LEGAL UPDATES

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An Examination of *Force Majeure* in Real Estate Contracts

Industry

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Force majeure events will delay a party's obligation to (i) complete construction, repairs and lease required alterations, (ii) open for business, (iii) operate for business, and (iv) to deliver possession. In order for the performance of an obligation to be excused due to *force majeure*, there must be a direct causal link between the unforeseen event and the nonperformance.

The obligation to pay rent and any sum owed under a lease (e.g., a tenant improvement allowance) is typically not excused by *force majeure*. Most commercial real estate contracts specifically provide that *force majeure* does NOT excuse the payment of rent. If the lease specifically states that the obligations under the lease are independent covenants, then this will strongly support the idea that the rent obligation is separate from operational issues. When you combine an independent covenant to pay rent and specific language under the *force majeure* provision, this creates a one-two punch that landlords may use to bolster their claim that no rent abatement is available.

***Force majeure* in the context of COVID-19**

How does all of this apply to the situation we currently find ourselves in with COVID-19? Is COVID-19 an event of *force majeure*? It may depend on a number of factors:

Is the *force majeure* language in your real estate contract broad enough to encompass a pandemic like COVID-19—i.e., acts of God, circumstances beyond the control of either party, or a specific reference to pandemics, epidemics and other types of outbreaks? If a tenant stops operating for business as a result of the mere threat of the virus (as opposed to an inability to obtain supplies or complete construction), is that a sufficient basis for a claim of *force majeure*?

At this point in time, it may still be unclear—can the tenant remain open for business? Are they able to access the premises? If neither the landlord nor any governmental entity is preventing a tenant from being open and operating, then it may not be an event of *force majeure*.

If COVID-19 is an event of *force majeure*, then a tenant would be excused from meeting any lease-imposed obligation to complete construction, initially open for business, or remain open and operating for business. Additionally, if the lease requires a tenant to comply with applicable laws, then a government-mandated closure would further excuse the performance of these obligations.

If tenants are prohibited from accessing their premises by the landlord or a governmental agency, this could create an impossibility (or impracticability) of performance for the tenant; however, a court could find that while it might be impossible to operate, it is not impossible for tenant to write a rent check. It's not a slam-dunk argument, particularly if the obligation to pay rent is an independent obligation under the lease; however, there may be a "frustration of purpose" argument—the inability to operate may negate the obligation to pay rent. This would be a common-law argument and one that might be persuasive to a judge.

The longer tenants are prevented from operating for business, the more likely they would be able to successfully make a claim for rent abatement. Equitable arguments and arguments based on public policy would also likely be persuasive following an extended period of closure.

The tenant position

If you are a tenant, communicate with your landlord and let them know you need to request a rent abatement until this situation resolves. Maintain an open line of communication with your landlord and plan to touch base every 30 days with an update. Rather than take a hardline position, try to create a dialogue and request for your landlord to partner with you to offer some relief in the short-term in order for you to remain viable over the long-term.

Both parties should adhere to the notice requirements set forth in the lease when invoking a *force majeure* provision, and to the extent possible such notice should be given as promptly as is reasonably possible (and no later than any required timeframe set forth under the lease).

The landlord position

If you are a landlord, respond to tenant requests in writing. You may not want to concede a rent abatement immediately, but it is a good idea to maintain a line of communication. Landlords can

consider the following approaches when responding to (or proactively offering) relief in the short-term to tenant:

Deferred rent

Abate rent and then add term at the end (if you think the tenant will be able to remain viable over the long term)

If some rent is better than no rent (after all, landlords have to pay their bills, too), you might consider offering to let the tenant pay 50% rent and forgive the other 50% so you can keep money coming in the door

Consider allowing tenants to apply their security deposits against the next installment(s) of rent to afford the tenant some relief without disrupting landlord's rental stream. Applying the security deposit in this manner would be beneficial to a landlord in the event the tenant ultimately ends up in bankruptcy

If a construction allowance is outstanding, consider applying the construction allowance against the rental obligation

Defer rent for a specified period of time and require tenant to repay the amount through an amortization period once the current pandemic has run its course

Be mindful of the requirements imposed by lenders. Lenders typically reserve approval rights over any amendment that abates or reduces rent. The nature of the COVID-19 crisis makes it critical for landlords and tenants to act quickly. Landlords may need to evaluate whether moving ahead without lender consent (and trying to keep things afloat) is the wiser course of action

Landlords should also review their operating agreements if the landlord entity is an LLC, and obtain necessary consents from the members/managers of the LLC if such consent is required. Further, landlords should keep their investors informed as to the course of action being taken by landlord to manager through this crisis.

Both parties should review the operating expenses provisions of their leases to determine whether a deep clean necessitated by the coronavirus is an expense that can be passed through to their tenants

If a landlord becomes aware of a tenant or employee that tests positive for COVID-19, they are not legally required to report this to the other tenants of the building, but it is recommended that notice should be given (though identities should be withheld). It is also recommended that, in conjunction with such notice, a landlord should share its plans for a detailed cleaning and efforts to be taken going forward to mitigate any further spread of the virus

If landlords take a hardline position on the payment of rent, there is a greater risk of losing tenants who end up in bankruptcy, not to mention additional litigation risk, particularly if this crisis prevents a tenant from being open and operating over an extended period of time

Eviction proceedings in many jurisdictions are being delayed pursuant to legislative measures, and as a practical matter, if a landlord seeks to evict tenants due to lease defaults, this remedy doesn't really put the landlord in a better position because if they prevail, they will have an empty space they need to fill

For both landlords and tenants, it is in each party's best interest to try to figure out a way to work together, so that both can be in business for the long term

Insurance concerns

Tenants and landlords may have questions related to the applicability of business interruption insurance and rental interruption insurance in response to the COVID-19 pandemic. Both of these insurance coverages require there to be property damage. The current situation has not triggered property damage. Based on the language typically found in insurance policies, there is no insurable claim to make under either business interruption or rental interruption insurance.

Some business interruption insurance policies will cover casualties by contamination. There has been some discussion as to whether there might be a claim for contamination based on the idea that, if the virus infects the personal property in the premises, then a casualty has occurred. It's still too soon to know whether this will be a viable argument, but it is something to consider if your business interruption insurance covers contamination (not all policies do).

Covenant of quiet enjoyment

A claim based on a breach of the covenant of quiet enjoyment will only excuse a tenant's performance if the landlord interferes with the tenant's right of quiet enjoyment. The COVID-19 pandemic is not something any landlord has caused; therefore, it is unlikely that a claim for a breach of the covenant of quiet enjoyment would make a strong argument.

Eminent domain and public necessity

There may be some merit to the argument that a government-mandated closure constitutes a taking of private property for a public purpose (in which case the landlord, and possibly also the tenant depending on the condemnation language set forth in the lease, would be entitled to adequate compensation). Obviously, there is no case law relating to this argument within the context of COVID-19.

Next steps

Unfortunately, we're still early into this public health crisis, and it's hard to know exactly how things will ultimately end up. Mass foreclosures and evictions are not the preferred outcome, and this prospect will hopefully create an incentive for all parties to work together to find a solution to get through this crisis.

As for next steps, first and foremost, read your lease so you know what is required and maintain an open dialogue with your counterparties so that you can be alert to opportunities to partner in a solution. And if you're a landlord (or a tenant that uses its own lease forms), consider revising your *force majeure* provision to more specifically address a COVID-19 situation.

Contact us

If you have further questions about *force majeure* in the COVID-19 context, please contact Wendy Proctor or your Husch Blackwell attorney.

Comprehensive CARES Act and COVID-19 guidance

Husch Blackwell's CARES Act resource team helps clients identify available assistance using industry-specific updates on changing agency rulemakings. Our COVID-19 response team provides clients with an online legal Toolkit to address challenges presented by the coronavirus outbreak, including rapidly changing orders on a state-by-state basis. Contact these legal teams or your Husch Blackwell attorney to plan a way through and beyond the pandemic.