

SPECIAL REPORT: CORONAVIRUS CONSIDERATIONS FOR THOSE ENGAGED IN COMMERCIAL REAL ESTATE

The situation surrounding the coronavirus disease (COVID-19) is rapidly changing, with government guidelines, shutdowns, laws and other directives being released on a nearly constant basis. It is important to stay on top of all new developments and to review leases, insurance policies, and loan policies to understand COVID-19's impact on the property, contractual obligations and business operations.

Health Guidelines

The COVID-19 outbreak has been declared a pandemic by the World Health Organization. On March 13th, the United States declared a national emergency. As such, property owners, operators, developers, managers and tenants should stay apprised of all health guidelines being issued by the CDC and other federal, state and local health authorities.

Such resources include:

- Center for Disease Control (CDC) – cdc.gov/coronavirus/2019-ncov
- Illinois Department of Public Health (IDPH) – dph.illinois.gov
- World Health Organization (WHO) – who.int/emergencies

Force Majeure

“Force majeure” or “acts of god” provisions generally address events, beyond the reasonable control of either party, that may prevent the parties from performing their obligations within a specific period of time or by a date certain under a contract, that could be delayed due to an unforeseeable event. Force majeure provisions excuse a party from defaulting under the contract due to the party's inability or delayed performance due to such an event and is nearly always interpreted to apply only to events beyond the parties' control. An excused party must not be already in default prior to the event.

It is imperative to review the specific contract language, as contract law does not have a general definition for force majeure events or acts of god. Instead, contracts are interpreted narrowly on a case-by-case basis based upon the language in the contract. Some jurisdictions may find COVID-19 outbreak to be beyond the reasonable control of the party and fall within the meaning of an “act of god” if the quarantines and travel restrictions put into place by the government renders a party unable to perform. However, in certain jurisdictions, if a contract does not specifically include a provision for an epidemic, pandemic, disease or the like, then a party may potentially be out of luck in asserting force majeure.

Even if the contract includes a force majeure clause, there is very little precedent when it comes to epidemic-related lease disputes, so it is not entirely clear how a court would settle a dispute if the parties are not in agreement as to whether a force majeure event of an act of god occurred.

Furthermore, it is important to note that force majeure provisions only generally pertain to non-monetary obligations that require performance. They generally do not apply to monetary obligations e.g., payment of rent, earnest deposits, etc.). Contract language should be checked to confirm this or to note any deviations. Since the force majeure clause usually do not pertain to payment obligations, tenants should not be alleging force majeure as a bases for rent relief requests. However, this may serve as bases for other relief from other obligations such as operating contracts.

It is also critical that the party asserting the doctrine provide timely notice to the other party of their inability to perform due to such force majeure event. In addition to notifying the other party of any disruptions, it is recommended that the party claiming force majeure to take any appropriate actions to mitigate damages/losses.

If a contract does not have a force majeure clause, then performance may be excused under the common law defenses known as the doctrine of “impossibility” or the doctrine of “commercial frustration.”

Doctrine of Impossibility (Impracticability)

Depending on the jurisdiction, a court may excuse a breach of contract if (i) an unforeseeable event makes performance impracticable by causing a very high level of difficulty or extra expense for the breaching party if it were to perform under the contract; (ii) the event is beyond the control of the breaching party; and (iii) the breaching party did not expressly assume the risk of the event occurring. The party asserting the doctrine must demonstrate that it has tried all practical alternatives available to effectuate performance.

The doctrine is premised on the theory that the parties to a contract made their bargain with specific circumstances in mind, and that their basic assumptions about the world in which the contract was to be performed were thereafter upset by a contingency whose nonexistence was a basic assumption of the contract. In such an event, a court may conclude that the contract was not intended by the parties to apply to the new set of events and that performance should be excused or modified.

Doctrine of Commercial Frustration

Depending on the jurisdiction, a court may excuse a breach of contract if an unforeseeable event totally or almost totally destroys the purpose of the contract to the breaching party. For the doctrine to apply, the non-breaching party must have known the purpose of the contract to the breaching party at the time of entering into the contract.

Default Considerations under Loan Documents

As the mandated closures, and self-shuttering, of commercial businesses continue to grow, there are specific issues relating to loan agreements in light of the current COVID-19 crisis. The list below is not intended to be all encompassing, but rather highlight important considerations when reviewing particular financing arrangements.

Events of Default: It is imperative that borrowers review their current loan documents understand the situations in which an event of default may be triggered. Clearly, a failure to make monetary payments will cause a default. However, attention should be paid to what, if any, cure or grace period is available under the loan document. Additionally, the failure to perform or meet other non-monetary obligations (including, financial and notification covenants) will likely trigger an event of default. Any cure or grace period for these non-monetary obligations should also be re-visited. Other considerations that may trigger an event of default include a cross-default provision which would lead to a loan default if a default occurs under other indebtedness agreements.

Breach of Financial Covenants: Financial covenants are generally included in loan agreements that provide for an event of default if certain financial covenants are not met. The financial covenants should be reviewed to analyze the certain requirements or thresholds that must be met or maintained under the financing agreement. Consideration must be given to determine if notice is required in these situations.

Reporting Obligations: Borrowers should review any obligations to report material adverse changes, potential disputes (such as litigation over interpretation of a force majeure event under a separate contract), or other information required to be reported to lenders. Under some documents, forbearance agreements, amendments, and even terminations, require notice (and/or approval) of lenders.

Force Majeure: If a loan agreement has a force majeure clause, it is important to understand how the clause defines an extraordinary event that may excuse or permit delay for performance of an obligation under the agreement. The language may not specifically identify a pandemic or infectious disease outbreak, but it may contain language that addresses a governmental order or action which could apply depending on the particular circumstances. Further, the language must be analyzed to determine the extent and timeframe in which a performance obligation may be excused or delayed. Force majeure clauses that excuse monetary payment obligations in the event of a pandemic are not typically included in commercial loan agreements.

Limitations of Business Interruption Insurance

Another pressing concern for businesses and their commercial landlords is whether loss of business and/or income resulting from COVID-19 may be covered by business interruption insurance. Business interruption insurance is a form of property insurance that provides coverage for damages during a period of interruption arising from a "direct physical loss or damage to" the insured property. Generally, a health crisis such as COVID-19 does not meet the definition of a "direct physical loss" such that business interruption coverage will apply. However, this is a policy-specific inquiry, and businesses should consider several factors when analyzing their policy to determine whether there may be coverage.

A policy which contains "basic" coverage extends coverage for losses resulting only from specified types of peril that are named in the policy. This coverage likely will not extend to business interruption resulting from communicable diseases. Conversely, policies which provide "all risk" coverage are triggered by all perils not excluded by the language of the policy, and in theory would provide coverage. Unfortunately, most "all risk" policies contain language that expressly excludes losses caused by contagious diseases from coverage.

The possibility of business interruption coverage is also dependent on the specific cause of the loss. For instance, loss or damage due to an actual contamination of the insured property is more likely to be deemed a “direct physical loss” than loss of business due to informal measures such as “social distancing”. In addition, losses caused by disruption to a business’ supply chain could arguably trigger contingent business interruption coverage, if the policy so provides. A business interruption policy may also contain a “civil authority” clause extending coverage when a business is denied access to its property due to a government order. However, advisory action by the government, or even government orders to reduce or limit occupancy at the insured property, likely are not sufficient to trigger coverage under a civil authority provision.

The New York Department of Financial Services (NYDFS) has taken a proactive step to address these complex issues by directing all property and casualty insurers that provide business interruption and related coverage in New York to send a “clear and concise explanation of benefits” to all commercial policyholders by March 18. This explanation will hopefully provide valuable guidance not only for New York insureds, but for all businesses and commercial landlords in the U.S.

Rent Loss Insurance Policy Coverage

Landlords could have their rental streams disparately impacted by COVID-19 if tenants are unable to meet their lease obligations, and rent loss insurance (also known as rent default insurance) unlikely to provide coverage for the loss of rental income. Businesses are facing mounting pressure with newly enacted regulations limiting the size of gatherings and reducing store hours in an effort to combat the spread of COVID-19. As new regulations begin to disrupt daily routines, business operations will be impacted with restaurants, bars, theaters, gyms, and similar retailers particularly affected.

A consequence of COVID-19 and new regulations is that tenants may experience decreased revenue and reduced cash flow hindering their ability to meet rent and other lease obligations. By extension, landlords will also be impacted if a portion of their tenants are no longer able to make monthly rent payments. However, rent loss insurance is unlikely to provide landlords with a safe harbor.

The extent of coverage for COVID-19 losses will depend on the terms of a rent loss insurance policy and the nature of loss. The terms of rent loss insurance policies vary widely, and policy limitations cannot be generalized. However, rent loss insurance policies tend to exclude coverage for bacteria, mold, and other disease agent losses, which would encompass COVID-19. Policyholders are encouraged review the specifics of their individual policy to determine whether they have coverage in the event of the loss of rent stemming from COVID-19.

Guidance for Employers and Employees

COVID-19 is resulting in employees, individually and entire workforces, not being able to report to work, and employers along with their employees are asking whether they are entitled to be paid for time they are not at work. One thing is certain, employees should be paid for all time actually worked, even if the work is not physically done at the normal workplace. Somewhat less clear are the various circumstances in which employees are not working at all during this current COVID-19 crisis.

If the employees are exempt under the Fair Labor Standards Act (“FLSA”), their compensation will likely not be affected by the closure or absence from work. There can be exceptions when the employer is open for business but an employee decides to stay home and performs no work. Generally, the FLSA requires that exempt employees to be paid an entire salary for a particular workweek if such employee performs at least some work in that employee’s designated workweek.

Nonexempt employees, present a different scenario. Employers need to consider whether nonexempt employees are entitled to compensation under the business' sick, vacation, or other paid-time-off policy, short-term disability policy, or under applicable state or local paid sick leave laws.

For example, under the Cook County Earned Sick Leave Ordinance and the City of Chicago Ordinance, employees accrue sick leave over time worked. An employee earns 1 hour of paid sick leave for every 40 hours worked, up to a maximum of 40 hours of paid sick leave earned in one year. However, in Cook County, several municipalities have opted out of the earned sick leave ordinance so it may be necessary for employers to review whether their specific municipality has opted out.

Currently, many employers are considering providing additional compensation or benefits to their employees. Employers who implement changes in their normal compensation or time-off policies should be clear to describe any such changes as limited to address the unique demands caused by COVID-19.

Employees may also be entitled to unemployment benefits when their unemployment is attributable to COVID-19. The Illinois Department of Employment Security ("IDES") recently adopted emergency rules to try to make the unemployment insurance system as responsive to the current situation as possible. An individual temporarily laid off because their place of work is temporarily closed due to the COVID-19 Virus could qualify for benefits as long as he or she was able and available for and actively seeking work. Under emergency rules IDES recently adopted, the individual would not have to register with the employment service. He or she would be considered to be actively seeking work as long as the individual was prepared to return to his or her job as soon the employer reopened.

Families First Coronavirus Response Act - PENDING

The U.S. House of Representatives passed the Families First Coronavirus Response act. The Senate is expected to vote on this bill sometime this week. The bill contains several provisions that will impact employers including paid family medical leave and paid sick leave.

The bill provides 12 weeks of job-protected Family and Medical Leave Act (FMLA) leave, of which the first 14 days may be unpaid, for employees of employers with fewer than 500 employees. This leave benefit covers employees who have been working for at least 30 calendar days. Employees may use the leave to respond to quarantine requirements or recommendations, to care for family members who are responding to quarantine requirements or recommendations, and to care for a child whose school has been closed as a result of the COVID-19 virus. After the first 14 days, employers must compensate employees in an amount that is not less than two-thirds of the employee's regular rate of pay.

The bill also provides that employers with fewer than 500 employees will be required to provide full-time employees 2 weeks of paid sick leave for specific circumstances related to COVID-19. Part-time employees are entitled to the number of hours of paid sick time equal to the number of hours they work, on average, over a 2-week period.

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