

Real Estate Contracts in the Time of COVID: Insights and Best Practices for Contract Drafting and Enforcement

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Alicia is a litigation attorney at Cox, Castle & Nicholson and Co-Chair of the firm's litigation department. She has represented clients in both complex business and real estate litigation, including contractual disputes, partnership, member and shareholder disputes, insurance coverage disputes, fraud disputes, landlord-tenant disputes, valuation claims, environmental claims and easement and neighbor disputes. Although she is adept at leveraging cases to achieve settlements early, she also has significant trial and arbitration experience and has appeared and argued before the California appellate courts.

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Introduction

The purpose of this program is to discuss:

1. Contract provisions that have been highlighted during the COVID pandemic
2. Practical deal and litigation issues in today's environment
3. Highlight recent court cases involving COVID issues

High Leverage Contract Provisions

- Over the past year we have seen parties to contracts leverage various contract provisions to attempt to terminate contracts or avoid obligations thereunder
 - Force Majeure
 - Rent Abatement Clauses
 - Operation in the Ordinary Course Covenants

Force Majeure

- Confirm list of force majeure events. Is the pandemic covered (unlikely) or ancillary effects covered (more likely)?
- Does lease expressly provide that force majeure effects do not excuse, waive, or delay payment of rent and other monetary obligations?
- Seeing some tenants with leverage trying to push back on carve-outs for payment of rent.
- More useful for tolling non-monetary obligations.

Force Majeure Cont'd

If either party hereto shall be delayed or hindered in or prevented from the performance of any act required hereunder by reason of strikes, lock-outs, labor troubles, inability to procure materials, failure of power, governmental moratorium or other governmental action or inaction (including, without limitation, failure, refusal or delay in issuing permits, approvals and/or authorizations), a government declared health emergency, including pandemics and voluntary or involuntary health related quarantines, injunction or court order, riots, insurrection, war, terrorism, bioterrorism, fire, earthquake, inclement weather including rain, flood or other natural disaster or other reason of a like nature not the fault of the party delaying in performing work or doing acts required under the terms of this Lease (but excluding delays due to financial inability) (herein collectively, "Force Majeure Delay(s))", then performance of such act shall be excused for the period of such Force Majeure Delay and the period for the performance of any such act shall be extended for a period equivalent to the period of such delay. The provisions of this Section shall not apply to nor operate to excuse or delay Tenant from the payment of Monthly Base Rent, or any Additional Rent or any other payments required by this Lease.

Rent Abatement Provisions

- Failure of access to the premises or failure of services
 - What is the necessary threshold? Total failure? Material diminishment? Unable to conduct business substantially as before? Failure to provide services as required by the Lease?
 - Is there a landlord fault-based standard? Or is causation not qualified?
 - Does landlord have a cure period?

Rent Abatement Cont'd

In the event that Tenant is prevented from using, and does not use, the Premises or any portion thereof, as a result of (i) any repair, maintenance or alteration performed by Landlord, or which Landlord failed to perform, after the Lease Commencement Date and required by this Lease, or (ii) any failure of services, utilities or access to the Premises (either such set of circumstances as set forth in items (i) or (ii), above, to be known as an "**Abatement Event**"), then Tenant shall give Landlord notice of such Abatement Event, and if such Abatement Event continues for five (5) consecutive business days after Landlord's receipt of any such notice (the "**Eligibility Period**"), then the Base Rent, Tenant's Share of Direct Expenses, and Tenant's obligation to pay for parking (to the extent not utilized by Tenant) shall be abated or reduced, as the case may be, after expiration of the Eligibility Period for such time that Tenant continues to be so prevented from using, and does not use, the Premises or a portion thereof, in the proportion that the rentable area of the portion of the Premises that Tenant is prevented from using, and does not use, bears to the total rentable area of the Premises; provided, however, in the event that Tenant is prevented from using, and does not use, a portion of the Premises for a period of time in excess of the Eligibility Period and the remaining portion of the Premises is not sufficient to allow Tenant to effectively conduct its business therein, and if Tenant does not conduct its business from such remaining portion, then for such time after expiration of the Eligibility Period during which Tenant is so prevented from effectively conducting its business therein, the Base Rent and Tenant's Share of Direct Expenses for the entire Premises and Tenant's obligation to pay for parking shall be abated for such time as Tenant continues to be so prevented from using, and does not use, the Premises.

Rent Abatement Cont'd

Landlord's failure to furnish, or any interruption, diminishment or termination of services due to the application of Laws, the failure of any equipment, the performance of maintenance, repairs, improvements or alterations, utility interruptions or the occurrence of an event of Force Majeure (defined in Section _____) (collectively a "Service Failure") shall not render Landlord liable to Tenant, constitute a constructive eviction of Tenant, give rise to an abatement of Rent, nor relieve Tenant from the obligation to fulfill any covenant or agreement. However, if the Premises, or a material portion of the Premises, are made untenable for a period in excess of 3 consecutive Business Days as a result of a Service Failure that is reasonably within the control of Landlord to correct, then Tenant, as its sole remedy, shall be entitled to receive an abatement of Rent payable hereunder during the period beginning on the 4th consecutive Business Day of the Service Failure and ending on the day the service has been restored. If the entire Premises have not been rendered untenable by the Service Failure, the amount of abatement shall be equitably prorated.

Rent Relief Amendments

1. Rent Deferral (base rent only/CAM charges) by which tenant ultimately repays deferred rent at a later date inclusive of negotiated interest, sometimes adding new term to back-end of lease.
2. Rent Abatement (base rent only/CAM charges) for select period of time (e.g., 1-3 months) in exchange for adding new term to back-end of lease.

AB 255

This proposed bill, the COVID-19 Emergency Small Business Eviction Relief Act, would, until July 1, 2025, require a landlord, who receives a statement signed by a commercial tenant, as defined, and supported by documentary evidence that evidences that the tenant requests emergency rent relief because the business of the commercial tenant has experienced a decrease in average monthly gross revenue of at least 50%, which is reasonably attributable to public health regulations adopted to address the COVID-19 pandemic, during the qualifying time period, as defined, as compared with the 12 months immediately preceding the qualifying time period, to conduct a good faith negotiation to form a plan to allow the commercial tenant a reasonable opportunity to repay COVID-19 lease debt while minimizing the hardship to the landlord. The act would provide that failure by a landlord to comply with that requirement constitutes an affirmative defense in an unlawful detainer action.

Landlords and Tenants Allocating Costs

Parties looking to allocate expenses related to COVID. For instance building upgrades to HVAC, touchless, automatic doors, etc.

Parking Spaces

Notwithstanding the foregoing, if any Law or government order, restriction, or regulation, including any “shelter-in-place” or similar order related to COVID-19 (a “**COVID Restriction**”), expressly prohibits and prevents Tenant from using more than seventy-five percent (75%) of the allowable occupancy of the Premises, then, for the duration of the COVID Restriction, Tenant shall not be obligated to rent all of the Must Take Parking Spaces. Tenant’s obligation to rent the Must Take Parking Spaces (and Landlord’s obligation to make the same available) shall resume immediately upon termination or removal of the COVID Restriction.

Testing Protocols

Notwithstanding anything to the contrary set forth in the Lease or these rules and regulations, in order to safeguard the safety of the tenants, patrons and employees of the Project, Landlord reserves the right (but shall have no obligation) to implement a protocol for testing all individuals entering the Project or establishing other measures in connection with any health emergency related to a virus, disease, pandemic, epidemic or similar cause. Landlord may preclude entry to those who refuse to participate in such testing or other measures or who fail to meet the testing or other requirements set forth in such protocol.

Ordinary Course Covenants

- Ordinary course provisions help ensure that the business or asset the buyer is paying for is essentially the same as the one it elected to buy at signing.
- Works together with conditions to closing.
- *“The business of the Company and its Subsidiaries shall be conducted only in the ordinary course of business consistent with past practice”*.
- Can the seller negotiate for a “commercially reasonable efforts” qualifier or an “in all material respects” qualifier?
- What is ordinary course of business?

Ordinary Course Covenants

- Can sellers act in response to extra-ordinary events that cause a disruption to the ordinary operations of the company? E.g., are seller business responses to the COVID-19 pandemic deemed acts outside the ordinary course?
- *AB Stable VIII LLC, v. Maps Hotels & Resorts One LLC* (Breach of Ordinary Course Covenant Found)
 - Underlying Provision: *“The business of the Company and its Subsidiaries shall be conducted only in the ordinary course of business consistent with past practice in all material respects.”*
 - Seller closed 2 of 15 hotels. Operations at hotels that remained open were radically different from normal and routine operation of business (food and beverage service stopped other than in-room dining, amenities shut down).
 - All capital expenditures were placed on hold.
 - Marketing expenses decreased year-over-year by large percentages.

AB Stable VIII LLC

- Key Findings for Court's Ordinary Course Decision:

- Relevant time period for “ordinary course” began when the purchase agreement was signed.
- Required standard was the way in which the company normally operates. It is not ordinary course for a company operating during a pandemic.
- Covenant was flat and unconditional. It was not qualified by an efforts obligation.
- Ordinary and reasonable responses to extraordinary events can be found to breach the covenant to operate in the ordinary course of business.

AB Stable VIII LLC

- *AB Stable VIII* highlights the importance of including specific language in ordinary course covenants to address business responses by sellers during COVID-19 and other unanticipated external conditions.
- “Notwithstanding the foregoing, Buyer acknowledges and agrees that none of Seller or the Company shall be in breach of this Section ___ or otherwise deemed to not be operating in the ordinary course due to Seller’s or the Company’s compliance with any applicable Laws or any instruction, guidance, directive, requirement, restriction or suggested best practices of any Governmental Body relating to the CoVid-19 pandemic or otherwise.”

Compliance with laws related to COVID

Buyer shall, and shall endeavor to cause its Consultants (as defined below) to, comply with and follow the Center for Disease Control and Prevention (“CDC”) guidelines and recommendations as well as the direction of local health officials in connection with Buyer’s and its Consultants access to the Property, including any and all inspections thereon. At a minimum, Buyer and its Consultants agree that when accessing the Property and conducting any inspections thereon, face masks/coverings and/or other personal protective equipment shall be worn at all times, hygiene practices, including increased hand washing, sanitation of touched areas at the Property, and social distancing (at least six feet separation) shall be followed. At no time shall Buyer and/or its Consultants be permitted to access the Property if such party feels ill or otherwise displays any symptoms of COVID-19. Additionally, Buyer agrees not to access the Property if Buyer has knowledge that Buyer had recent contact (*i.e.*, within the last 14-days) with a person that has tested positive for COVID-19 or otherwise shows symptoms of COVID-19. Buyer shall also endeavor to ensure that its Consultants comply with such restriction at any time such Consultant(s) accesses the Property. “**Consultants**” shall collectively mean Buyer’s engineers, architects, directors, officers, consultants, employees, agents, representatives and advisors, and the engineers, architects, directors, officers, consultants, employees, agents, representatives and advisors of Buyer’s investor(s) and lender(s) and/or potential investor(s) and lender(s).

COVID Related Waivers

Buyer understands that exposure to disease-causing organisms and objects, such as COVID-19, and personal contact with others, including but not limited to inspectors, appraisers, contractors, occupants and others associated with the inspection and purchase of the Property, involves a certain degree of risk that could result in illness, permanent disability or death. Buyer acknowledges that it is impossible to screen and/or monitor all such individuals. After fully and carefully considering all the potential risks involved, Buyer hereby assumes the same and agrees to release and hold-harmless the Seller and the Released Parties from and against, all claims and liability resulting from exposure to disease-causing organisms and objects, such as COVID-19, associated with Buyer and/or its Consultants access to and inspections of the Property, including any individual apartment units therein. Buyer further agrees to indemnify, defend and hold Seller and the Released Parties harmless for any claims or injuries resulting from Buyer's and/or its Consultants access to and activities at the Property, as it relates to COVID-19, to the extent not resulting from the actions of Seller.

COVID Related Delays

COVID-19. Buyer and Seller acknowledge that the current spread of coronavirus disease 2019 (together with all variations in the name thereof, including without limitation “2019 novel coronavirus” or “2019-nCoV”, “COVID-19”) may cause unanticipated delays or otherwise directly or indirectly affect the transaction between the parties. Negative effects may include reduced access to services necessary to complete the transaction, including services provided by: underwriters, appraisers, inspectors, title companies, couriers, governmental offices, contractors and insurers. In light of these conditions, Buyer and Seller agree that it is prudent to incorporate a COVID-19 delay provision into the Agreement. Therefore, Buyer and Seller agree that performance under the Agreement may be modified upon compliance with the below stated conditions as stated below and agreed upon by the parties upon the occurrence of a “Condition Causing a Delay” (as defined below).

COVID Related Delays Cont'd

A “Condition Causing a Delay” in Buyer’s or Seller’s ability to meet a specific deadline in the Agreement shall mean (i) a governmental (federal, state, or local) declaration of emergency, “shelter in place” or “stay at home” order restricting movement, to the extent that such declaration or order impedes the performance of tasks to be performed pursuant to this Agreement and no commercially reasonable alternative exists for the performance of such tasks; or (ii) a lender, title insurer, attorney, insurance company, vendor, agent, utility, governmental agency or other party whose cooperation is necessary to the delayed party’s performance is unable to provide a necessary service.

Notwithstanding anything in this Agreement to the contrary, neither Buyer nor Seller shall be responsible for any fees, costs or penalties of the other party relating to any extension of the Closing Date due to a Condition Causing a Delay set forth in this Article 10.

COVID Related Delays Cont'd

Condition Causing a Delay. Subject to the provisions and procedure set forth in Section 10.3 below, Buyer and Seller agree that the Closing Date, if unable to occur due to, or arising from, a Condition Causing a Delay, will be postponed for the earlier of: (i) the amount of days until the Condition Causing a Delay is resolved, (ii) one hundred twenty (120) days following the original Closing Date, or (iii) the date when the Title Company is willing and able to issue the Title Policy.

COVID Related Delays Cont'd

Procedure. The procedure for obtaining and the granting of any extension of time as provided or as allowed in Section 10.2 above, shall be as follows:

The party seeking or requiring an extension for a the Closing Date beyond the Scheduled Closing Date shall, upon learning of the Condition Causing a Delay (but in no event after the deadline in question), promptly give written notice of the Condition Causing a Delay, which notice shall include the essential reason(s) for the Condition Causing the Delay (a “Closing Delay Notice”). Such Closing Delay Notice must be delivered to the other party prior to the expiration of the related contingency time period(s) as set forth in this Agreement. The Closing Delay Notice must describe with sufficient detail to state a particular problem (*e.g.*, an office closure as a result of a government isolation order) that constitutes a Condition Causing a Delay.

Unless expressly agreed to by Buyer and Seller in writing, no further extension beyond that set forth in Section 10.2 above shall be granted or extended for a Condition Causing a Delay for Closing. The failure to perform and complete Closing on or before the dates set forth in this Agreement, as may be extended pursuant to this Article 10, as a result of a Condition Causing a Delay for Closing shall not constitute a default under this Agreement and shall result in a termination of this Agreement, in which event the Deposit shall be returned to Buyer.

COVID Related Delays Cont'd

Good Faith. Buyer and Seller agree to use good faith efforts to remain in, and perform, under the Agreement and will utilize remote or electronic services to the extent possible to avoid or circumvent a Condition Causing a Delay.

COVID Due Diligence Inquiries

- **COVID-19 Business Impacts**
- Describe changes to (or impacts on) the normal course of business since March 1, 2020.
- Describe any supply chain interruptions or material third-party concerns regarding the ability of parties to perform under material contracts since March 1, 2020.
- Describe any other material developments or impacts in the Company or the business related to COVID-19 of which [buyer/insurer] should be aware.

COVID Due Diligence Inquiries

- **COVID-19 Business Responses**
- Describe mitigation steps the Company is taking to manage impact on business, customers, employees, and the market generally in light of COVID-19 .
- Describe any disruptions caused by COVID-19 on the Company's human resources, specifically senior management, key employees, or personnel. Indicate whether the Company has implemented any layoffs, furloughs, wage reductions, reduction in hours or workdays (or any other compensation or work scheduling changes) in light of COVID-19.
- Describe the ways in which the Company's functions can be undertaken remotely, and how IT systems are responding (i.e., capacity, security, productivity, etc.).

COVID Due Diligence Inquiries

- **Future Outlook**
- Describe expected impact to the business as a whole (both short and long-term), financial condition, and changes to the Company's overall business strategy with respect to COVID-19.
- Discuss whether any of the Company's insurance policies may cover losses related to COVID-19 (e.g., business interruption insurance coverage), and if so, whether the Company has made any claims with respect thereto.

COVID and the Courts

- Each County is different
- All are open and operating
- Mask and physical distancing requirements
- Courts have adopted new technology
- Motions being filed and heard
- Trials being set and moving forward
 - Remote court trials
 - Jury trial waivers
 - Stipulations to smaller juries
 - Remote juries
 - Use of larger courtrooms

COVID and the Courts

- Priority to:
 - Criminal cases
 - Family law cases
 - Unlawful detainer cases
- Civil cases are lowest priority
 - Discovery ongoing
 - Depositions in person and remote

COVID and the Courts

- Contra Costa:
 - No health screening at entrance
 - Clerk's hours 8 a.m. - 3 p.m.
 - E-filing available for some cases
 - Special notice to be included in motions
 - Remote proceedings via Zoom/CourtCall
 - Jury trials occurring as of March 1
- Information about all courts:
<https://www.courts.ca.gov/court-status.htm>

COVID Related Lawsuits

- Civil Cases:
 - Employment
 - Landlord Tenant
 - Anticipated influx of unlawful detainer cases
 - Construction Delay
 - Purchase and Sale
 - Other Breach of Contract

Unlawful Detainer

- Authorization from Newsom for eviction moratorium for commercial tenancies extended until 6/30/21
- Varies by jurisdiction
- Single property can be subject to multiple ordinances
- Most restrictive restrictions to be followed
- Many residential have expired – AB 3088/SB 91

AB 3088

- Tenant to pay at least 25% of monthly rent since September but can be paid at the end (June 30)
- Tenant to submit hardship declaration
- Landlords may not increase rent or charge late fees
- No breach of contract actions in superior court until July 1 but may file in small claims
- Rent to be applied to current month unless agreed to apply to the past due
- Cannot apply security deposit to past due rent
- 15 day notice to quit instead of 3 day notice
- Cannot refuse to lease based on non-payment of rent during COVID

SB 91

- Creates emergency rental assistance and extends AB 3088
- Extends statewide eviction moratorium for residential tenants through June
- Emergency rental assistance:
 - Tenant must meet requirements including demonstrating risk of homelessness or housing instability and income below 80% AMI
 - Payment of up to 80% of rent accumulated from April 1, 2020 to June 30, 2021
 - In exchange for no UD for period covered and forgiveness of balance of the past due rent
 - Landlord can apply directly but if does not and tenant applies then rental assistance limited to 25%

Challenges to Moratoriums

- Cases filed to challenge constitutionality
- *Apartment Association of Los Angeles County v. City of Los Angeles*
 - Challenge to residential eviction
 - Landlord appeal pending in 9th Circuit (argued last week)
- *Iten v. County of Los Angeles*
 - Challenge to commercial eviction ban
 - Pending Motion to Dismiss in federal court (May 24)

COVID & Contract Defenses

Force Majeure, Impossibility And Frustration Of Purpose

Force Majeure:

- Civil Code § 1511: Potential excuse to liability where performance “is prevented or delayed by an irresistible, superhuman cause, or by the act of public enemies of this state or of the United States, unless the parties have expressly agreed to the contrary.”
- Often include floods, fires, earthquakes, hurricanes, explosions, wars, labor strikes
- Contractual provision governs
 - Pandemics and government orders may not be covered
 - Contain any carve-outs
 - Construed narrowly and increase in financial obligations insufficient
 - Notice requirements

COVID & Contract Defenses

Force Majeure, Impossibility And Frustration Of Purpose

Impossibility and Frustration of Purpose:

- Different defenses but often applied together
 - Impossibility looks at whether the action to be performed in a contract was objectively possible under the circumstances, while the frustration of purpose doctrine analyzes whether the parties can achieve the stated or implied purpose of the contract
- Unforeseeable at time of contract's formation
- With respect to frustration of purpose, the doctrine applies when performance is possible but supervening, fortuitous event has virtually destroyed the value of the consideration to be rendered
 - Value destroyed entirely; does not matter if more expensive

COVID & Contract Defenses

- Not aware of published California decision has squarely confronted COVID-19 or a pandemic in relation to these defenses for COVID related non-performance
- Several state cases challenged by demurrer/motion to dismiss

COVID & Contract Defenses

- Decisions from other jurisdictions may be instructive
- Largely in landlord-tenant context but applicable to different contracts
 - Depends on type of business and extent of shut-down and if any limited operations are possible. Movie theaters or gyms that were completely shut down and no other options may have a better defense than a retail store that could do curbside, partial sales or online sales
- Terms of contract and allocation of risk between parties matter
- Only during time period were performance prevented

QUESTIONS?



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