

Here's How the Pandemic Is Changing 'Act of God' Clauses in Real Estate Contracts

Some Judges Side With Landlords, Refuse To Excuse Tenants From Paying Rent



The coronavirus outbreak caused the shut down of retail businesses and restaurants, prompting owners and landlords to try to change their lease terms to include losses from a pandemic. (Getty)

By Randy Drummer
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Attorney Zach Allen had never in his 20 years of practicing real estate law seen the possibility of a pandemic or epidemic included in a standard real estate lease as an "act of God" similar to a war, hurricane or earthquake. Until the past year.

The pandemic has fundamentally transformed how most attorneys and their clients consider force majeure, a lease clause that limits the liability or obligations of tenants and landlords in the event of such catastrophes, Allen said. Those clauses had formerly been "one of those often-overlooked boilerplate provisions," he added.

"Most landlords and tenants had little cause to invoke it except for maybe the occasional weather-related delay," Allen, a member of the real estate practice group at the Oklahoma-based Crowe & Dunlevy law firm, told CoStar News. "I've looked at a lot of lease agreements for national retail tenants," he said, and "I don't think I've seen one that actually anticipated a pandemic. We've never encountered a situation like this."

A year after the pandemic wreaked havoc on businesses ranging from stores, restaurants and movie theaters, force majeure clauses have become the most discussed portions of any new commercial real estate lease. They're also being modified or added to existing leases in anticipation

of the next crisis or unexpected event. And major changes are underway to other general lease language on issues such as rent abatement and lease termination rights, according to real estate attorneys and brokers representing both sides of negotiations.



Small businesses across the country have closed after struggling to pay their rent. (Getty Images)

The change comes after the pandemic and government emergency orders forced businesses in shopping malls, restaurants and office buildings as well as other commercial properties to close or sharply limit occupancy. Many struggling tenants stopped paying rent or

abandoned their space, causing high-profile fights between landlords and tenants. Some conflicts have escalated to lawsuits over who should bear financial responsibility for the disruption that has caused billions in lost sales and income and contributed to millions of lost jobs and a rising tide of business bankruptcies.

"We're seeing language involving government-mandated shutdowns in virtually every new lease," said Scott Burns, retail brokerage lead in Los Angeles and managing director for JLL.

Almost one-third of leases signed between April 1 and Dec. 31, 2020, in the United States specifically listed a pandemic as a force majeure event, compared with just 4% of leases signed prior to the crisis in 2018 and 2019, according to a survey of more than 300 recently signed leases conducted by business and legal research firm LexisNexis.

In total, more than 60% of leases signed from April through December mentioned the pandemic, other public health crises, coronavirus-driven emergency shutdowns or laws that could effectively make it illegal to fulfill the lease terms, the survey found.

"Force majeure clauses went from being somewhat boilerplate prior to the pandemic to being one of the more negotiated provisions in a lease negotiation," Michelle McAteer, a real estate litigation attorney with Chicago-based Jenner & Block, told CoStar News.

Negotiating force majeure provisions has taken on [a new sense of urgency](#) as attorneys and their clients track the progress of the first wave of lawsuits from tenants that seek to excuse or delay their lease obligations amid extreme financial hardship, McAteer's Jenner & Block colleague on the litigation side, Abraham Salander, told CoStar.

In the early weeks of the pandemic, tenants, owners and their attorneys rushed to review their leases and push for new terms that include references to pandemics and civil unrest, he said.

"We immediately started seeing feuds between landlords and tenants from day one of the pandemic," Salander said. "My phone was ringing off the hook. Emails were blowing up from clients, other partners in the firm and outside lawyers were calling to discuss issues. Tenants said they couldn't pay rent and didn't have to, and landlords pushed back."

That burst of activity "has now swelled into this wave of ongoing issues that my clients are facing," Salander added.

Burns said what stuck out to him was that, although leases weren't much of a road map for navigating the crisis, most struggling retail landlords and tenants pulled together and worked out their own agreements on deferred or abated rent without needing to call in the lawyers.

"Landlords could see they were struggling and tried to become partners instead of playing hardball," Burns said.

New Lease Terms

Force majeure clauses in property leases signed before 2020 typically defined fires, labor strikes, war or acts of terrorism, government prohibitions, natural disasters or other uncontrollable circumstances as being events that could free landlords or tenants from being liable for lease terms. Few of the clauses mentioned pandemics and almost all did not allow the abatement, extension or deferral of rent or other payments required by either party.

Now, attorneys have to grapple with whether a tenant can get rent full abated if a government order closes the doors to the business or whether they can get rent partially deferred if their capacity is reduced. For example, Crowe & Dunlevy's Zack Allen negotiated changes to a lease between a hospital tenant and property owner that would require rent abatement if the owner receives forbearance from its lender in the event of a government-ordered lockdown of 10 or more consecutive days.

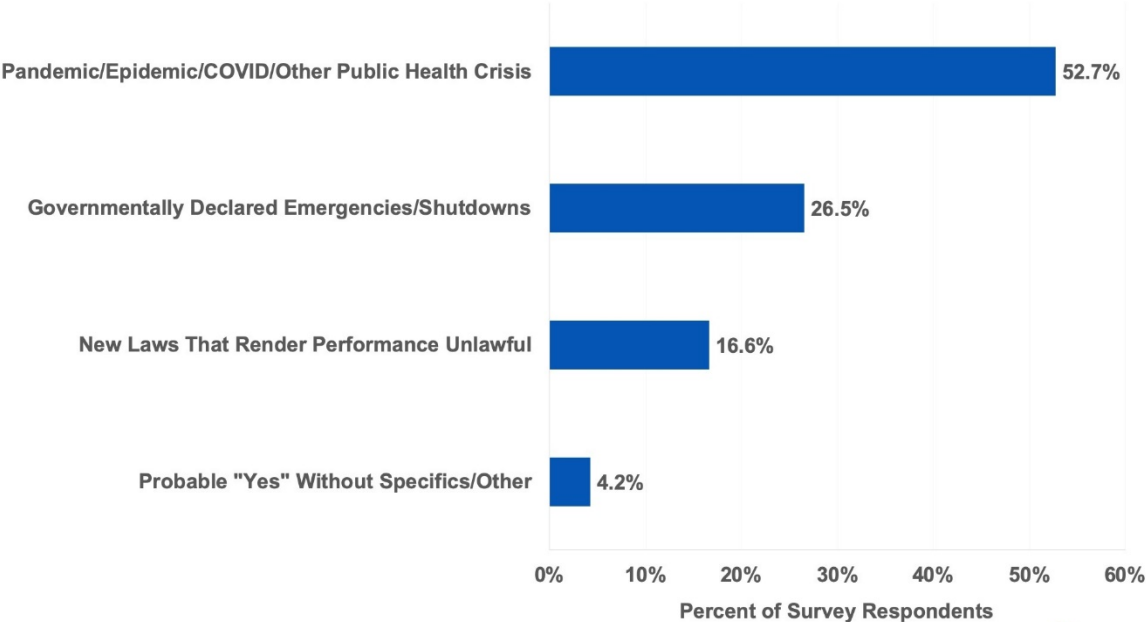
But many real estate attorneys are still trying to sort out exactly how force majeure clauses will change in coming months and years, said David Farren, an attorney with the Phoenix-based Jaburg Wilk law firm. The circumstances created by the pandemic have raised legal issues that are barely a year in the making and are difficult to analyze without the guidance of precedent-setting case law that hasn't yet been established.

“Unfortunately, the courts have not had time to catch up to the COVID-19 pandemic,” Farren told CoStar News.

Many owners and tenants that haven't yet added such lease provisions plan to do so, according to the survey of more than 300 recently signed commercial leases obtained from private sources by LexisNexis legal publication Practical Guidance Journal.

More than half the respondents whose force majeure lease clauses did not already include mention of pandemic-related events reported that they planned to renegotiate their leases to include one or more of those events in their contracts.

Tenants, Landlords Expect To Add New Lease Provisions Covering Public Health Crises



Source: LexisNexis, Feb. 24



The survey had 283 respondents to the question on whether they plan to add pandemic-related force majeure clauses.

Several cases working their way through U.S. federal and trial courts could define how judges interpret force majeure in light of a pandemic or government-ordered business closing. In addition to rent requirements in leases, the cases could help decide whether commercial

insurers are obligated to cover business losses or buyers and sellers are required to complete property sales. Other cases could determine whether developers, contractors and lenders have to meet construction timetables on projects delayed or canceled by pandemic shutdowns.

Landlords have won some early victories on leases, with judges refusing to exempt tenants from paying rent based on their claims of force majeure and other legal arguments, according to Jenner & Block's Salander.

Judges in several cases have denied tenants' force majeure claims under leases and casualty provisions, generally concluding that the premises were physically intact and the tenants were able to operate their businesses in some form, Salander said.

For example, U.S. District Judge Robert Scola denied a motion by Kirkland Stores Inc. to dismiss a lawsuit filed in April by Palm Springs Mile Associates, owner of the [Palm Springs Mile](#) shopping center in Hialeah, Florida, after the home decor and furniture chain stopped paying rent as the effects of the pandemic disrupted its business.

Kirkland argued that restrictions on its business operations constituted a force majeure event in the lease, according to the lawsuit. Scola rejected the motion in a

September ruling, concluding that the tenant failed to explain “how the governmental regulations it describes as a force majeure event resulted in its inability to pay its rent.”

Kirkland and Palm Springs Mile Associates did not respond to requests to comment on the case.



Kirkland's home furnishings was involved in a lawsuit over rent payments. (CoStar)

Tony Natsis, an attorney with the Allen Matkins law firm in Los Angeles who represents landlords, has yet to see a case where a tenant successfully invoked force majeure or

other common-law principles to forgo rent payments because of COVID-19.

"Exacting lease language that forgives a tenant from any rent is almost nonexistent," Natsis said. "Most leases in the history of real estate say that if there's a force majeure event, the tenant still has to keep paying rent."

He said that court cases until now have not given him or his landlord clients "anything to be afraid of."

While losses to retailers can be measured in lost sales, the financial impacts of pandemic shutdowns aren't as clear for office landlords and tenants, Burns said.

"In some cases, office landlords and tenants are in an even worse situation," he said. "It wasn't even the fact that governments mandated closures, it was the fact that companies including landlords didn't want their people coming back to office buildings, or those people refused to come back."

Bankruptcy Complications

Rulings in bankruptcy cases are also providing a glimpse into how judges view tenant arguments that force majeure provisions should allow them to withhold rent.

Movie theater chain Cinemex thought it had protection against any disaster in its standard commercial property lease. But what the lease didn't include was protection against an unprecedented health crisis that has sent most of the world into quarantine for a year.

Cinemex learned the hard way like most tenants in the United States that the force majeure clause doesn't give it the right to avoid paying rent. The Miami-based parent of Mexico's second-largest movie theater chain, Cinemex Holdings USA, filed for Chapter 11 bankruptcy protection last April and sought to pay reduced rent to landlord Cobb Theaters at the [Lakeside Village Shopping Center](#) in Lakeland, Florida for the time that it was required to operate at 50% capacity when Florida Gov. Ron DeSantis closed movie theaters as part of precautionary measures to control the virus.

U.S. Bankruptcy Judge Laurel Isicoff of the Southern District of Florida ruled in January that no rent was due for the time period covered by the full shutdown, based on the force majeure lease provision excusing performance when it was impossible due to "acts of God [or] governmental action."

However, Isicoff noted that the provision did not fully excuse Cinemex's rent obligation. It merely extended the

lease term for a period equal to the duration of the full shutdown orders. Cinemex Holdings ultimately renegotiated some leases and emerged from bankruptcy reorganization in November.

Cinemex and Cobb Theaters did not reply to requests for comment.

The decision reinforced the importance of concise and accurate force majeure lease provisions, Quinto Martinez, a real estate attorney for Orlando, Florida-based Lowndes law firm who was not involved in the case, said in an email.

"It's important to strategically negotiate the allocation of risk in a force majeure provision, but it's equally as important to carefully craft the provisions to ensure that the lease language makes the intent of the parties clear," Martinez said.

—20.3 Force Majeure. Neither Landlord nor Tenant shall be required to perform any term, condition or covenant in this Lease so long as such performance is delayed or prevented by force majeure, which shall mean acts of God, strikes, lock outs, material or labor shortages, or restrictions by government authorities and other causes which are not reasonably within the control of either Landlord or Tenant, and which, by the exercise of due diligence, Landlord or Tenant would be unable, wholly or in part, to prevent or overcome. ~~Provided however, this provision shall not apply to Tenant's obligation to pay Base Rent and Additional Rent.~~ Provided however, in the event Tenant is prohibited or restricted by governmental order from conducting substantially all of its ordinary business operations within the Premises for ten (10) or more consecutive days ("Lockdown"). Landlord shall make commercially reasonable and good faith efforts to work with Landlord's existing lender, if any, to obtain forbearance under Landlord's then existing loan for the period of such Lockdown. To the extent Landlord is successful in the foregoing, Landlord will abate Tenant's monthly Base Rent and Additional Rent obligations during the Lockdown by an amount equal to the reduction in Lender's monthly debt service for the same period as a result of such forbearance. If Landlord is unable to obtain such requested forbearance relief within thirty (30) days after commencement of the Lockdown, Landlord agrees to thereupon adjust Tenant's monthly Base Rent and Additional Rent during the Lockdown to an amount sufficient to service only Landlord's monthly debt service to its lender during the period of Lockdown. If no mortgage indebtedness is secured by the Premises during a Lockdown, then Tenant's monthly Base Rent and Additional Rent obligations shall abate by fifty percent (50%) during the Lockdown. Upon the expiration of any Lockdown, Tenant's Base Rent and Additional Rent shall immediately return to the amounts set forth by the terms of this Lease.

Attorneys for a hospital tenant were able to negotiate changes to the force majeure clause in a negotiated lease between an unnamed landlord and a hospital tenant that would require rent abatement if the owner received forbearance from its lender in the event of a government-ordered lockdown of 10 or more consecutive days. In red are the changes the tenant was able to negotiate.

Many companies haven't yet started to negotiate new leases with language providing more clarity on short-term rent deferrals because of the pandemic and other issues.

"It hasn't crept into our lease negotiations" said Peter Mavoides, CEO of New Jersey-based Essential Properties Realty Trust Inc., a real estate investment trust that owns and manages single-tenant properties leased to retail and service-oriented companies.

Most of the 3% of uncollected rent due to Essential Properties is from five theaters leased to AMC, which has had to close hundreds of cinemas for months because of government mandates prohibiting public gatherings and it owes hundreds of millions in back rent, Mavoides said during a recent earnings call with analysts.

AMC did not respond to a request for a comment on the status of its leases with Essential Properties or other landlords.

Mavoides declined to comment on how much rent the REIT is collecting from the embattled theater chain or whether the tenant cited force majeure. But the CEO said that he wouldn't be surprised if more tenants start looking to share some of the risk of state-mandated shutdowns with landlords in future leases.

"Currently, the tenants bear those risks and are required to pay rent regardless of mandated shutdowns. That's why we were able to structure rent deferral agreements as opposed to tenants just being able to say 'force majeure' and not pay rents," Mavoides said.