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Second Quarter, 2020

HOW THE HOSPITALITY INDUSTRY MIGHT RE-EXAMINE CONTRACTUAL OBLIGATIONS DURING THE CORONAVIRUS PANDEMIC

Force Majeure, Impossibility and Frustration of Purpose In the COVID-19 Era

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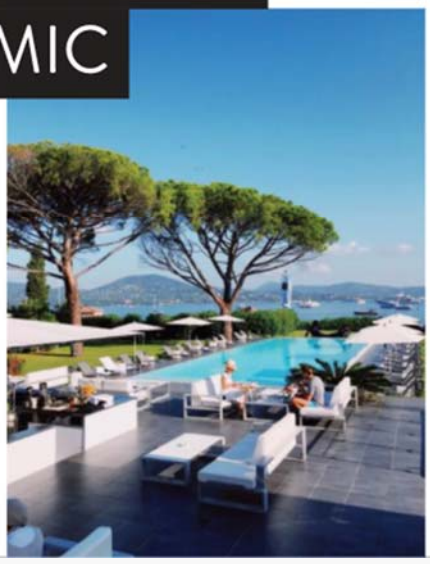
The COVID-19 pandemic has presented hotels with unprecedented financial challenges. The hospitality industry is bearing a significant brunt of the pandemic, with government mandates restricting the operation of non-essential business and grinding travel to a halt. These measures have thrown hotel operations into disarray, causing drastically lower occupancy rates, program and reservation cancellations and supply chain disruptions for goods and supplies that hotels need for their daily operations. The pandemic also has placed tremendous strain on retail stores restaurants and bars, jeopardizing critical revenue streams for hotels. The nationwide shuttering of hotels and hospitality services has forced industry actors to extricate themselves from a morass of contractual obligations with property owners, lenders, contractors, guests, organizers and vendors. Under these pressing circumstances, hoteliers should closely examine their contracts for opportunities to invoke force majeure clauses and/or raise impossibility and frustration of purpose defenses (together with other equitable remedies) so as to gain breathing room and help survive the coronavirus pandemic.

Depending on the contract's jurisdiction and language, a force majeure clause may excuse performance due to circumstances beyond the parties' control, such as fire, flood, war or acts of God. Force majeure clauses are intended to allocate risk between or among the contracting parties if an external, unpredictable and unavoidable event (such as the current COVID-19 pandemic) makes it impossible for the parties to perform under the contract.



The first step in determining whether force majeure applies is to review the agreement's terms. Hotels seeking to cancel events should identify whether their contracts contain a force majeure clause. The next step is to determine whether any of the events listed in the force majeure clause apply to the pandemic or its related effects. For example, if the agreement includes a concept like "act of government", "public health-related event", "outbreak" or "pandemic" as a force majeure event, performance may be excusable or deferrable if it is impossible to hold the event due to a ban on social gatherings or reductions of the in-person workforce.

If the agreement lists a pandemic or its effects as a force majeure event, the next practical step is to notify the counterparty that the force majeure clause has been triggered. Many agreements require parties to cooperate to find a mutually agreeable path forward in response to a force majeure event before terminating the agreement. While there is an implied duty to act in good faith with respect to any agreement, it's best to cooperate with vendors and business partners regardless of the terms of the force majeure provision, especially when it comes to lucrative and repeat contractual relationships. To reduce risk, a business should only terminate an agreement if the agreement explicitly provides for termination or if performance remains impossible despite the parties' cooperative efforts.

Keep in mind that force majeure provisions also have potential pitfalls. If a business is seeking to excuse performance, it should tread carefully around the application of "catchall" force majeure terms. For instance, in New York, courts only give force majeure effect to events that are of the same general kind as those specifically listed in the force majeure clause, even if the clause permits termination for "any other reason." Moreover, in many jurisdictions, performance may not be excused if it would merely be more burdensome or unprofitable to carry out the agreement. In any event, force majeure may be more readily applicable to contractual obligations that are tied to a specific date such as a construction completion date or an event like a concert, wedding or program relating to a religious holiday such as Passover or Easter. When invoking a force majeure clause in this context, a hotel should communicate that its ability to perform within the contractual time frame is prevented, hindered or precluded by COVID-19-related restrictions.

If a pandemic or its effects are not included in the force majeure clause (or if the contract has no force majeure clause), a business might be excused from performance under the "impossibility" doctrine. Impossibility may be invoked where the performance of the contract has been rendered objectively impossible, and the event causing the impossibility was unforeseeable at the time the parties entered the contract. Hotels may rely on this defense in situations where their performance is rendered impossible by COVID-19 related restrictions. Generally, courts apply the doctrine of impossibility narrowly. Accordingly, hotels may not be released from contracts where their only obligation is to pay an agreed upon sum, because it may remain objectively possible to render payment. By the same token, performance would not be excused where the rescheduling of an event or program is objectively possible.

Contractual performance also may be excused under the "frustration of purpose" doctrine if the COVID-19 pandemic's impact has rendered the agreement's performance worthless. To invoke this doctrine, a hotel must establish that the pandemic has substantially frustrated the contract's basis to the point where the contract makes little sense. A common example of frustration of purpose in the COVID-19 context is when a large event must be cancelled due to social distancing mandates, depriving the contractual parties of any value from the agreement. While this doctrine may release a hotel from its obligation to host the event, it does not necessarily settle prior commitments such as nonrefundable deposits and payments made to suppliers, sponsors or other vendors.

Disputes between contracting parties over non-refundable deposits and other advance payments are ripe for litigation. Under these circumstances, a court may apply principles of fairness to determine parties' rights with respect to any guest deposits or the value of any payments for goods and services in connection with a cancelled event. Hotels may be able to recoup some losses from vendors by invoking the common law doctrine of "restitution", which prevents parties who do not or cannot perform from obtaining a windfall. Once hotels maximize their recovery from vendors, they will be in a better position to resolve disputes with guests concerning the return of deposits for cancelled events or reservations.

Other areas ripe for litigation include disputes over operating lease payments, loan payments, unmet construction deadlines and termination of exclusive use provisions to maximize revenue from the premises. Disputes such as these currently are in their early stages and most U.S. courts have been impacted by COVID-19-related restrictions. As a result, the full panoply of rights and remedies available to contract counterparties has not yet been determined.

In upcoming weeks and months, hospitality businesses should examine their contracts for force majeure clauses and consider the above doctrines for ideas as to approaches to contract-unwinding negotiations. In addition, they should negotiate current and future contracts carefully to ensure the contracts include as a force majeure line item the possibility of pandemics (or, more broadly, public health-related events) and government actions or mandates relating thereto.

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