

Maximizing Leverage & Collection for the Commercial Landlord

By Leo K. Barnes Jr.

The commercial real estate sector has been particularly hammered during Covid, with tenants legally unable to occupy retail and office space, while consumers and professionals adjust to the “new normal,” including working remotely, and enhancing an already well-heeled capacity to order items online without a trip to the store. In this light, a nearly unprecedented number of tenants in the retail and office space sectors have failed to pay rent timely. With nothing but uncertainty concerning the end of the Covid-crisis, parties to commercial leases have been forced to review existing and prospective leases for applicable provisions, which may avoid (for the tenant) or enhance (for the landlord) the likelihood of monetary recovery incident to a default. From the landlord’s perspective, two key provisions may aid its goal of collection after a default.

The duty to mitigate

Each first year law student learns during *Contracts* that the Plaintiff on a breach of contract claim has an absolute obligation to mitigate damages. Indeed, as it relates to the duty to mitigate, Pattern Jury Instruction § 4:20 provides:

The law imposes upon a plaintiff injured by a breach of contract the active duty of making reasonable exertions to render the injury as light as possible. If plaintiff unreasonably or intentionally allows the damages to be unnecessarily enhanced, then he or she may not recover for the increased loss. The duty to mitigate damages arises when a rea-



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sonable person would give up hope that defendant will perform its duties under the contract. Since the duty to mitigate damages is implied by common law, it need not be expressly bargained for in a contract to be enforceable. [] Plaintiff’s failure to mitigate damages is an affirmative defense to be proven by defendant. Defendant has the burden of establishing not only that plaintiff failed to make diligent efforts to mitigate its damages, but also the ex-

tent to which such efforts would have diminished its damages [internal citations omitted].

However, in the commercial real estate sector, the landlord is under no duty to mitigate its damages. More specifically, black letter law confirms that commercial landlords have no obligation to mitigate their damages. For example, in *Holy Properties Ltd. L.P. v. Kenneth Cole Productions, Inc.*, 87 N.Y.2d 130 (1995) the New York State Court of Appeals confirmed that a landlord did not have a duty to mitigate damages after tenant’s abandonment of the subject premises and subsequent eviction, and a provision of lease that stated that tenant was liable for rent after eviction was enforceable. See also the Second Circuit’s recent opinion in *Leeber Realty v. TrustCo Bank*, 2019 WL 6918514, *3 (2d Cir. 2019):

Trustco argues that rent acceleration clauses are not enforceable where the lease does not require the land-

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lord to re-rent the premises and apply the rent received to the benefit of the tenant. *The New York Court of Appeals, however, has already rejected this argument on the ground that a landlord is not required to mitigate damages in the event a tenant breaches its lease agreement. See 172 Van Duzer Realty Corp. v. Globe Alumni Student Assistance Ass'n, Inc.*, 24 N.Y.3d 528, 535 (2014) (“once a tenant abandons the property prior to expiration of the lease, a landlord is within its rights under New York law to do nothing and collect the full rent due under the lease” [bold added].)

Savvy counsel for the commercial real estate landlord will nonetheless explicitly include a provision in the lease underscoring tenant’s liability for rent subsequent to a breach, such as:

Notwithstanding any contrary provisions contained elsewhere in this Lease, Tenant’s obligation to pay the Base Rent and/or Additional Rent shall survive after Tenant’s default hereunder and/or after Tenant vacates, abandons and/or surrenders the Leased Premises or is otherwise evicted or dispossessed by summary proceeding or otherwise from the leased premises. In that regard, the failure of Owner to re-let the Leased Premises or any part or parts thereof shall not release or affect Tenant’s liability for damages hereunder.

The liquidated damages clause

In an effort to gather a lump sum payment at the time that the breach occurs, without being required to wait for the same on a month-

ly basis, counsel for the landlord may also seek to include a liquidated damages clause within the lease which will have the practical effect of an acceleration clause. In that regard, a liquidated damages clause in a commercial lease may provide as follows:

If there shall remain an Event of Default after the expiration of any applicable notice and cure periods as provided in this Lease then the Base Rent and Additional Rent, if any, shall become due thereupon and be paid to Owner up to the time of such default, termination, re-entry or dispossession. In addition, Tenant shall also pay Owner, as liquidated damages, for the failure of Tenant to observe and perform Tenant’s covenants herein contained, any deficiency between (x) the Base Rent and Additional Rent, if any, due hereunder and (y) the net

amount, if any, of the rents collected on account of the lease or leases of the Leased Premises for each month of which would otherwise have constituted the balance of the term of this Lease. The failure of Owner to re-let the Leased Premises or any part or parts thereof shall not release or affect Tenant’s liability for damages hereunder. Any such liquidated damages shall be paid in monthly installments by Tenant on the rent date specified in this Lease and any suit brought to collect the amount of the deficiency for any month shall not prejudice in any way the rights of Owner to collect the deficiency for any subsequent month by a similar proceeding. *At any time,*

at Owner’s election, Owner may require that any unpaid liquidated damages be paid in one lump sum (in lieu of monthly installments on the rent day as hereinabove provided) computed by discounting to present value at an interest rate of four percent per annum the monthly amount of the deficiency between the Base Rent and Additional Rent hereby reserved and the net amount of the rents payable pursuant to an existing subsequent lease of the Leased Premises for the balance of the term of this Lease.

Suit or suits for the recovery of such damages, or any installments thereof, may be brought by Owner from time to time at its election, and nothing contained herein shall be deemed to require Owner to postpone suit until the date when the

term of this Lease would have expired if it had not been so terminated under the provisions of this Lease, or under any provision of law, or had Owner not re-entered the Leased Premises.

It is well settled that a contractual provision fixing damages in the event of breach will be sustained if the amount bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation.” *Truck Rent– A–Ctr., Inc. v. Puritan Farms 2nd, Inc.*, 41 N.Y.2d 420, 425 (1977). Although the tenant’s first affirmative defense will likely assert that the liquidated damages clause is an unenforceable penalty, various appellate courts have determined to the contrary.

For example, in *New 24 West 40th Street*

LLC v. XE Capital Management LLC, 104 A.D.2d 513 (1st Dep’t 2013), the landlord sued the tenant for breach of a lease containing a liquidated damages provision with a 4 percent discounted rate. The First Department held that this provision was enforceable, and not a penalty, because “the landlord applied the terms of the parties’ accelerated rent provision favorably so as to reduce defendant’s liability exposure under the lease by seeking payment of the fixed annual rent and additional rent payable through the end of the lease at a 4 percent discounted rate.” Similarly, in *720 Lex Acquisition LLC v. GUESS Retail Inc.*, 2014 WL 4184691 (S.D.N.Y. 2014), Southern District Judge Nathan found “plainly enforceable” (and calculated damages using) a lease’s acceleration provision containing a 4 percent discounted rate. Finally, in *Leeber Realty v. TrustCo Bank*, 2019 WL 6918514 (2nd Cir. 2019) the Second Circuit Court of Appeals affirmed a Southern District of New York decision holding that a lease’s acceleration provision with a 6 percent discounted rate was enforceable and not a penalty.

The inclusion of the “no obligation to mitigate” and the “liquidated damages” clauses in a commercial lease will provide greater leverage and increase the opportunity for a landlord to recover monetary damages for the remainder of the lease term, in the event of a tenant breach.

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