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COVID-19 Update: Thoughts on Force Majeure and Impossibility of Performance

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Force majeure clauses are provisions in contracts that either defer or release parties from contractual obligations due to specific circumstances beyond the control of the breaching party. Such clauses allocate the risks of certain unforeseeable events that might result in a party's nonperformance and in each case are (or at least should be) highly tailored to the nature of the transaction. Qualifying events that constitute force majeure, the contractual obligations to which the clause is applicable, as well as the rights and obligations of the parties upon the occurrence of such an event in order to invoke a force majeure defense, are specifically defined in and limited by the agreed upon terms of the force majeure clause. Some common examples of what might constitute force majeure include acts of God, war, riots, strikes, labor disputes, casualty, terrorism, civil commotion, earthquakes, floods, shortages of, delays in obtaining or an inability to obtain labor, utilities or materials, and generally any event beyond the control of the relevant party. Typically, parties will agree that force majeure is applicable to only certain types of breaches, such as a borrower's obligation to restore its collateral after a casualty or to complete the construction of improvements by a certain date pursuant to a construction loan. In some documents, force majeure may apply to any breach of the agreement without limitation. However, many agreements provide for a limit or "cap" on the period of time that a force majeure may apply, such as ninety days. In addition, it is typical that lack of funds is carved out as an event that is beyond the control of a party seeking to invoke force majeure. Typically, a force majeure provision will *not* apply to an obligation to pay rent or an obligation to pay debt service.

In the absence of a looming natural disaster or pandemic, force majeure clauses are sometimes treated as boilerplate language and the implications are easily overlooked. However, the increasing economic effects of the coronavirus (COVID-19) have underscored the potential significance of force majeure clauses, especially with respect to commercial real estate lending. Over the past week, in an effort to slow the spread of COVID-19, multiple governors have issued state-wide orders closing all non-essential businesses, and in some states, governors have issued "shelter-in-place" orders mandating residents to stay inside. At this rate, it is not difficult to imagine scenarios in which some borrowers may no longer have adequate cash flow to pay the monthly debt service on their loans or may be in breach of other non-monetary obligations or covenants as a result of tenants whose businesses have been shut down and are no longer able to pay rent. In these cases, borrowers may begin to look to force majeure clauses for protection from what is hopefully a temporary condition.

Even if the specific language of a contract or lease would arguably give rise to a claim of force majeure, the claim must satisfy the following:

- the event must be beyond the reasonable control of the applicable party;
- the applicable party must have been prevented from performing its obligation;
- the applicable party must have taken all reasonable steps to avoid its non-performance and have satisfied its duty to mitigate damages as a result thereof; and
- 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.

Whether a borrower can successfully invoke force majeure will depend on the language of the force majeure clause itself and the nature and cause of the breach. For example, if the breach in question is the borrower's failure to pay the

monthly debt service and the force majeure clause specifically excludes breaches for failure to satisfy monetary obligations, then the force majeure clause may not provide the borrower any relief. However, if the borrower's failure to pay its monthly debt service is the direct result of the government mandate requiring its tenants to shut down and the definition of force majeure includes governmental restrictions without any exclusion as to monetary breaches, then the protection of the force majeure clause may apply.

In the absence of a qualifying event that is ancillary to COVID-19 and can be identified as the cause of a borrower's breach, such as a government-mandated shutdown of a tenant's business operation, it is not clear whether and in what circumstances the COVID-19 outbreak alone would successfully provide the basis for a borrower to claim force majeure. As previously stated, the bargained-for language of the clause would first determine whether the clause is applicable to COVID-19 at all. Assuming the force majeure clause contains language such that it applies to "pandemics," "epidemics," "disease," or similar events and the specific breach in question is subject to the force majeure clause, the borrower would still have to show that its failure to perform was caused by COVID-19. It is unclear when a pandemic rises to the level of interfering with performance of contractual obligations, especially monetary obligations. Further, to the extent that a borrower's non-performance is the result of its tenants voluntarily shutting down as a preventative measure, the virus is unlikely to be viewed as the direct cause of the breach.

In addition to force majeure provisions, there remains the doctrine of impossibility of performance, which is applicable to all contracts and may excuse performance in limited circumstances. Generally speaking, impossibility of performance of a contract would require that the event in question was not the fault of either party to the contract, the event occurred after creation of the contract, and that there was an intervening event, which was both unforeseeable and destroyed either the subject matter of the contract or the means of performance. This doctrine is applied narrowly and the current case law specifically states that the performance of a contract is not excused where impossibility or difficulty in performance is caused by financial difficulty or economic hardship, even in the case of bankruptcy or insolvency.

These are unprecedented times and with each passing day, they become more unprecedented. While it is common knowledge that under New York and Federal law, courts will generally enforce as written commercial agreements entered into between sophisticated parties represented by counsel and will not "read into" an agreement a force majeure provision to relieve a party from its obligation to perform, it remains unclear what a court might hold given a dramatic set of facts such as the ones we are currently experiencing. Additionally, force majeure provisions are strictly construed, which means that the specific language will need to be analyzed to determine if the facts and events will give rise to relief from the applicable obligation. However, even if the language of a force majeure clause does not contain the specific words "pandemic," "epidemic" or "COVID-19," the language still needs to be examined to determine whether the current pandemic or its effects fall within language such as a "governmental restriction," "an act of God" or some other catch-all such as "events outside of the reasonable control" of the applicable party. It remains unclear whether the current pandemic would satisfy such a provision.

While a tenant or borrower can always make a claim that it is absolved from its obligations due to force majeure or the doctrine of impossibility of performance regardless of the language in its documentation, claims of that sort are very difficult to prevail upon absent extraordinary facts and circumstances, which may weigh upon the discretion of the courts. Given the unprecedented nature of the events we are living through, we would suggest that many of these claims and issues will be resolved through good old-fashioned negotiations between reasonable parties who are cognizant of the severity of the facts at hand.

Finally, there have been and will no doubt continue to be governmental proposals, executive orders and regulations promulgated to address some of the distress impacting tenants and borrowers. Please see the following links to recent publications outlining some of these relief measures: **New York Governor Issues Executive Order on Forbearance Actions**; **DFS Releases Emergency Regulation on Forbearance Actions**.