



PROGRAM MATERIALS
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COVID-19 and Force Majeure: Potential Impact on Transactions and Projects in Real Estate and Hospitality

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5301 North Federal Highway, Suite 180, Boca Raton, FL 33487
Phone 561-241-1919 Fax 561-241-1969

COVID-19 and Force Majeure: Potential Impact on Transactions and Projects in Real Estate and Hospitality

Celesq Presentation

July 31, 2020

Paul “Tad” M. O’Connor III
Jennifer McDougall

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1633 Broadway, New York, NY 10019 | +1 (212) 506-1700

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AGENDA

- Introduction – Impact of COVID-19
- Force Majeure Background
- Force Majeure Industry Impacts
- Common Law Doctrines
- Instructive Case Law
- Force Majeure Drafting Considerations
- Questions



INTRODUCTION: IMPACT OF COVID-19

- COVID-19, and related government shut downs and supply chain disruptions, are preventing many business owners from meeting a variety of contractual obligations.
- Leading to questions from both sides of the contract around force majeure, and the doctrines of impossibility, impracticability, and frustration of purpose.
- Many of these issues are in a holding pattern right now as parties attempt to negotiate a resolution.
- Courts beginning to decide issues in wake of pandemic.

Force Majeure Background



FORCE MAJEURE CLAUSES

- A contractual doctrine governed by varying states' laws.
- May permit avoidance of contractual obligations.
- Generally requires showing of:
 - > event at issue falls within contract definition
 - > beyond party's reasonable control and unforeseeable
 - > ability to perform made impossible or impracticable
 - > mitigation
- Notice often required.

COMMON EVENTS INCLUDED IN FORCE MAJEURE CLAUSES



- War, terrorism, strikes, labor disputes, riots.
- Acts of God.
- Supply chain issues.
- Newly enacted laws or regulations.
- Catchall phrases such as any other cause beyond a party's reasonable control.

EXAMPLES OF FORCE MAJEURE CLAUSES – Building Loan Agreement



The occurrence of any of the following events which results in the delay of some performance mandated by this Agreement and/or any of the other Loan Documents: (1) strike, (2) labor disputes, (3) governmental preemption in connection with a national emergency, (4) any newly enacted rule, order or regulation of any governmental agency, (5) conditions of supply or demand which are affected by war or other national, state or municipal emergency, (6) fire or other casualty, (7) acts of God or (8) any other cause beyond Borrower's reasonable control . . .

provided that an event of Force Majeure shall have been deemed to have occurred no earlier than fifteen (15) days prior to the date Borrower notifies Lender of such event. Under no circumstances shall lack of funds or inability to obtain financing constitute Force Majeure. Notwithstanding anything in this Agreement to the contrary and for the purposes of clarification, Force Majeure shall not excuse Borrower's obligation to keep the Loan and the Other Loans in balance . . .

EXAMPLES OF FORCE MAJEURE CLAUSES – Hotel Management Agreement



. . . any act of God (including adverse weather conditions); act of the state or federal government in its sovereign or contractual capacity; war; civil disturbance, riot or mob violence; terrorism; earthquake, flood, fire or other casualty; epidemic; quarantine restriction; labor strikes or lock out; freight embargo; civil disturbance; or similar causes beyond the reasonable control of Manager.

EXAMPLES OF FORCE MAJEURE CLAUSES – Hotel License Agreement



. . . any of the following events that has a material adverse effect on the Property: war, invasion, rebellion, insurrection, riots, acts of terror or civil war; (ii) acts of government in its sovereign capacity; (iii) hurricanes, earthquakes, fires or other casualty, acts of God or any operation of the forces of nature as reasonable foresight and ability on the part of the affected party could not reasonably provide against; (iv) strikes, lockouts or other significant employee disturbances; and (v) any other similar events which are beyond the reasonable control of the affected party to prevent or overcome. . . .

In no event shall a Force Majeure include any inability of a party to perform any of its obligations under this License solely by reason of lack on its part of sufficient funds required for the performance of such obligation or by reason of a change in general economic conditions affecting the hotel industry in Manhattan, New York.



JUDICIAL INTERPRETATION

- Clauses are interpreted using standard contract interpretation guidelines in each jurisdiction (except some jurisdictions, e.g., California, have a statutory overlay).
- Threshold question is whether event falls within the clause.
- Even if the event fits within the clause, application requires that the performance has been rendered impossible or impracticable.



JUDICIAL INTERPRETATION (Cont'd)

- Followed by fact-intensive inquiry based on that legal analysis.
- Typically would also require some showing of efforts to mitigate.
- Applicable and timely notice must have been given to the counterparty in accordance (and usually in strict accordance, time being of the essence) with the relevant agreement.



FORCE MAJEURE UNDER NEW YORK LAW

- General contractual interpretation rules apply.
- Courts viewed as construing clauses more narrowly than some other states (e.g., California).
- Some NY courts have included a requirement of unforeseeability, even if not expressly stated in the clause.
- Courts have held that the event must objectively affect the ability of the party claiming force majeure to perform.



FORCE MAJEURE UNDER DELAWARE LAW

- DE courts have analyzed and construed clauses similar to those in New York.
- DE courts typically afford great respect to parties' contractual language and, as such, have enforced very broadly written force majeure provisions.
- Like some New York courts, some DE courts have required unforeseeability even in absence of the clause.
- Some DE courts have held that the defense is not applicable unless performance is impossible “by any means” – closer to an impossibility defense.



FORCE MAJEURE UNDER CALIFORNIA LAW

- CA courts are viewed as having interpreted these provisions more broadly than others, including New York.
- Some CA courts have held the defense applicable to events not specifically mentioned in the contract.
- Unlike New York and DE, even if there is no force majeure provision in your contract, under California law can turn to the Civil Code for the outlines of a potential force majeure defense.
 - > **California Civil Code § 3526:** “No man is responsible for that which no man can control.”
 - > **Cal. Civ. Code § 1511(2):** providing that the performance of an obligation is excused “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.”

NY CLE Code

Industry Impacts



FORCE MAJEURE – HOSPITALITY

- The hospitality industry has faced severe hardship given the immense disruption in travel, with wide scale event cancellations and postponements.
- A force majeure event can also affect a broad level of hotel operations.
- Scope and duration of pandemic and the government response to it are historic, particularly as to hotels.
- Occupancy rates and most other relevant metrics are at historic lows, particularly as to large hotels in major metropolitan areas.



FORCE MAJEURE – HOSPITALITY (Cont'd)

- Many, but not all, significant hotel-related agreements contain force majeure clauses.
- Those clauses differ widely in how much protection they might offer under current circumstances.
- Hotel Management Agreements:
 - > Clause potentially relevant to performance tests (i.e., a formula to calculate manager's financial performance)
 - > Potential for non-compliance to be excused
- Franchise Agreements:
 - > Many agreements do not contain force majeure clauses



FORCE MAJEURE – REAL ESTATE

- Force majeure provisions often found in commercial real estate-related documents (e.g., loan documents, joint venture agreements).
- As in 2008/2009, there will likely be significant litigation over the obligation to close and right to walk away.
- Again, each contract will be different in terms of how much protection it will offer.



FORCE MAJEURE – REAL ESTATE (Cont'd)

- Many force majeure clauses in the real estate industry will not excuse payment obligations (i.e., rent, loan servicing fees).
- Commercial Leasing:
 - > Many buildings open even if unoccupied (clauses often exclude obligation to pay rent)



FORCE MAJEURE – REAL ESTATE (Cont'd)

- Commercial Leasing: recent law firm lease disputes
 - > Simpson Thacher & Bartlett LLP:
 - > “ ... if Tenant shall be unable to use, and shall have vacated, the Premises or any substantial portion thereof (i.e., more than 6,000 contiguous usable square feet) for at least ... (b) sixty (60) consecutive days if a result of Force Majeure ... and Tenant is unable to continue the reasonable operation of its business, then Tenant (as its sole remedy) shall be entitled to a rent abatement with respect to all rent allocable to such portion of the Premises which is unusable and unoccupied for the period in excess of the aforesaid number of days until such time as the Premises or the applicable portion thereof shall be again usable or shall be occupied by Tenant...”
 - > “‘Force Majeure’ shall mean ... governmental preemption of priorities or other controls in connection with a national or other public emergency ... or any other cause ... beyond Landlord’s or Tenant’s reasonable control ...”



FORCE MAJEURE – REAL ESTATE (Cont'd)

> Jenner & Block LLP:

- > “In the event of the interruption ... of access not caused by Tenant to the Premises or Building, arising out of any event (Force Majeure or otherwise), which persists for a period longer than three (3) consecutive business days, and Tenant is unable to and does not utilize all, or a portion consisting of at least twenty percent (20%) of the Premises, as a result of such interruption or cessation, Tenant shall receive an abatement of all Rent for the portion of the Premises rendered Untenantable or inaccessible, from the period following such three (3) business day period until such time as such services or access is restored on a continual basis.”

• Residential Leasing:

- > Current bar on evictions in certain large jurisdictions (e.g. New York)
- > Soon to expire



FORCE MAJEURE – CONSTRUCTION

- In many jurisdictions, construction came to a halt. Has since restarted.
- Even where construction never stopped (essential), there were concerns about:
 - > labor
 - > supply chain
 - > duration
- Governmental response could have a larger force majeure impact than the pandemic itself.

Common Law Doctrines

WHAT IF CONTRACT DOES NOT CONTAIN FORCE MAJEURE CLAUSE?



- Even in the absence of a force majeure provision, at least two common law doctrines potentially remain available as a defense:
 - > impossibility
 - > frustration of purpose
- Each of these defenses is recognized at common law in most jurisdictions.



IMPOSSIBILITY/IMPRACTICABILITY

- Some courts have applied doctrine to excuse non-performance when based on a change of circumstances that makes performance objectively impossible/impracticable.
- Application depends upon whether an unanticipated circumstance has made performance of the contract materially different than reasonably anticipated.
- Doctrine not typically held to excuse performance where caused by financial difficulty or economic hardship.



FRUSTRATION OF PURPOSE

- A party's contractual obligations may be discharged if, after the contract is made, the party's principal purpose is substantially frustrated:
 - > without the party's fault
 - > where the occurrence or non-occurrence of an event was a basic assumption on which the contract was made
- Courts in some jurisdictions have excused performance under this doctrine based on newly enacted government orders (potentially relevant to pandemic-related orders).

Instructive Caselaw



CASELAW – PANDEMIC/EPIDEMIC

The Progreso, 50 F. 835 (3d Cir. 1892)

- Shipper agreed to load cargo of cotton bales, but quarantine went into effect. Court held that performance was excused only through the date quarantine ended.

Mobile Fruit & Trading Co. v. Boero, 55 S.W. 361 (Tex. Civ. App. 1900).

- Purchaser cannot hold the seller responsible for damage sustained to goods that were shipped via an unusual route due to a quarantine order.

Rembrandt Enterprises, Inc. v. Dahmes Stainless, Inc., No. C15-4248-LTS, 2017 WL 3929308 (N.D. Iowa Sept. 7, 2017).

- Attempt to use frustration of purpose defense following outbreak of avian flu.



CASELAW – HOSPITALITY

Wyndham Hotel Grp. Int'l, Inc. v. Silver Entm't LLC, 2018 WL 1585945 (S.D.N.Y. Mar. 28, 2018)

- Nonpayment of taxes and seizure of the hotel were not force majeure events because the hotel's financial default "is not the kind of unanticipated, blameless event contemplated by the Franchise Agreement's force majeure clauses."

OWBR LLC v. Clear Channel Commc'ns, Inc., 266 F. Supp. 2d 1214 (D. Haw. 2003)

- Discussion of whether a force majeure clause would allow a conference organizer to get out of a contract to hold a conference at a hotel in Hawaii five months after September 11th.

Associated Acquisitions, L.L.C. v. Carbone Properties of Audubon, L.L.C., 962 So. 2d 1102 (La. Ct. App, 2007)

- Party claimed performance was impossible due to Hurricane Katrina. Court rejected this, holding that although certain factors made performance more onerous, performance was not impossible.



CASELAW – REAL ESTATE & CONSTRUCTION

In re Hitz Restaurant Group, No. BR 20 B 05012, 2020 WL 2924523 (Bankr. N.D. Ill. June 3, 2020)

- COVID-19 Related: Court concluded that the force majeure clause in the parties' lease supported a 75% reduction in rent.

Latino v. Clay LLC, No. 18-cv-12247 (S.D.N.Y. May 8, 2020)

- COVID-19 Related: Court would not excuse gym owners from paying rent under impossibility doctrine as no showing that performance was “objectively impossible.”

Toll Bros., Inc. v. SiennaCorp., No. CIV 06-4378, 2009 WL 961379 (D. Minn. Apr. 7, 2009)

- Real estate developer did not show that force majeure excused its breach where delays were due to events and circumstances within the developer's control.

Burnside 711, LLC v. Nassau Reg'l Off-Track Betting Corp., 67 A.D.3d 718 (2d Dep't 2009)

- Force majeure clause applied as a defense to contract obligations when town ordinances were changed to restrict the use of the premises.

Drafting Considerations

DRAFTING CONSIDERATIONS FOR FORCE MAJEURE CLAUSES



- Going forward, in drafting new force majeure clauses, the following should be considered:
 - > coverage of COVID-19 or a similar future pandemic (foreseeability)
 - > governing law
 - > notice
 - > suspension and termination rights, and relevant time periods
 - > mitigation provisions

Questions?



Paul M. “Tad” O’Connor III

Partner / New York

Paul M. “Tad” O’Connor is a distinguished trial and appellate litigator focusing on complex commercial cases. He is regularly cited for his legal knowledge by publications including *The Wall Street Journal*, *The American Lawyer* and *Law360*.

Tad has significant experience handling real estate disputes related to commercial and hotel properties around the country. His clients include major domestic and international real estate and hospitality companies.

Tad also represents private equity firms, real estate developers and investors, large hotel operators, major corporations and wealthy individuals in federal and state courts around the country and before arbitration tribunals in the United States and Europe. He has been involved a number of times in obtaining discovery outside the United States under international conventions and treaties.

Tad has been recognized by *Chambers USA*, *The Legal 500* and *Benchmark Litigation* as one of the top real estate and commercial litigators in the United States.



poconnor@kasowitz.com

T +1 (212) 506-1723



Jennifer McDougall

Partner / New York

Jennifer McDougall's practice primarily focuses on commercial real estate, securities, and complex financial products litigation, where she represents both plaintiffs and defendants in state and federal courts at the trial and appellate levels, as well as in arbitrations. She also has experience in matters involving creditors' rights and bankruptcy. Jennifer has a successful track record of recovering or defending against claims for hundreds of millions of dollars for the firm's clients.

Jennifer's clients include private equity firms, real estate developers and investors, large hotel operators, major corporations and wealthy individuals in federal and state courts around the country. She also works with Kasowitz's Real Estate Transactions group to counsel clients concerning the litigation implications of their agreements.

Jennifer also devotes her time to pro bono work. She leads Kasowitz's efforts in providing pro bono representation to marginalized and vulnerable Westchester residents through a partnership with the Legal Services of the Hudson Valley.



jmcdougall@kasowitz.com

T +1 (212) 506-3345

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