About the Firm

Shapiro Sher was founded in 1972 with the mission of providing outstanding legal counsel for businesses of all sizes. Based in Baltimore, the firm is nationally recognized for its practices in business and real estate law, construction litigation, bankruptcy, and creditors' rights. For over four decades, the firm has provided invaluable representation to large corporations, emerging growth businesses, governments, non-profits, and individuals. Our real estate and construction attorneys are experienced in all aspects of acquisitions and dispositions of real property interests, development, leasing, and real estate finance.

David B. Applefeld heads Shapiro Sher's Construction and Real Estate Litigation Practice and represents developers, contractors, design professionals, and property owners throughout the Mid-Atlantic region and beyond. Mr. Applefeld has successfully litigated construction defect claims, landlord-tenant disputes, insurance coverage actions, mechanics' liens, and architectural and engineering professional negligence claims in all levels of state and federal courts, and before administrative agencies. Mr. Applefeld currently serves as Section Counsel to the Maryland State Bar Association's Construction Law Section, and has been nationally recognized by T*he Best Lawyers in America*® in the area of construction litigation.

Mark L. Miller concentrates his practice in real estate and business transactions, construction, and design law. He holds degrees from the University of Maryland College Park in Architecture and Civil Engineering, and has been involved in real estate projects across the United States aggregating in the hundreds of millions of dollars. In these projects, he has served in a variety of roles including lead counsel, owner's representative, developer, construction manager, foreman, and tradesman. In addition to practicing as an attorney, Mr. Miller currently serves as an asset manager and co-trustee of a multi-state portfolio of commercial income producing properties.

REAL ESTATE, LEASES & COVID-19

By David B. Applefeld, Esquire and Mark L. Miller, Esquire

Recent governmental restrictions, mandatory business closures, and "stay at home" orders imposed to help curb the spread of the coronavirus present a number of legal issues for the real estate and construction industry. This includes leases, construction contracts, development agreements, purchase-and-sale agreements, and restrictive covenants, to name only a few. Parties to such agreements should carefully review their contracts now to determine how these changes might impact their legal obligations. Most importantly, taking the appropriate steps now will be critical to preserving your rights and controlling liabilities in the face of delays and non-performance that have become all too common in recent weeks.

In the context of leases, there are several ways the current state of emergency may impact performance obligations. For example, a landlord may be prevented from performing a build-out obligation, duty to repair, complying with a co-tenancy requirement, or even the fundamental obligation to provide possession. Leases must be carefully examined to determine whether and to what extent these obligations are excused. Leases often contain a risk-shifting provision known as a *force majeure* clause in one form or another, although the specific words "*force majeure*" may not be expressly stated. Taken from French law, the term *force majeure* literally translates to mean "superior force". It refers to a contractual risk allocation provision which excuses performance when circumstances beyond the contracting parties' control make performance commercially impracticable, illegal, or impossible. When in place, such clauses have been successfully invoked to excuse performance, obtain time extensions and, in rare cases, delay or change a party's economic obligations following natural disasters, acts of terrorism, and changes to governmental regulations.

Regardless of the terminology which is used, by definition, a *force majeure* event must include three characteristics.

- The event must have been unforeseeable – *i.e.,* an event that could not have been foreseen by the party seeking relief at the time the contract was entered.
- The event must arise from an external cause – *i.e.,* an event outside the control of the party seeking relief.
- The event must be unavoidable – *i.e.,* the party seeking relief could not have avoided the adverse effect on its contractual obligation by exercising due diligence.

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Not all *force majeure* clauses are identical. Depending how the clause is written, a *force majeure* provision can be invoked to either delay performance (*i.e.,* temporarily excuse the obligation to perform), or in rare cases allow one party to terminate the agreement. However, most *force majeure* provisions require the party seeking relief to provide notice of the supervening event and its effect on performance in a specific format, within a specific time. A party who fails to comply with contract notice requirements may waive its rights.

The state of emergency caused by the current coronavirus pandemic may also impact tenant performance obligations. This could include a breach of a continuous-operation clause, the inability to pay rent and other pass-through expenses, or a tenant's inability to enforce an exclusive-use restriction for its benefit if the tenant fails to operate. However, leases almost always expressly provide that the tenant has an obligation to comply with all applicable laws, orders, and regulations. Accordingly, a tenant is not likely to be in breach of a continuous operation clause in the event of a mandated closure of its "non-essential" business. Even when a lease contains a *force majeure* provision excusing the tenant from continuous occupation, this does not necessarily excuse the tenant's obligation to pay rent unless the lease specifically provides otherwise. Resolving these issues requires a careful reading of the lease and interpreting the exact language of the closure order and its impact on the particular business.

Real estate development projects also face significant impacts from the state of emergency and the various emergency orders that have been issued. For example, a party to a purchase-and-sale agreement may be able to terminate the agreement given the change in the economic climate or the condition or character of the property. In addition, projects in the midst of design or construction may face significant delays and additional costs, including those resulting from lost or delayed financing, inability to obtain governmental approvals, and shortages of labor, equipment, and materials. Delays from these circumstances can cause a ripple effect through the tiers of project participants, including investors, owners, lenders, design professionals, contractors, bonding companies, and insurers. All too often the allocation of these types of risks is addressed in an incomplete or ambiguous manner in the contract. It is critical for a party to understand its rights and to properly assert and document the delays immediately, particularly where there may be notice deadlines.

In the absence of a *force majeure* provision, contracting parties will need to examine applicable common law provisions such as frustration of commercial purpose and impossibility of performance. The general principle underlying the doctrine of frustration is that where the purpose of a contract is completely frustrated by a supervening event or circumstance which renders performance impossible, the contract will be discharged. Some U.S. courts have also held that the doctrine can apply in cases of extreme hardship.

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Most courts look to three factors in determining whether the doctrine of frustration of commercial purpose applies:

- Whether the supervening act was reasonably foreseeable;
- Whether the supervening act was an exercise of a sovereign power; and
- Whether the parties were instrumental in bringing about the event.

The first and most commonly addressed factor is whether the supervening event was reasonably foreseeable, such that the parties could and should have protected themselves through the terms of their contract or, alternatively, by insuring the known risk.

Clearly, more is required than showing that it would be financially disadvantageous to perform, and courts addressing these issues have cautioned the doctrine of commercial frustration should not be applied if the only result would be to allow a party to withdraw from a poor bargain. Thus, cases applying the doctrine of frustration are usually limited to situations where a supervening ordinance renders performance illegal, and thereby impossible. Courts addressing this issue have also stressed that a temporal change in the law rendering a certain activity illegal which can reasonably be reversed or modified through subsequent administrative or judicial action is insufficient. Thus, in the context of COVID-19, the parties' rights will likely be determined by the scope and duration of any mandated business closures, and a temporary delay or interference should not avail a party of the right to terminate their contract. The doctrine of impossibility follows the same line of reasoning and has been applied in cases where the subject of the contract or a party's ability to perform is destroyed.

Notwithstanding these principles, in certain circumstances some courts have recognized that a state of "temporary impossibility" may exist when a party is unable to perform its contract during a state of emergency. In such cases, the obligations of the parties could be suspended during the period that performance is impossible. It is unclear, however, whether a court would apply this legal principle in the context of the coronavirus pandemic.

Many contracts contain specific insurance clauses that require one of the parties to procure insurance in both the form and amount specified. One of the most common examples of this is a commercial lease that requires the tenant to maintain business interruption insurance, and a tenant's failure to do so, may be a breach of its obligations under the lease. Clearly, contracting parties should now be undertaking a review of their insurance obligations under their contracts and any available insurance policies which may be a source of funds to mitigate their losses.

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When considering these issues, it is important to understand that each contract is different, each business relationship is unique, and we are in the midst of an unprecedented and fluid event. The best course of action is always for the parties to work through the issues in good faith and reach a common-sense business decision. Perhaps the most critical part of negotiating a fair resolution is understanding your legal rights and liabilities under your contract before you pick up the phone or start writing an email. Parties who chose to work through these issues together should then carefully and accurately document any modifications to their contractual relationship. Doing so now will clarify each parties' obligations and help to avoid future misunderstandings and disputes.

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