

# The Impacts of the Coronavirus Pandemic on the Performance of Real Estate Contracts: Frustration of Purpose, Impossibility, Impracticability and Force Majeure

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# CoVid 19 Pandemic

A Frightening and Frightened World!





# Force Majeure and the Pandemic

- The Pandemic is the very definition of force majeure, so my real estate contract obligations are clearly excused..... Or are they?
- Force majeure is **not** a common law remedy!
  - But, a bargained-for term to **excuse** performance.
- This means it **only** applies if:
  1. Your **contract contains** a force majeure clause
  2. The clause **defines** force majeure in a way that it applies to your contract
  3. The **particular obligation** is covered by the clause



# Typical events covered by force majeure clauses

- War
- Riots
- Invasion
- Sabotage
- Terrorism
- Famine
- Civil commotion, riots
- Earthquakes
- Extreme weather and floods
- Strikes
- Fire
- Condemnation
- Government action/intervention





# Types of Force Majeure Clauses

**Broad Form:** in addition to a list of events, contain language like:

- A. **"any event neither caused by nor reasonably foreseeable by the parties"**

- Non-performance triggering event need **not** be similar to the specific causes listed in the force majeure clause

- Specialty Foods of Ind., Inc. v. City of S. Bend*, 997 N.E.2d 23 (Ct. App. Ind. 2013)

("any other reason not within the reasonable control of [party]" excused obligation to food provider to allow operation of business in the Hall of Fame building after the Hall of Fame terminated the Management and License Agreements and moved to another state).

- Whole Foods Mkt. Grp., Inc. v. Wical Ltd. P'ship*, 2019 U.S. Dist. LEXIS 182086 (D.D.C. Oct. 22, 2019)

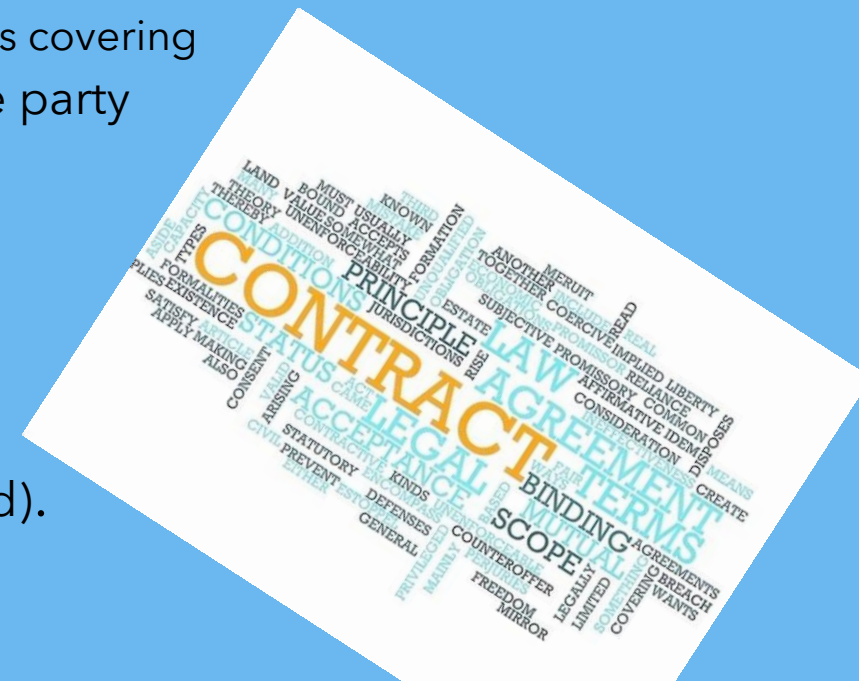
(rodent infestation might excuse tenant's continuous operation duty under clauses covering "Acts of God" and "other cause without fault and beyond the control of the party obligated to perform").

- B. **"or other similar causes beyond the control of such party."**

- Triggering events **must** be similar to listed events

- Kel Kim Corp. v. Central Markets, Inc.*, 519 N.E. 2d 295 (N.Y. 1987)

(event was of a different kind and nature from the particular events listed).





# Types of Force Majeure Clauses

- **Narrow Form: Strictly construed and limited to specific list of events**

- ***Kel Kim Corp. v. Central Markets, Inc.***, 519 N.E. 2d 295 (N.Y. 1987)
  - unforeseen event was neither specifically included in the force majeure provision, nor generally included within the provision's catchall phrase "or other similar causes beyond the control of such party".
- ***United Equities Co. v. First Nat'l City Bank***, 363 N.E. 2d 1385 (N.Y. 1977)
  - only if the *force majeure* clause specifically includes the event that actually prevents a party's performance will that party be excused.



# Statutory Force Majeure

- **California**: Cal. Civil Code § 1511:
  - “The want of performance of an obligation... is excused by the following causes, to the extent to which they operate:
    - **1.** When such performance ... is **prevented or delayed by ... the operation of law**, even though there may have been a stipulation that this shall not be an excuse...
    - **2.** When it is prevented or delayed by **an irresistible, superhuman cause**, or by the act of public enemies of this state or of the United States, unless the parties have expressly agreed to the contrary...”
- **Georgia**: O.C.G.A.Ga. § 13-4-21:
  - “If performance of the terms of a contract becomes impossible as a result of **an act of God**, such impossibility shall excuse nonperformance, except where, by proper prudence, such impossibility might have been avoided by the promisor.”
  - O.C.G.A. § 1-3-3: “Act of God” means “an accident produced by physical causes which are irresistible or inevitable, such as **lightning, storms, perils of the sea, earthquakes, inundations, sudden death, or illness**. This expression excludes all idea of human agency.”



# Other Defenses to Performance

Impossibility	Impracticability	Frustration of Purpose
<ul style="list-style-type: none"><li>performance has become literally and objectively impossible<ul style="list-style-type: none"><li>❑ Destruction or deterioration of a thing necessary for performance</li><li>❑ Death or incapacity of a person necessary for performance</li><li>❑ Government action prohibiting the performance or making the performance unlawful</li></ul></li></ul>	<ul style="list-style-type: none"><li>performance is excessively burdensome or inordinately more difficult</li><li>due to the occurrence of an unforeseen event not caused by one of the parties</li></ul>	<ul style="list-style-type: none"><li>principal purpose of the contract is substantially frustrated<ul style="list-style-type: none"><li>❑ without fault</li><li>❑ by the occurrence of an unforeseen event</li></ul></li></ul>



# Applying Force Majeure and Common Law Defenses to COVID-19 in real estate contracts

- Triggering Factors in the Current Pandemic:
  - Non-essential business closures
  - Stay-at-Home Orders
  - Presence of Virus Contamination
  - Supply Disruptions
  - Interruption of Services





# *Leasing: General Tenant Issues*

- Separate review of each lease
  - You can't just send a notice to all landlords stopping rent
- No force majeure clause
  - Leases often do not have them and when they do, they generally exclude payment of rent. Common law remedies may be available
- Is termination allowed?
  - Even if payment is excused, termination is probably not permitted
- If building is contaminated
  - Decontamination takes just a few days
- Review any SNDA provisions



# *Leasing*

## General Issues

- Operations open
  - But no business
- Setoff and abatement
  - Usually prohibited
- Inability to vacate or do end-of-term repairs
- Remediation
  - Issues involving infected employees



# *Rent Abatement Theories*

1. Temporary impossibility per Restatement of Contracts §462
2. Breach of Covenant of Quiet Enjoyment
  - Contaminated building
  - Stay-at-home order (non-essential business)
  - Interruption of services by landlord
3. Some landlords are offering to abate in exchange for lease extension



# *Particular Types of Leases*

- Retail
  - Anchor is closed, but small tenant is an essential business
  - May not be required by law to close, what if reduced to limited operations?
    - Take out only restaurant or bar
    - Limits on density
  - Percentage rent clause may have a minimum. What to do?
  - Will low business impact an exclusive vendor clause
  - Continuous operations clause
- Medical Office
  - Can landlord ask you to close?
  - May be recommended, but not ordered to close
  - Impact of contamination of premises by patients



# *Landlord's Perspective*

- Force Majeure Clause
  - probably only permits landlord to interrupt services or deliver space late
- Dealing with requests to defer or abate rent
  - Talk to lender first
  - Are notices to lender required for workout, tenant default, etc.
  - Be extremely careful not to trigger a default or void a non-recourse carve-out
  - Review any SNDA provisions
- Be quick to decontaminate and advise tenant if someone tests positive
- Ensure a safe environment by extra cleaning, disinfectant supplies
- Inability to deliver space on time (construction or holdover)



# *Lease Workout Issues and Options*

- Pre-negotiation agreement
- Consider payback of rent over remainder of term
- Consider adding on months to end of term
- Credit enhancement
  - Guaranty
  - Additional Security
- Paycheck Performance Program



# *Purchase and Sale*

- Typical impacts of the Pandemic:
  - Inspection and other due diligence delays
  - Financing contingency
  - Seller move-out delays
  - Title and environmental searches
  - Notarizations
  - Recording documents



# *Purchase and Sale*

- New contracts must deal specifically with the pandemic
- It is **not** an unforeseeable event for new contracts!



# Typical “Covid Clause” for new PSA

- The Parties agree that the COVID-19 Pandemic may have an impact on the timing of this transaction due to closures or reductions in staffing of government offices and private businesses, travel and contract restrictions and other issues beyond the control of the parties.
- If a party is delayed or unable to perform due to COVID-19-related closures, staffing reductions (other than by Purchaser or Seller) or other restrictions (each a “COVID-19 Delay”), such affected party shall give notice to the other party, and Purchaser and Seller shall work, in good faith, to (1) extend the Inspection Period and the Closing and (2) amend this Agreement as reasonably necessary to account for such COVID-19 Delays; provided however, that no such extension of the Closing shall extend beyond [DATE], unless mutually agreed to by the parties in each such party’s sole discretion.



# Other Options in Purchase and Sale

- Extend closing for actual period of delay
- Automatically extend for an agreed period
  - Consider you may have multiple overlapping delays
- Cover personal illness of parties



# Closing Issues

- Notarizations
  - Governors' Orders for remote notarization – are they enforceable? Will the title company insure?
- Recorder's office closures
  - See ALTA Closure Status at <https://www.alta.org/business-tools/county-status.cfm>
- Cancellation of loan approval



# Construction

- Nearly all construction contracts have a force majeure clause
  - So your focus will be on the language of the clause
  - Common law remedies will only apply if the contract does not cover the situation
- AIA A-201 - Not called **force majeure**, but **Delays and Extensions of Time** (§8.3), which is quite broad:
  - (3) labor disputes, fire, unusual delay in deliveries, unavoidable casualties, adverse weather conditions documented in accordance with Section 15.1.6.2, or other causes beyond the Contractor's control;...(5) by other causes that the Contractor asserts, and the Architect determines, justify delay.



# Construction

## Considerations:

- Essential Activity
  - Is the particular construction an essential activity under stay-at-home order
- Shortages of labor or materials
- Permitting and inspection delays
- Jobsite PPE requirements and shortages
- Social distancing slowing the work



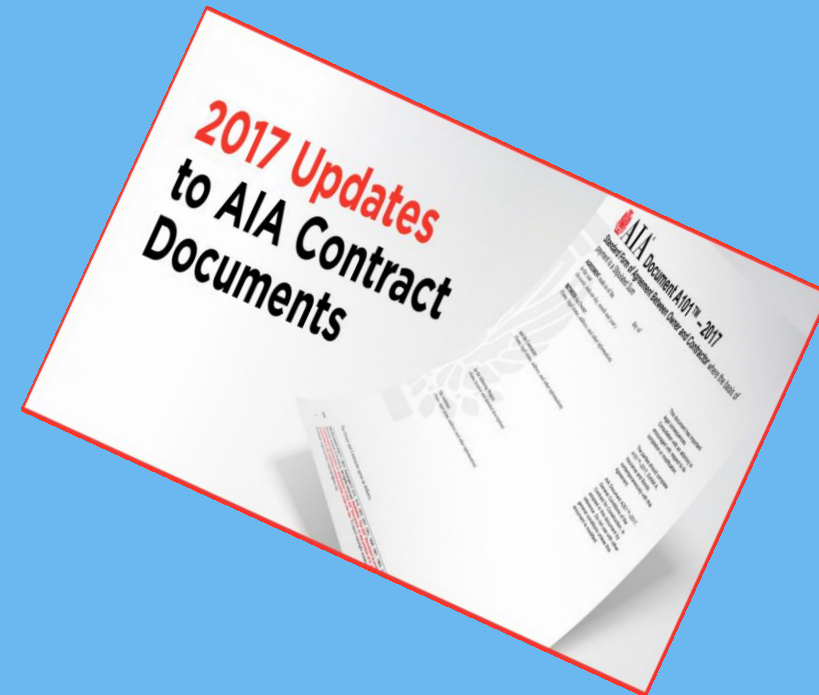
# Construction

- Architect determines reasonable additional time
  - A-201 §15.1.5 Claims for additional cost
- What costs can be added?
  - Mobilization & demobilization
  - Required or recommended PPE
  - Delay damages



# Construction

BUT, always check your particular contract language as AIA contracts tend to be heavily revised.





# Some Covid-19 Suits Asserting *Force Majeure*

- ***In re Hitz Restaurant Group***, 2020 WL 2924523 (Bankr. June 3, 2020)
  - force majeure clause was “unambiguously triggered” by governor’s stay at home order
  - notwithstanding language that “lack of money shall not be grounds for force majeure”.
- ***Martorella v. Rapp***, 2020 Mass. LCR LEXIS 104 (Mass. Land Ct. June 1, 2020)
  - effects of pandemic on financial markets did not excuse purchaser from closing
  - contract had no financing contingency clause
- ***Pending***
  - ***Victoria’s Secret LLC v. Herald Square Owner LLC***, # 651833 (Sup. Ct. N.Y. Co. 2020)
  - action for rescission of lease based on unenforceability due to the pandemic and related government-mandated shutdowns, including Governor Cuomo’s “New York State on PAUSE” Executive Order
  - asserting frustration of purpose and other common law doctrines



## Some Covid 19 Suits Challenging the Moratoria

- ***Elmsford Apartment Associates, LLC v. Cuomo***, # 20-cv-4062 (CM) (S.D.N.Y. June 29, 2020)
  - rejecting takings and impairment of contracts claims
- Pending:
- ***Matorin v. Sullivan***, # SJ-2020 (Sup. Jud. Ct. Mass 2020)
  - asserting takings, impairment of contracts and denial of right to access to courts



# Drafting Tips Going Forward

- Force Majeure Clause
  - Carefully define triggers
  - Determine if a broad catch-all is beneficial to client
  - Clearly note remedies – delay, extra payment, termination
- In Leasing context
  - Specify remedies
    - Set off
    - Abatement
    - Termination
  - Reservation of Rights/No Waiver clauses
  - Performance Guarantors



# Drafting Tips Going Forward (con't)

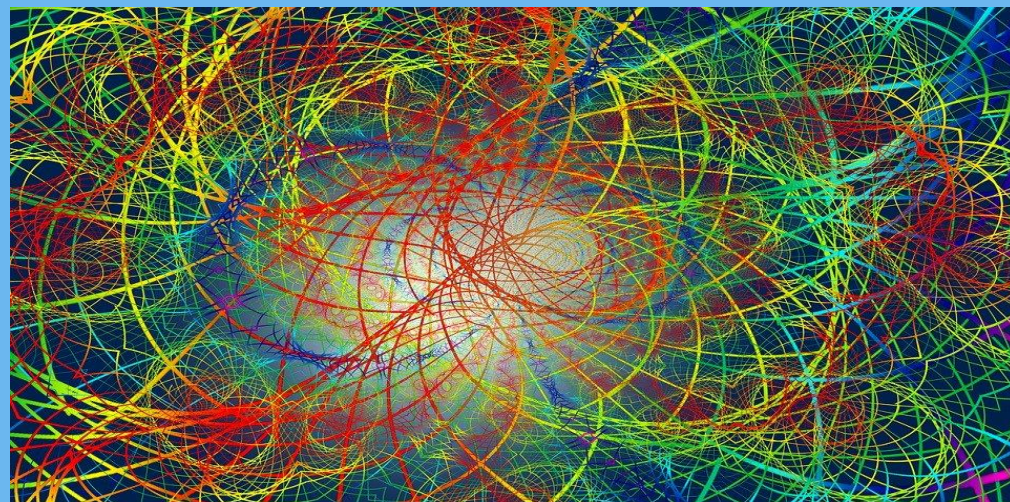
- Purchase and sale context
  - Include a force majeure clause
  - Specify conditions causing delay
    - Declaration of emergencies
    - Death or illness of parties
    - Transaction participant (lender, title company, vendor, agent, government agency) unable to provide necessary service
    - Automatic extensions
  - Include financing contingency clause
  - Address buyer/seller unable to move because moving companies are shut down



# Drafting Tips Going Forward

- Construction Context
  - Include epidemic/pandemic
  - Permitting/inspection delays
  - Subcontractor delays
  - Worker slowdowns/walkoffs
  - Specify remedies, time and cost
    - PPE expense
    - Delay damages
    - Mobilization & Demobilization





Questions?