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Mind the Gap: No Rent Relief for The Gap in New York

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In one of the latest and most high-profile decisions from across the country relating to commercial tenants' rent obligations during the COVID-19 pandemic, the United States District Court for the Southern District of New York rejected an attempt by The Gap, Inc. ("Gap") to excuse payment of such obligations due to the pandemic and related government restrictions.

While the COVID-19 pandemic and government orders preventing business operations have prompted numerous retailers and restaurants to seek bankruptcy protection, other companies have avoided such an action by (at least in part) withholding rent payments. Gap quickly made the decision in April 2020 to suspend payment of rent for all of its North American stores, including its Gap and Banana Republic-branded stores located at the corner of 59th Street and Lexington Avenue in New York City.

Gap had been a tenant at the property since 2005 and its lease term was set to expire on January 31, 2021. The stores at the property were initially closed altogether by government order, but were later reopened to offer curbside pickup and to fulfill online orders. Unlike its other New York City locations, however, Gap did not reopen these stores at limited capacity for business reasons.

Gap thereafter brought a lawsuit against its landlord, Ponte Gadea New York LLC ("Landlord"), in which it contended that the closure of its stores at the property due to the pandemic warranted release from the payment of its rental obligations after March 19, 2020. The court rejected each of Gap's arguments and granted judgment in favor of Landlord, largely based on the strength of the lease's force majeure clause.

The Force Majeure Clause

The application of force majeure clauses in light of the COVID-19 pandemic has become a significant topic of discussion as it has become clear that parties need to properly define such events in order to prevent disputes concerning existing obligations following the occurrence of an unforeseen event. Here, the lease defined a "Force Majeure Event" to mean "a strike or other labor trouble, fire or other casualty, ***governmental preemption of priorities or other controls in connection with a national or other public emergency*** or shortages of fuel, supplies, or labor resulting therefrom, or any other cause beyond Tenant's reasonable control" (emphasis added). The clause was silent on whether the payment of rent could be excused following the occurrence of a Force Majeure

Event, but context imputed from the only reference to this clause in the lease helped lead the court to the conclusion that rent is indeed not excused by a Force Majeure Event. The lease's only use of the term "Force Majeure Event" was in the default provision, which provided that a non-monetary default could excused if the default "cannot be remedied by reasonable diligence during such period of thirty (30) days (including by reason of the occurrence of a Force Majeure Event)." Since the default provision explicitly excluded monetary defaults being excused because of a Force Majeure Event, the court held that a Force Majeure Event did not apply to rent payments. Following the ruling in this case, as will be discussed below, it is easy to see how a landlord's proper drafting of a force majeure clause can be a critical component to potentially avoiding significant losses in the future.

Gap's Rejected Arguments

In its lawsuit, Gap pursued five arguments as to why it should not be held responsible for the payment of accrued rent during the COVID-19 pandemic. The court used both historical precedent and the Force Majeure Event clause as a sword to dismiss all of Gap's equitable claims:

- Casualty: Gap asserted that the pandemic should be treated as a "casualty" rendering the entirety of the property unusable and that such provisions related to rent abatement should govern. The court had little trouble finding that the COVID-19 pandemic did not fit within the definition of casualty, which is an event typically related to a fire or other damage or destruction of the building itself. As the court pointed out, unlike other casualty events, there was no way for the Landlord to "remedy" the damage caused by the pandemic. Attempting to rely on such language to excuse the payment of rent would pervert the intention of such lease clauses.

- Frustration of Purpose: Under the frustration of purpose doctrine, a party is excused from performance of its contractual obligations where a "wholly unforeseeable event renders the contract valueless to one party." The court held that the doctrine did not apply because the pandemic (or at least its effects) was *not wholly* unforeseeable. Indeed, the force majeure clause was defined to include "governmental preemption of priorities or other controls in connection with a ***national or other public emergency***," of which a pandemic certainly falls within. Most importantly, however, the court held that the doctrine did not apply because the pandemic and government restrictions did not make the lease valueless. In fact, Gap operated the stores for curbside pickup and simply chose not to reopen the stores at limited capacity as it did at other locations in New York City. Such choices by a tenant should not allow it to escape its rental obligations.

- Impossibility/Impracticability: In a related equitable doctrine argument, Gap contended that the pandemic rendered its performance under the lease impossible or impracticable. Under New York law, impossibility/impracticability is a defense "only when performance is rendered objectively impossible by an unanticipated event that could not have been foreseen or guarded against in the contract." The court rejected these arguments because, once again, the force majeure clause demonstrated that the parties had already anticipated the possibility of a pandemic by describing a national emergency. Furthermore, performance was

not rendered impossible as Gap elected to operate a retail business at the property—albeit to a much less profitable extent.

- Failure of Consideration: Gap next asserted that a "failure of consideration," i.e. that it did not receive a benefit from the lease, had occurred as a result of the pandemic. This argument was quickly rejected on the basis that Gap continued to receive a significant and tangible benefit under the lease – use of the property during the pandemic. Even if the pandemic had led to a partial failure of consideration, the court held that such logic would not be a basis for full rescission of the lease.

- Mutual Mistake: Lastly, the court rejected Gap's argument that there was a mutual mistake under the lease on the basis that the parties failed to foresee and address the possibility of a pandemic. Under New York's "mutual mistake" doctrine, a successful litigant must show that "the parties have reached an oral agreement and, unknown to either, the signed writing does not express that agreement." Significantly, the doctrine does not apply to situations in which one party's prediction or judgment as to the future is erroneous. The court held that just because Gap had mistaken assumptions about the future, such assumptions did not amount to a mutual mistake warranting rescission of the lease.

Takeaways

The decision in favor of the Landlord on all of Gap's claims provides several lessons for commercial landlords and tenants as these types of disputes continue to play out in the courts:[1]

First, the language of force majeure clauses matter: Here, the lease's force majeure clause included specific language referencing "national or public emergencies," which was significant to the court's finding that the parties contemplated events such as the COVID-19 pandemic even if the lease did not refer specifically to "pandemics." Undoubtedly, commercial landlords and tenants will seek to specifically address the possibility of pandemics in future leases, but revising force majeure clauses to contain broader language, such as a "national or public emergency," will be critical in narrowing the ability of tenants like Gap to employ many of the arguments it attempted.

Additionally, the Gap case is a further reminder that impossibility truly means impossibility as courts continue to reject frustration of purpose and impossibility arguments where the tenant has the ability to operate its business—even if those operations are at a significantly reduced capacity. Simply because a lease becomes less profitable for a tenant due to an event such as the COVID-19 pandemic does not mean that it is impossible for a tenant to perform.

[1] These lessons may apply to commercial tenants in bankruptcy as well, as bankruptcy courts in the Cinemex and Chuck E. Cheese bankruptcies reached similar conclusions. Still bankruptcy courts may also be more willing to craft rulings that offer at least some rent relief, such as extensions to pay rent or partial rent abatements, as in the Pier 1 and Hitz Restaurant Group bankruptcies.

As a result, it cannot thereafter attempt to receive complete forgiveness of rent. Tenants should generally not expect to prevail on these arguments unless government restrictions force them to cease operations entirely.

Lastly, as with all litigation, resolution of commercial rent disputes is time consuming and expensive. The court here issued its decision on summary judgment and avoided a trial, but it still took nearly a year following the beginning of the pandemic for the Landlord to obtain a favorable ruling. Even though other landlords may look to this decision for leverage in rent relief negotiations, there are still significant incentives for both landlords and tenants to reach a consensual resolution regarding the payment of rent that has accrued during the pandemic.

Buchalter is committed to helping our clients assess their rights with respect to COVID-19 and stands ready to assist in navigating these uncharted waters.

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