be, sooner rather than later. The result should be that the clause subject to a frustration of purpose defense can be severed from an otherwise enforceable lease and declared either temporarily or permanently unenforceable.

Clients, on either side of the ledger, should be cognizant of these fact patterns. Not every cessation of business in compliance with Governor Cuomo's executive order will give rise to a frustration of purpose argument. However, that is not going to stop tenants from defending it. Our collective experience from the World War II era provides us with some guidance. We, of course, would be happy to answer any of your questions.

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[1] *United States v. Gen. Douglas MacArthur Senior Vill., Inc*., 508 F.2d 377, 381 (2d Cir.1974).

[2] *Id*.; *Aukema v. Chesapeake Appalachia, LLC*, 904 F.Supp.2d 199, 211 (N.D.N.Y. 2012).

[3] *Port Chester Central Corp. v. Leibert County Court,* 179 Misc. 839, 839–40, 39 N.Y.S.2d 41, 42 (Westchester Co. Ct. 1943).

[4] *Colonial Operating Corporation v. Hannan Sales & Service, Inc*., 178 Misc. 885, 36 N.Y.S.2d 745 (2d Dep't 1942).

[5] *Mutual Life Insurance Co. of New York v. Lester Pianos*, 180 Misc. 669, 42 N.Y.S.2d 350 (Sup. Ct. New York Co. 1943)

[6] *Fisher v. Lohse*, 181 Misc. 149, 42 N.Y.S.2d 121 (Sup. Ct. Queens Co. 1949)

[7] Restatement (Second) of Contracts §§ 269, 270 (1981)

[8] *Nash v. Bd. of Ed., Union Free Sch. Dist. No. 13, Town of Islip*, 38 N.Y.2d 686, 688, 345 N. E.2d 575, 576 (1976); *See In re Food Mgmt. Grp., LLC*, 372 B.R. 171, 208 (Bankr. S.D.N.Y. 2007).