

## Landlord and Tenant Rights and Remedies after Default (Commercial Lease) (NY)

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(Agreement for Early Termination)**

*Current as of: 03/03/2020*

This practice note discusses default and remedy provisions that are commonly included in commercial leases in New York focusing on office, retail, and industrial leases. This note also addresses recent changes to the law pursuant to New York's Housing Stability and Tenant Protection Act of 2019 (2019 Act), bankruptcy provisions in commercial leases, and early lease termination via use of a voluntary surrender agreement. Specialized leases involving leasehold mortgages and ground leases vary widely and usually include complex, deal-specific provisions, and requirements. This practice note does not address the unique situations these leases present, but instead concentrates on the defaults, remedies, and defenses that often arise in commercial lease disputes, through the lens of New York law.

For further guidance on negotiating commercial leases, see Commercial Real Estate Leasing (NY), Office Lease Agreement, Retail Lease Agreements, and Industrial Lease Agreements. For commercial lease forms, see Office Lease Agreement (Short Form) (NY), Office Lease (NY), Retail Lease Agreement (Long Form) (NY), Residential Lease Agreements (NY), and Retail Lease Agreement (Short Form) (Pro-Landlord) (NY). See 4 NY Practice Guide: Real Estate §§ 27.01–27.04 for information on rights and liabilities of landlords and tenants in commercial leases in New York.

### Importance of Lease Terms

In New York, commercial leases are governed by the same rules that apply to contract interpretation generally and by statute, including N.Y. Real Prop. Acts. Law § 101 et seq. and N.Y. Gen. Oblig. Law §§ 7-101–7-109. See *Hertzog, Calamari & Gleason v. Prudential Ins. Co. of Am.*, 933 F. Supp. 246 (S.D.N.Y. 1996). Courts generally use the express intention of the parties as the primary consideration in interpreting lease terms. Commercial tenants are afforded far fewer protections under the law than tenants in residential leasing transactions. In New York, many lease terms in a commercial context can be negotiated depending upon the bargaining power of the parties and the landlord's rights and remedies can be extensive and detailed. Thus, it is imperative that counsel for each party carefully consider and negotiate the lease, which will, for the most part, contain all their respective rights and remedies. For more on the rules of construction and interpretation of leases, see 3A NY Practice Guide: Real Estate § 25.03.

### Tenant Defaults

What constitutes a tenant default under the terms of a well-negotiated lease in New York should be set forth clearly in the lease and generally consists of monetary and nonmonetary defaults. The notice and cure rights that are provided to the landlord are an important component of these default provisions.

#### ***Monetary vs. Nonmonetary Defaults***

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Monetary defaults result from the tenant's failure to timely pay amounts owed under the lease. These amounts include not only base rent but also additional rent, percentage rent (common in retail leases), and common area maintenance fees. Most tenant defaults are monetary defaults.

A nonmonetary default is any default under the terms of the lease other than a monetary default. Common nonmonetary defaults include the failure of the tenant to take possession, holding over, failure to maintain operating hours, destruction of the landlord's property, and the breach of a covenant or rule set forth in the lease.

### ***Notice and Cure Rights and Obligations***

Historically, commercial tenants in New York have not had a statutory right to notice of a lease default. Likewise, there is no general obligation imposed on the landlord to provide a commercial tenant with the right to cure a default. That said, a revision N.Y. Real Prop. Law § 235-e(d) brought about by the 2019 Act states that any "lessor" that does not receive payment of rent within five days of the date specified in the lease agreement must send the tenant, by certified mail, a written notice stating that the landlord has not received payment. If a landlord fails to send this notice prior to commencing a proceeding based upon the failure to pay rent, the tenant can raise the omission as an affirmative defense. This subsection does not specifically indicate that it is limited to residential tenancies. However, when considered fully, N.Y. Real Prop. Law § 235-e appears to deal exclusively with residential tenancies and it seems unlikely that the notice requirement was intended to apply to commercial tenancies. Even so, some commentators have suggested that until this ambiguity is addressed, the best practice is for a commercial landlord to send a notice by certified mail when a tenant fails to pay rent within five days of its due date.

In addition, commercial leases in New York generally include some requirement that the landlord provide the tenant with notice of default and the opportunity to cure. For monetary defaults, a 5 to 10-day cure period following notice is common (often, this right is limited to one occurrence per 12-month period). For nonmonetary defaults, cure periods are often set at 30 days following notice. Counsel for both the landlord and the tenant should take care to fully negotiate both notice and cure rights and obligations and clearly set out these terms in the lease.

### ***Extension of Cure Period for Nonmonetary Default (Yellowstone Injunction)***

Since 1968, a commercial tenant in New York who has received a notice of nonmonetary default has benefitted from a unique tool commonly referred to as a "Yellowstone injunction." However, a 2019 ruling by the New York Court of Appeals, has thrown the future viability of Yellowstone injunctions into doubt.

A Yellowstone injunction allows a commercial tenant who has been served with a notice to cure an alleged lease default to toll the period for curing the default while seeking a declaratory judgment on the question of whether a default exists. Even if the tenant receives an adverse decision on the merits, the cure period remains tolled so the tenant can later cure the default and avoid losing its lease. *First Nat'l Stores, Inc. v. Yellowstone Shopping Ctr., Inc.*, 290 N.Y.S.2d 721 (1968).

To obtain the injunction, the tenant must show that:

- It holds a valuable commercial lease.
- It has received a notice of default, notice to cure, or concrete threat of termination of the lease from the landlord.
- It requested injunctive relief prior to the termination of the lease.—and—
- It is ready and willing to cure the alleged default, by any means short of vacating the premise, if it is ultimately determined that the tenant is in default.

In *159 MP Corp. v. Redbridge Bedford, LLC*, the New York Court of Appeals ruled that a commercial tenant waives the right to seek a Yellowstone injunction if its lease contains a specific waiver of the right to bring a declaratory judgment action. 33 N.Y.3d 353 (2019). Assuming that most landlords have the leverage to include a waiver of declaratory judgment in their leases, the Yellowstone injunction will no longer be widely available to commercial

tenants. This will make it harder for tenants to save their leases if the landlord attempts to recapture the space for a lease infraction, even one that is trivial or technical. A tenant may now have to choose between curing the default within the required time period, even if the tenant has legitimate grounds to contest the default and the cost to cure is very high or taking its chances by letting the cure period expire and hoping it can prevail in a summary process proceeding.

## **Landlord Remedies**

The remedies available to a landlord following the tenant's default are typically determined by the terms of the lease. These remedies must be enforced in accordance with New York law. Beyond looking to the tenant's security deposit and any lease guarantors, the use of a summary proceeding to obtain possession of the leased premises is the most commonly used remedy in New York.

### ***Use of Security Deposit***

Most commercial leases in New York require the tenant to deposit funds with the landlord or provide a letter of credit as security for its performance under lease. The lease's treatment of the security deposit is open to negotiation, but, generally, the security deposit can be used as follows:

- **As an interim remedy for nonmaterial breaches.** If a default does not rise to a level that prompts the landlord to terminate the lease or when recovery of a relatively small amount of money does not justify the cost of litigation, the landlord may cure the default by using the security deposit. If the security deposit is used for this purpose during the term, most leases require the tenant to restore the security deposit to its previous amount after written demand by the landlord.
- **As liquidated damages.** If the lease provides, in circumstances when the actual damages are difficult to measure, the landlord may retain the entire security deposit as its sole remedy upon a tenant default. However, such a clause may be held invalid as a penalty if the damages are easy to ascertain or the security deposit has been treated as an advance payment of rent at the end of the term.
- **At end of term.** Most commercial leases provide that the landlord may also use the security deposit to correct unfulfilled conditions or obligations at the end of the lease term after the tenant has vacated the premises. In this case, leases usually provide that any unused portion of the security deposit be returned to the tenant.

For more on security deposits, see Commercial Real Estate Leasing (NY) and the relevant sections in Office Lease Agreements, Residential Lease Agreements, and Industrial Lease Agreements. See also Current Leasing Law and Techniques—Forms § 3D.29 and 31 Current Legal Forms with Tax Analysis § 23.29 (6).

### ***Enforcement of Guaranty***

Whether or not a guaranty is required in a lease transaction is a negotiated business term that typically depends on the financial strength of the tenant. If there is a lease guaranty, the landlord may pursue enforcement according to its terms, which commonly include the right to join the guarantor(s) in a legal action against a tenant after default, subject to the limitations of the guaranty.

If the guaranty is limited to the payment of rent, the landlord may use N.Y. C.P.L.R. Law § 3213 to file an immediate motion for summary judgment instead of a complaint. *Royal Equities Operating, LLC v. Rubin*, 62 N.Y.S.3d 337 (App. Div. 2017). This procedure can allow the landlord to avoid a lengthy and costly trial. However, N.Y. C.P.L.R. Law § 3213 may only be used in an action based “upon an instrument for the payment of money only.” Thus, it cannot be used when the guaranty extends to the performance of other lease covenants and obligations. *Times Square Assocs. v. Grayson*, 333 N.Y.S.2d 155 (App. Div. 1972). When permitted under the lease, Section 3213 can be used to collect accelerated rent from a guarantor. See *Royal Equities Operating, LLC v. Rubin*, 62 N.Y.S.3d 337 (App. Div. 2017).

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For more on commercial lease guaranties, see Good Guy Guaranties (NY), Guaranty of an Office Lease Agreement, Guaranty of a Retail Lease Agreement, and Guaranty of an Industrial Lease Agreement.

For forms, see Guaranty of an Industrial Lease Agreement; Guaranty of an Office Lease Agreement; Guaranty of a Retail Lease Agreement; Guaranty (Personal Guaranty, Retail Lease); Limited Guaranty of Lease (Retail Lease); and Guaranty (Guaranty by Corporation, Retail Lease).

### ***Summary Proceeding to Recover Possession***

Summary proceedings aim to provide landlords in New York with a streamlined process for obtaining possession of leased premises following a tenant default. This process is set forth in Article 7 of the N.Y. Real Prop. Acts. Law.

#### *Jurisdiction*

Although summary proceedings may be brought in either supreme court or civil court, they are almost always brought in civil court because the process is much faster there. Where the only issues involved are the rights of the parties to possession of the premises and claims for rent (or abatement of rent), the civil court will have full jurisdiction. Where rent is sought within the context of a summary proceeding, there is no maximum limit as to the amount in controversy and the normal \$25,000 limit does not apply. NY CLS UDCA § 204; NY CLS NYC Civil Ct Act § 204. The parties should not use the supreme court unless the civil court (by reason of its limited equitable jurisdiction) cannot grant appropriate relief.

When a landlord has brought, or is about to bring, a summary proceeding in civil court, the tenant frequently brings an action in supreme court seeking either an injunction against the prosecution of a summary proceeding or consolidation of the civil court and supreme court actions. Consolidation, however, is not permitted unless it can be shown that the civil court cannot afford complete relief between the parties. *Lun Far Co. v. Aylesbury*, 338 N.Y.S.2d 84 (1st Dept. 1972). That said, the supreme court is the proper forum when a tenant seeks a Yellowstone injunction and some landlords in this situation prefer to counterclaim with an ejectment action rather than bring a new action in civil court to pursue a summary proceeding.

#### *Grounds for Summary Proceeding*

A landlord may bring a summary process proceeding under the following circumstances:

- The tenant holds over (this includes both a holdover following the expiration of the lease term and the termination of the lease by the landlord for a nonmonetary default).
- The tenant defaults in the payment of rent pursuant to the lease terms and either a demand has been made for rent or a 14-day written notice requiring the possession of the premises has been served.
- If required to do so in the lease, the tenant in a city fails to pay taxes or assessments for more than 60 days after they become due and payable and a three-day written notice (requiring either the payment thereof (with interest and penalty) or the possession of the premises) has been served.
- Under a lease for a term of three years or less, the tenant takes the benefit of an insolvency statute or has been adjudicated a bankrupt.
- The premises are used or occupied for illegal business.
- The tenant, in a city having a population of one million or more, disables an installed smoke or fire detector without permission.

N.Y. Real Prop. Acts. Law § 711.

Most summary proceedings based on Section 711 in commercial tenancies are holdover and nonpayment proceedings. These proceedings are discussed in detail below.

#### Holdover Proceedings

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A tenant becomes a holdover tenant when it remains in occupancy of the leased premises after (1) expiration or termination of the lease pursuant to its terms or (2) termination of the lease by the landlord due to a default. The landlord must be careful not to convert a holdover tenant into a tenant at will by taking actions that may be seen as acquiescing to the tenant's holdover (such as accepting the payment of rent). N.Y. Real Prop. Acts Law § 232-c. Note that if the tenant is deemed a month-to-month tenant, the tenancy must be terminated pursuant to N.Y. Real Prop. Law § 232-a (if the premises are in New York City) or N.Y. Real Prop. Law § 232-b (if the premises are outside of New York City). For sample termination notices, see Notice to Terminate Month-to Month Tenancy (New York City) and Notice to Terminate Month-to Month Tenancy (Commercial Tenancy) (NY - Outside New York City).

### Nonpayment Proceedings

N.Y. Real Prop. Acts. Law § 711(2) provides that a nonpayment proceeding may be maintained when the tenant has defaulted in the payment of rent. In a nonpayment proceeding, the landlord typically seeks both the recovery of rent owed and possession of the premises.

#### *Notice Requirements for Summary Proceeding*

In a nonpayment proceeding, the landlord must give 14 days' written notice before bringing a summary proceeding. N.Y. Real Prop. Acts. Law § 711(2). (The 2019 Law increased the required notice from 3 to 14 days.) For a sample notice, see 14-day Demand for Payment of Rent or Possession (Eviction) (NY).

In a commercial holdover proceeding where there has been no conduct that would create a month-to-month tenancy or give rise to a right of further occupancy, no notice (beyond what may be required under the lease) is necessary before bringing an action.

The statutory timelines prevail over conflicting lease terms unless the lease default and notice provisions specifically enumerate a notice requirement for a summary proceeding. See *Retail Prop. Tr. v. Charles David of Cal.*, 977 N.Y.S.2d 670 (Dist. Ct. 2013). However, there are exceptions to this rule. For example, where the lease expressly stated that the service of a notice is required before the commencement of "any proceeding," the court found that the provision served to lengthen the statutory time period. *Hendrickson v. Lexington Oil Co.*, 340 N.Y.S.2d 963 (App. Div. 1973).

#### *Commencement of Summary Proceeding*

After all required notices are given, the landlord may begin the summary proceeding by serving a notice of petition (similar to a summons) and a petition (similar to a complaint) on the tenant. The notice may be issued by a judge, clerk of court, or attorney, except that in New York City, it may not be issued by an attorney. N.Y. Real Prop. Acts. Law § 701; NY CLS NYC Civil Ct Act § 401.

N.Y. Real Prop. Acts. Law § 741 requires the petition to be verified and contain the following minimum information:

- The name(s) of the parties and their respective interests (landlord/tenant)
- A description of the premises
- A description of facts on which the proceeding is based (i.e., rent arrears and periods or holdover)—and—
- The relief sought

The notice of petition must specify the time and place of the hearing on the petition. If the proceeding is for nonpayment of rent, Section 732 requires that the notice of petition be returnable before the clerk within 10 days after its service. (Note that prior to enactment of the 2019 Law, the tenant had only five days to answer.)

If the tenant answers, the clerk will fix a date for a hearing within no less than three and no more than eight days. If the tenant does not answer within the days, the judge will enter a judgment for the landlord. If the tenant answers, the matter will proceed to trial. N.Y. Real Prop. Acts. Law § 732. In a nonpayment proceeding, the tenant's answer may contain any legal or equitable defense as well as counterclaims. N.Y. Real Prop. Acts. Law § 743. However, lease waivers of counterclaims in a summary proceeding are enforceable. *Chemical Bank New York Trust Co. v.*

Batter, 31 A.D.2d 802, 297 N.Y.S.2d 363 (1st Dept. 1969). Likewise, a provision in a lease waiving in advance a jury trial in the event of litigation between the landlord and tenant is enforceable. *Waterside Holding Corp. v. Lask*, 253 N.Y.S. 183 (App. Div. 1931).

### ***Suit for Collection of Rent***

Most landlords that bring a summary nonpayment proceeding also seek past due rent and civil court is the preferred court for landlord-tenant disputes. However, landlords also have the option to collect past due rent through a suit based on breach of contract without going through the eviction process. This is a plenary action brought in supreme court. Discovery is permitted and the tenant may assert defenses and bring counterclaims, and such an action can take much longer than seeking rent in conjunction with a summary proceeding. For further guidance, see 4 NY Practice Guide: Real Estate § 31.02.

Counsel for the landlord should ensure that the lease includes a provision giving the landlord the right to (1) recover all rent and other sums up to the time of termination (or recovery of possession); (2) recover the cost of improvements made by landlord in connection with the lease; and (3) recapture of brokerage commissions, rent abatement, and/or concessions paid in conjunction with the lease.

### ***Accelerated Rent***

The landlord will want the lease to include a provision allowing the landlord to collect an amount equal to the balance of the rent for the term as damages (known as rent acceleration). Rent acceleration is a contract remedy based on anticipatory breach of the lease by the tenant's failure to pay future installments of rent. In general, when a tenant is removed from the premises, the landlord-tenant relationship "ceases and the landlord may not recover from the tenant, *as rent*, subsequent installments thereof for which the lease provides." *Int'l Publ'ns, Inc. v. Matchabelli*, 184 N.E. 51 (N.Y. 1933). However, this does not prevent the landlord and tenant from contracting as they please; therefore, if the lease provides that the obligation to pay rent survives the landlord's reentry onto the premises upon the tenant's default, the landlord may bring a suit to recover accelerated rent. *Id.*

If possible, the tenant should negotiate to limit the landlord's ability to accelerate rent under the lease. Common limitations include:

- Longer cure periods
- Acceleration limited to (1) demanding full rent upon default or (2) requiring the tenant to meet ongoing obligations
- Mitigation of damages requirement for the landlord
- Reduction of accelerated rent to present value (i.e., discount the aggregate amount by a negotiated percentage)
- Offset of accelerated rent by the amount of any rents the landlord receives from a replacement tenant

If the landlord agrees to any limitations on its ability to accelerate rent, it may require one or more of the following: (1) a larger security deposit, (2) a personal guaranty, and/or (3) a reduction of any tenant offset for rents received from a replacement tenant by the amount paid by the landlord to obtain the new tenant.

For more on rent recovery and rent acceleration in New York, see 7 Warren's *Weed New York Real Property* § 84.05.

### ***Landlord's Duty to Mitigate Damages***

In New York, a commercial real estate landlord has no duty to mitigate its damages. If a tenant under a commercial lease abandons the premises before expiration of the lease, the landlord has the option to do nothing, leaving the tenant responsible for the full rent due under the lease, or it may accept the tenant's surrender and reenter the premises to relet the space directly, or it may notify the tenant that it is entering and reletting the premises for the

tenant's benefit with the tenant to remain on the hook for the duration of its lease term. *Holy Properties Ltd., L.P. v. Kenneth Cole Prods.*, 87 N.Y.2d 130 (1995). See also *Wienecke v. Evans*, 841 N.Y.S.2d 222 (Justice Ct. 2007).

### ***Other Landlord Remedies***

#### ***Action in Ejectment***

Prior to the enactment of the summary process statute, a landlord that wished to remove a defaulting tenant needed to bring a common-law action to recover real property (formerly known as an action in ejectment). This remedy is governed by Article 6 of the N.Y. Real Prop. Acts. Law and is still available; however, because it takes much longer, it is rarely used unless a summary process action is not available. See N.Y. Real Prop. Acts. Law § 601 et seq. and 12 Warren's *Weed New York Real Property* § 129.05.

#### ***Self-Help Evictions***

In New York, a landlord may use the remedy of peaceable reentry to regain possession of the leased premise in certain, very limited circumstances that meet the following four requirements:

- The lease reserves the landlord's right to reenter and regain possession of the premises upon the tenant's default for nonpayment of rent.
- The landlord serves a demand for an approximate sum of rent owed on the tenant.
- The tenant is in default of its obligation to pay rent.—and—
- The entry does not breach the peace.

Although this remedy is available to commercial landlords, its use is not recommended in most cases because it may subject the landlord to liability as well as treble damages. See N.Y. Real Prop. Acts. Law § 853 and *N. Main St. Bagel Corp. v. Duncan*, 775 N.Y.S.2d 362 (App. Div. 2004). Given the simplicity and speed of the statutory summary proceeding scheme, counsel for landlords should advise their clients to avoid self-help evictions.

### ***Abandoned Personal Property***

Following a tenant default and lease termination, it is common for a tenant to leave property behind when it vacates the premises. New York does not have a statute that regulates the way landlords must handle personal property left behind by a tenant. As an initial matter, the landlord should secure legal possession of the premises before disposing of the tenant's property. The landlord should then determine whether any of the tenant's personal property is a fixture (meaning it becomes part of the realty after annexation and thus the property of the landlord). See 7 Warren's *Weed New York Real Property* § 82.08 for more information on determining whether the tenant's property can be considered to be a fixture. Given the absence of statutory guidelines for abandoned property in New York, landlord's counsel should include provisions in the lease detailing what happens if the tenant leaves personal property behind when it vacates the premises.

### **Tenant Defenses**

Depending on its bargaining power, it may be difficult to negotiate provisions in a lease that provide viable defenses in response to the enforcement of remedies by the landlord. The defenses discussed below may be available in a summary proceeding.

#### ***Actual Eviction***

An actual eviction involves the wrongful physical expulsion of the tenant from the premises and can occur when the tenant is physically unable to enter the premises, or the owner changes the locks or padlocks the door. *Fifth Ave. Bldg. Co. v. Kernochan*, 117 N.E. 579 (1917); *Barash v. Pa. Terminal Real Estate Corp.*, 256 N.E.2d 707 (1970). The tenant may claim an actual partial eviction as a defense if the tenant is denied use of a portion of the premises or of a right or service that was necessary for the tenant's use of the premises. For example, in *Union City Union*

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Suit Co. v. Miller, 556 N.Y.S.2d 864 (App. Div. 1990), the tenant was denied the use of elevator service for its textile business, in effect creating a partial actual eviction. For years, the recognized rule in New York was that the entire rent is abated when an actual partial eviction exists (see Fifth Ave. Bldg. Co. v. Kernochan, 117 N.E. 579 (1917)). In 2012, the Court of Appeals recognized an exception to this rule when the impact on the tenant's use and enjoyment of the premises is "de minimis." Eastside Exhibition Corp. v. 210 E. 86th St. Corp., N.E.2d 246, 249 (2012).

The tenant does not need to vacate the premises to raise actual partial eviction as a defense (although the tenant that remains in possession cannot bring an action for damages). Broadway-Spring Street Corp. v. Jack Berens Export Corp., 171 N.Y.S.2d 342 (N.Y. Mun. Ct. 1958).

### ***Constructive Eviction***

A tenant may claim constructive eviction where the landlord's failure to maintain the premises has resulted in the premises being untenable. Constructive eviction is similar to a violation of the warranty of habitability (which is not available in a commercial context). The constructive eviction defense often involves a claim that deficient conditions in and services to the premises substantially interfere with the tenant's use of the premises. See Manhattan Mansions v. Moe's Pizza, 561 N.Y.S.2d 331 (Civ. Ct. 1990).

The tenant is required to abandon the premises to claim constructive eviction as a defense. However, some courts have adopted the concept of a partial constructive eviction to circumvent this rule when a tenant raises constructive eviction as a defense in a rent proceeding. See Bet Constr. Corp. v. New York, 410 N.Y.S.2d 524 (Sup. Ct. 1978). The tenant must abandon the portion of the premises for which the partial constructive eviction is claimed. *Id.* Note that a claim of partial constructive eviction is only available as a defense in a rent proceeding brought by the landlord rather than in an action brought by the tenant. Elkman v. Southgate Owners Corp., 649 N.Y.S.2d 138 (App. Div. 1996); Minjak Co. v. Randolph, 528 N.Y.S.2d 554 (App. Div. 1988).

For more on the use of the defense of constructive eviction, see 4 NY Practice Guide: Real Estate § 27.02.

### ***Landlord's Acceptance of Rent or Other Delay in Enforcing Rights and Remedies***

Payment is a defense in a nonpayment proceeding, as is a written waiver by the landlord of the right to collect by means of a nonpayment proceeding or otherwise. N.Y. Real Prop. Acts. Law § 711(2). Acceptance of rent after service of a notice to cure and before commencement of a holdover summary proceeding can constitute a waiver. B.G. Smith Real Estate v. Byrne, 112 N.Y.S.2d 893 (App. Term 1st Dept. 1952). Likewise, acceptance of all rent owed after judgment and before execution of the warrant can avoid eviction. Walker v. Ribotsky, 275 A.D. 112, 88 N.Y.S.2d 207 (1st Dept. 1949).

Nonwaiver clauses in commercial leases are enforceable. Jefpaul Garage Corp. v. Presbyterian Hosp. in N.Y., 474 N.Y.S.2d 458, 462 N.E.2d 1176 (1984). If the lease is silent, however, a classic tenant defense in an eviction action is that the landlord's acts or omissions created a waiver of the default. The landlord should include the following provisions to protect itself from this tenant defense:

- No delay in the enforcement of any right or remedy will constitute a waiver of a tenant default or any of the landlord's rights and remedies.
- Receipt of partial payment will not affect the landlord's right to pursue remedies such as eviction or to recover the balance of the rent.
- No endorsements on a tenant rent check, such as paid in full, will be an accord and satisfaction if the landlord cashes it.
- Reentry by the landlord is not considered to be an acceptance of surrender of the lease or release the tenant of its obligations under the lease.
- The tenant will be considered to have vacated the premises under the following circumstances (e.g., shutting off utilities, failure to continuously operate, etc.).



### **Common Landlord Defaults**

The lease terms dictate what constitutes a default by the landlord and, if the tenant had a strong negotiating position, any resulting tenant remedies. At a minimum, the tenant should attempt to include lease provisions that cause the landlord to be in default if it fails to:

- Deliver the premises at lease commencement
- Enforce any exclusive use provisions granted to the tenant
- Provide the promised services or amenities
- Repair, replace, or maintain common areas not under the tenant's control
- Provide or maintain services such as utilities, if required by the lease
- Comply with the Americans with Disabilities Act
- Allow full use and quiet enjoyment of the leased property

In addition, counsel for the tenant should attempt to negotiate provisions granting the tenant all rights and remedies available at law and in equity, including a right of setoff and a right to recover legal fees in any action against the landlord.

### **Tenant Remedies**

A commercial tenant in New York does not have the benefit of the special protections afforded residential tenants. In fact, many statutory rights and remedies that a commercial tenant is entitled to in New York are waivable. A tenant who is less financially sound or desirable, and therefore lacks bargaining power, may not have any specific rights or remedies in the lease, and the landlord default provision may be cursory or nonexistent. Nevertheless, certain remedies are available to commercial tenants in New York.

#### ***Action for Damages following Actual or Constructive Eviction***

##### *Actual Eviction*

An actual eviction involves the wrongful physical expulsion of the tenant from the premises and can occur when the tenant is physically unable to enter the premises, or the owner changes the locks or padlocks the door. *Barash v. Pa. Terminal Real Estate Corp.*, 256 N.E.2d 707 (1970). An actual eviction can be full or partial. As noted above, although the common-law rule in New York was that the entire rent is abated when an actual partial eviction exists (see *Fifth Ave. Bldg. Co. v. Kernochan*, 117 N.E. 579 (1917)), in 2012, the Court of Appeals recognized an exception to this rule when the impact of the tenant's use and enjoyment of the premises is de minimis. *Eastside Exhibition Corp. v. 210 E. 86th St. Corp.*, N.E.2d 246, 249 (2012).

If the tenant refuses to pay rent, the tenant is deemed to have elected the remedy of rent abatement and cannot maintain an action for damages; conversely, a tenant who brings an action for damages waives the defense of eviction in an action brought by the landlord for rent. *Frame v. Horizons Wine & Cheese, Ltd.*, 467 N.Y.S.2d 630 (2d Dept. 1983); *487 Elmwood Inc. v. Hassett*, 486 N.Y.S.2d 113 (4th Dept. 1985).

##### *Constructive Eviction*

As noted above, constructive eviction occurs when defects in the leased premises due to the landlord's wrongful acts or omissions deprive the tenant of the beneficial enjoyment of the premises. Abandonment of the premises by the tenant is required in order to maintain a constructive eviction action. As noted above, some courts have adopted the concept of a partial constructive eviction to circumvent this rule when a tenant raises constructive eviction as a defense in a rent proceeding. See *Bet Constr. Corp. v. New York*, 410 N.Y.S.2d 524 (Sup. Ct. 1978). However, a claim of partial constructive eviction is only available as a defense in a rent proceeding brought by the landlord

rather than in an action brought by the tenant. *Elkman v. Southgate Owners Corp.*, 649 N.Y.S.2d 138 (App. Div. 1996); *Minjak Co. v. Randolph*, 528 N.Y.S.2d 554 (App. Div. 1988).

Abandonment of the premises followed by a claim of constructive eviction should be used as a remedy of last resort. There is considerable risk in vacating the leased premises and leasing other accommodations, and the tenant may be forced to pay rent in two places in the event that a court determines that there was no constructive eviction. For more on actual and constructive eviction, see 4 NY Practice Guide: Real Estate § 27.02.

### ***Suit for Tort Damages***

New York courts have not adopted the view that a commercial tenant's covenant to pay rent is dependent on the landlord's covenant to make repairs. However, the tenant may still bring an action against the landlord for tort damages when the lease provides that the landlord is obligated to repair the premises. *Putnam v. Stout*, 381 N.Y.S.2d 848 (1976). In practice, many commercial leases shift some or all of the responsibility for maintenance and repair of the premises onto the tenant, thereby making a viable tort action difficult for a tenant to bring in New York. Exceptions can exist where the landlord through a course of conduct assumes such responsibility or where the landlord is aware of a latent defect. See *Davison v. Wiggand*, 686 N.Y.S.2d 181 (App. Div. 1999). For further discussion, see 4 NY Practice Guide: Real Estate § 27.03 (3).

### ***Equitable Relief for Unlawful Entry***

If a landlord uses self-help to evict a tenant through forcible entry and detainer, a tenant may bring an action to regain possession and for treble damages under N.Y. Real Prop. Acts. Law § 853. The cause of action under N.Y. Real Prop. Acts. Law § 853 has a one-year statute of limitations because it is considered an action for an intentional tort. *Gold v. Schuster*, 694 N.Y.S.2d 646 (App. Div. 1999).

### ***Bankruptcy Considerations***

Although leases generally provide that seeking bankruptcy protection is a default or that the lease will terminate on the voluntary or involuntary filing, these provisions are generally not enforceable. However, the bankruptcy of either party will necessarily affect and limit both parties' rights and remedies under the lease, and because bankruptcies are not uncommon in landlord/tenant relationships, it is important to have a basic understanding of how rights are affected when one party files. This section provides a general outline of the rights and remedies provided under the Bankruptcy Code (11 U.S.C. § 101 et seq.) as applied to commercial landlord/tenant relationships.

The Bankruptcy Code governs the rights, obligations, and remedies of landlords and tenants when a bankruptcy is initiated. A landlord or tenant that files for bankruptcy protection becomes a debtor in possession. Upon the filing, an estate is created that is made up of "all legal and equitable interests of the debtor in property as of the commencement of the case." See 11 U.S.C. § 541(a)(1). The non-filing party becomes a creditor of the estate. Upon filing, an automatic stay springs into effect to protect the property of the estate. See 11 U.S.C. § 362. This stay acts to halt the non-filing party's execution of its rights or remedies under the lease unless the stay is lifted. An exception to this is created by 11 U.S.C. § 541(b)(2), which excludes a debtor's interest as lessee from the bankruptcy estate in nonresidential property where the lease has terminated at the expiration of its term and ceases to cover such interests where the lease terminates at the expiration of its term during the case.

### ***Effect of Bankruptcy on the Parties***

When a landlord or tenant commences a Chapter 11 reorganization bankruptcy case and becomes a debtor in possession, they can take one of two actions regarding the lease: assume the lease or reject it. If they assume the lease, they may then assign it without regards to prohibitions contained in the lease (subject to a few specific exceptions). For a detailed discussion of assumption, assignment, rejection, and timing rules for commercial leases, see Assumption, Assignment, and Rejection of Executory Contracts and 1-3 Collier Lending Institutions & Bankruptcy Code P 3.03.

If a case is commenced under Chapter 7 of the Bankruptcy Code, the trustee of the estate will make the election. If the debtor is the lessee and the property is nonresidential, the election must be made within 120 days of the order for relief, subject to the grant of an additional 90-day period on the motion of the trustee or lessor. 11 U.S.C. § 365(d)(4). If an election is not made by the earlier of the time permitted or the date of entry of an order confirming a plan, the lease shall be deemed rejected and the trustee/debtor must surrender possession of the property. See 11 U.S.C. § 365(d)(4).

#### *Tenant's Rejection of Lease*

If the tenant/debtor or trustee rejects an unexpired lease, the Bankruptcy Code requires the tenant to surrender the premises to the landlord upon approval by the court. The rejection is subject to court approval and is not tantamount to a termination of the lease but is a breach of the lease. The tenant/debtor or trustee, as applicable, must timely perform all obligations under the lease, including payment of rent until the rejection is approved. 11 U.S.C. § 365(d)(3). This breach entitles the landlord to damages for future rent and other lease obligations arising as a result of the rejection. Courts disagree over the treatment of a landlord's claim for rejection damages when the tenant/debtor is in default on post-petition payments, with some granting an automatic administrative expense claim without the need for notice and a hearing, while others require notice and a hearing and proof by the landlord of benefit to the estate. See *Post-Petition Performance Under Executory Contracts and Unexpired Leases*. The landlord's claim for damages for post-petition rent due to the debtor/tenant's rejection are subject to a statutory cap under 11 U.S.C. § 502(b)(6). For further discussion of the steps a landlord can take to protect itself following a tenant's bankruptcy filing, see *Bankruptcy Risks to Landlord when Tenant Files a Bankruptcy Case* and *Special Considerations for Assumption, Assignment, and Rejection of Certain Executory Contracts*. Landlord claims for damages to property may not be subject to this cap.

#### *Landlord Rejection of Lease*

If a landlord/debtor rejects a lease, its duties and obligations thereunder are discharged. See 11 U.S.C. § 365(h)(1)(B). However, the tenant retains substantial rights under the lease. The tenant may:

- **Reject the lease.** The tenant may treat the lease as terminated, since a rejection of a lease is a breach of the lease under 11 U.S.C. § 365(h)(1)(A)(i). Tenants should protect their termination rights by insisting on a provision similar to the language in 11 U.S.C. § 365(h)(1)(A)(i). When the debtor landlord rejects the lease, the tenant becomes an unsecured creditor of the landlord's bankruptcy estate for any pre-petition damages arising from the rejection.
- **Continue occupancy.** If the tenant does not wish to terminate the lease and vacate the premises, it has the right under 11 U.S.C. § 365(h)(1)(A)(ii) to remain in possession and continue to pay rent under the terms of the lease for the balance of the term (and any extension) to the extent enforceable under non-bankruptcy law. The tenant will have the right to offset against the rent the value of any damage caused by the nonperformance of the debtor/landlord after the date of the rejection, "of any obligation of the debtor under such lease." The tenant does not have any other right of enforcement against the debtor/landlord or the estate for damage resulting from post-termination nonperformance. 11 U.S.C. § 365(h)(1)(B). Tenants should insist on lease terms that permit the tenant to perform services on behalf of the landlord and either assign a monetary value or a formula for the value of such services. See 11 U.S.C. § 365(b)(3), (h)(1)(C), and 1-3 *Collier Lending Institutions & Bankruptcy Code* P 3.03 (7)(d) for special provisions for leases of property in shopping centers.

#### *Assignment or Assumption of Lease (Landlord and Tenant)*

With a few small exceptions, the process and effect of electing to assign or assume an unexpired lease is the same whether landlord or tenant is the debtor. For both assumption and assignment, the lease must be unexpired. The debtor or trustee may not assume or assign a commercial lease if the lease has been terminated under non-bankruptcy law before the petition date. See 11 U.S.C. § 365(c). Note that prior to passage of the 2019 Act, in a nonpayment proceeding, the tenancy was deemed terminated upon the issuance of the warrant of eviction pursuant to N.Y. Real Prop. Acts. Law § 749(3). However, the 2019 Act removed the termination language from N.Y. Real

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Prop. Acts. Law § 749(3) and it is now unclear when a lease is deemed terminated in a nonpayment proceeding and whether such a lease may be assumed or assigned in a bankruptcy proceeding, even following issuance and execution of the warrant of eviction. Best practice is to monitor this developing issue.

To assume the lease, the debtor/trustee assuming the lease must cure all defaults, including payment of all amounts owed, or provide adequate assurance that they will be promptly paid. 11 U.S.C. § 365(b)(1)(A). Finally, the party assuming the lease must give adequate assurance of future performance under the lease. 11 U.S.C. § 365(b)(1)(C). It is important to note that the assumption is “all or nothing.” Once assumed, the lease will resume in full force and effect for its term.

If the landlord chooses to assign the lease after it is assumed, the third party will have to provide adequate assurances that the lease obligations will be performed. If it is the tenant/debtor assigning the lease, the landlord will have a new tenant and vice versa. Courts generally will disregard anti-assignment clauses. See 11 U.S.C. § 365(f)(1).

### *363 Sale of the Property by the Debtor Landlord*

Notwithstanding that the tenant has rights under a rejected lease pursuant to 11 U.S.C. § 365(h), purchasers of assets can take the property “free and clear” of interests such as liens and encumbrances per 11 U.S.C. § 365(f). See Section 363 Sale Procedures, Hearings, Orders, and Appeals and Selling Assets and Assigning Contracts and Leases in a Section 363 Sale — Assumption and Assignment of Contracts and Leases in Section 363 Sales. See also *Precision Indus. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (Apr. 23, 2003). For examples of lease clauses that will help to protect the tenant in this situation, see *Bankruptcy Risks to Tenant when Landlord Files a Bankruptcy Case*.

### **Voluntary Surrender (Agreement for Early Termination)**

While not a default remedy, an agreement for early termination of the lease and surrender of the premises can help to avoid a potential lease default. The parties may agree to a voluntary lease termination to avoid the cost and expense of litigation, especially if the tenant no longer needs the space and the landlord has a replacement tenant.

#### ***Advantages of Early Surrender***

Early surrender provides a flexible and forward-thinking way for landlords and tenants to address potential problems within the landlord-tenant relationship before costly litigation arises. Landlords can eliminate the time and expense of managing difficult or chronically delinquent tenants and avoid the costs associated with eviction and suits for collection of rents. The landlord can also gain flexibility in providing space for a more desirable tenant or to meeting expansion needs of other tenants.

The advantages to the tenant in early termination often include being released from an unmanageable financial relationship, the freeing of resources, and resolution of the circumstances that gave rise to the tenant seeking an exit in the first place. A tenant who is experiencing financial difficulty, whether at one or more locations, may want to negotiate a surrender agreement to close a location. Alternately, a tenant who has outgrown its space may wish to leave the premises for a more suitable space. (A tenant can, of course, also seek a sublet or assignment pursuant to the lease to deal with these situations.)

In addition, if either party is financially unstable and likely to file bankruptcy, the relative rights of the parties after bankruptcy could be worse than a mutual surrender, making an early termination more attractive.

#### ***Terms of the Agreement***

The terms of the surrender or early termination should be clearly set out in an agreement signed by both parties. Terms that should be addressed include:

- **Surrender of the premises.** This term should address when and how the property will be surrendered as well as its expected condition. The landlord will want the condition of the premises on the date of surrender to be as required under the lease terms at the very least, while the tenant may try to surrender the premises in an “as is” condition. The parties often compromise by allowing for reasonable wear and tear and insured casualty and condemnation to be excepted. If the premises suffer from a defect, the parties may disagree whether it requires a repair (which is normally the tenant's responsibility) or a replacement (normally a capital expense borne by the landlord). A pre-agreement inspection and determination of these matters can prevent disagreements at the time of surrender.
- **Financial obligations of the parties.** This will include any early termination fees paid by the tenant if the tenant initiates the surrender, costs associated with relocation of the tenant if the landlord has agreed to pay such amounts, liability for past due amounts, or any other amounts agreed to by the parties. If the surrender is deemed a taxable event, unpaid tax liabilities should be the responsibility of the party requesting the termination. The effect of bulk sales restrictions regarding transfer of the tenant's property should be determined and provided for in the agreement.
- **Default provisions.** The surrender agreement should address what happens if a party fails to perform their obligations. For instance, the agreement may provide that if the tenant fails to surrender possession of the premises as agreed, the original lease will remain in effect and all of the tenant's obligations under the lease would be enforceable, including payment of rent, or that the tenant will be a tenant holding over and the landlord will be entitled to seek dispossession and damages. In drafting this provision, both parties, but particularly landlord's counsel, should make sure the termination of the lease is predicated on full execution of the surrender agreement and fulfillment of any conditions precedent. If the tenant is financially stable, the landlord may wish to have the right in the surrender agreement to reinstate the lease upon a holdover. If the landlord believes the tenant may not be able to meet its lease obligations on a holdover, it may require a letter of credit to help defray any damages.
- **Survival of lease terms.** The agreement should set out any obligations contained in the lease that will remain in existence and not be terminated, such as obligations to restore the premises or a duty to make repairs. Additionally, the parties will want to set out whether lease terms such as representations and warranties, environmental indemnities, and liability for reconciliation of annual expenses will survive the surrender. Rather than enumerate the representations, warranties, and liabilities that will survive, the parties may provide that unless otherwise provided, those terms will survive.
- **Personal property.** The agreement should provide for which items of personal property, improvements, and trade fixtures are to be removed and which will remain. If the tenant is leaving behind improvements or trade fixtures, it should be required to provide the landlord with a bill of sale, so no third parties can make claims.
- **Releases.** It is common for a surrender agreement to contain mutual releases of all claims, damages, and liabilities under the lease from and after the surrender date. The tenant usually remains liable for claims arising during its tenancy; however, the landlord usually is liable for claims arising during its ownership of the property. The releases may exclude unknown liabilities, breaches under the surrender agreement, and indemnities by either party as to prior third-party claims. The tenant will want an estoppel provision from the landlord acknowledging that the tenant is not in default under the lease as of the effective date of the surrender agreement, so the landlord cannot later assert a claim.

For a detailed discussion of surrender, see Surrender Agreements in Commercial Leasing. For a form of surrender agreement, see Surrender Agreement.