

# Navigating Commercial Leases and Real Estate Loans during COVID-19

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*This article discusses issues that commercial landlords and tenants, and real estate loan borrowers and lenders, are facing in connection with their contractual obligations during the COVID-19 pandemic.*

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**A**s the spread of COVID-19 causes the closures or severe cutbacks of businesses, many in the commercial arena are left to consider their options as landlords and tenants in commercial leases, and lenders and borrowers in real estate loans. Concepts such as force majeure, material adverse effect, and frustration of purpose are becoming part of the current lexicon for these commercial actors. The next step is to understand how such concepts operate in lease provisions and loan documents to determine how they can work for the parties in these unsettling times.

This article provides the legal groundwork to understand commercial lease and real estate loan terms and noncontractual common law defenses that are particularly relevant in the COVID-19 environment. It reviews how commercial landlords and tenants, and real estate loan borrowers and lenders, are tackling pandemic issues with these terms in mind.

### **Legal Concepts in Commercial Leases and Real Estate Loans**

Parties typically contract to provide who bears the burden of risk for events that commonly affect performance. Such events include acts of God, and financial, business, and property conditions. Parties also rely on noncontractual common law principles that excuse performance.

#### ***Force Majeure***

Force majeure clauses are contract provisions that excuse a party's nonperformance when acts of God or other extraordinary events prevent a party from fulfilling its contractual obligations.<sup>1</sup> Whether certain events triggered by the COVID-19 pandemic constitute force majeure depends on whether and how force majeure is defined in a particular contract.<sup>2</sup>

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When considering the applicability of a force majeure clause, courts analyze (1) whether the event qualifies as force majeure under the contract,<sup>3</sup> (2) whether the risk of nonperformance was foreseeable and able to be mitigated,<sup>4</sup> and (3) whether performance is truly impossible.<sup>5</sup> The primary focus is on whether the clause encompasses the type of event a contractual party claims is causing its nonperformance.<sup>6</sup>

Force majeure clauses are generally interpreted narrowly; therefore, for an event to qualify

as force majeure, the clause at issue must use precise terms such as “war” and “pandemic” to state the event.<sup>7</sup> Even when a clause encompasses a potential force majeure event, a party cannot invoke force majeure where the potential nonperformance was foreseeable and could have been prevented or otherwise mitigated.<sup>8</sup> Further, nonperformance will not be excused if it is merely financially or economically more difficult to satisfy contractual obligations.<sup>9</sup> Some jurisdictions, however, may only require that performance be impracticable.<sup>10</sup>

A party that considers terminating a contract or delaying its performance based on the existence of a force majeure event should carefully consider the specific events upon which it relies in asserting that right. There will likely be disagreement about whether the event was beyond the terminating party's control; was reasonably foreseeable and could have been prevented; or fits the contractual definition of a force majeure as opposed to a change of economic circumstances, the risk of which the terminating party assumed.

If a party is contemplating termination based on a force majeure event, it should provide notice of the event as soon as practicable, even if it does not know whether the event will result in its inability to perform. Doing so reduces the risk of an unnecessary dispute about the timeliness of any notice.

#### ***Material Adverse Effect***

Commercial real estate loans typically allocate significant financial, business feasibility, and property condition risks to the borrower. Borrowers often seek to mitigate these risks by negotiating for “material adverse effect” (MAE) clauses, which provide an option to terminate the contract where certain circumstances occur that result in a material or adverse change to the

property's condition before closing. Sometimes the term "material adverse change" (MAC) is used interchangeably to refer to an MAE clause.

Whether an event falls within the definition of an MAE depends on (1) how MAE is defined, (2) the scope of any carve-outs to the MAE definition, and (3) whether the adverse event is material to the agreement as a whole. The applicability of the provision may also depend on the extent to which the parties could foresee the event in question and/or negotiated specifically regarding the risk of the event. An adverse event is generally considered material if it "substantially threaten[s]" the fundamental agreement "in a durationally-significant manner."<sup>11</sup> To qualify as an MAE, the adverse event "must be expected to persist significantly into the future."<sup>12</sup>

Whether an MAE has taken place usually presents a factual inquiry, and expert testimony and detailed financial information are almost always necessary.<sup>13</sup> A party seeking to terminate a contract based on an alleged MAE bears the burden of proving that the risk was unforeseeable at the time the party executed the contract and that the event in question will significantly impact the property in the long term.<sup>14</sup> Similar to force majeure clauses, courts evaluate whether the party's decision to terminate the contract based on an MAE was due to a circumstance that was reasonably foreseeable and has a long and lasting impact.

For example, in *Capitol Justice LLC v. Wachovia Bank, N.A.*, Wachovia Bank asserted its rights under an MAE clause to terminate a loan commitment for a loan intended to be secured through commercial mortgage-backed securities (CMBS) financing when the CMBS market ceased to function in 2007.<sup>15</sup> In its analysis of whether a material change had occurred, the court focused on whether significant changes in the CMBS market were reasonably foreseeable when the contract was drafted.<sup>16</sup> The court held that "parties often include MAC clauses to protect against *unknown*, not *known*, events[.]"<sup>17</sup> but that the MAC clause at issue was ambiguous "because there is more than one interpretation that a reasonable person could give to the MAC clause . . ."<sup>18</sup>

Even where COVID-19 has led to dramatic governmental actions and shutdowns, it cannot

be assumed that such conduct would justify triggering an MAE clause. Each case must be evaluated based on its specific factual circumstances, the language in the agreement, and the context of the transaction. If negotiations are

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ongoing for a prospective transaction, careful consideration should be given to crafting the MAE clause in light of the COVID-19 pandemic.

A review of recently filed complaints illustrates that contractual provisions other than MAC/MAE have been relied upon by parties seeking to avoid contractual obligations in the COVID-19 era, including failing to comply

with obligations to continue operations in the normal course of business due to compliance with government-mandated shutdowns; specific performance, for failing to comply with the scheduled closing; breach of contract, for refusing to close on a merger because financial information the seller provided the buyer did not take into account the effects of coronavirus; and declaratory judgment seeking a declaration that a buyer validly terminated a Transaction Agreement under which it would acquire a majority interest in the seller's retail business because the seller breached covenants, representations, and warranties by substantially altering its business operations.<sup>19</sup>

#### ***Noncontractual Common Law Principles that Excuse Performance***

Even in the absence of contractual MAC or force majeure clauses, parties may turn to common law defenses of impracticability or frustration of purpose as potential options to discharge their obligations under real estate contracts. Each of these defenses is incorporated into the *Restatement (Second) of Contracts*,<sup>20</sup> which is followed in Colorado.<sup>21</sup>

Under the doctrine of impracticability, a party's contractual obligations may be discharged if, after the contract is made, the party's performance becomes impracticable by the occurrence of an event that is outside of a party's control and the nonoccurrence of which was a basic assumption on which the contract was made.<sup>22</sup>

Similarly, under the doctrine of frustration of purpose, a party's contractual obligations may be discharged if, after the contract is made, the party's principal purpose is substantially frustrated without the party's fault and where the occurrence or nonoccurrence of an event was a basic assumption on which the contract was made.<sup>23</sup>

The application of each of these defenses depends on whether an unanticipated circumstance has made the performance of the contract materially different from what reasonably should have been within the contemplation of both parties when they entered into the contract.<sup>24</sup> Economic conditions generally do not constitute an unanticipated circumstance.<sup>25</sup> A governmental regulation or order, the nonoccurrence of which

was a basic assumption of the contract, may constitute commercial impracticability,<sup>26</sup> but a party must overcome a high bar to succeed on a commercial impracticability argument.<sup>27</sup>

### **Potential COVID-19 Issues with Commercial Leases**

Governmentally imposed stay-at-home orders implicate numerous issues in commercial leases involving nonessential businesses. With an understanding of those potential issues, landlords and tenants can work to craft solutions as they arise.

#### ***Force Majeure***

The force majeure provision in a commercial lease often provides for delayed performance of an obligation under the commercial lease for items such as acts of God, weather, inability to obtain labor or materials, pandemics, governmental actions, or other reasons similarly beyond the party's control. Thus, tenants will want specificity in the list of force majeure events while landlords may prefer less precise terms.

Stay-at-home orders and business shutdowns may amount to a force majeure event. Also, slowdowns in construction and material shortages caused by the COVID-19 situation may impact either party in the performance of the landlord or tenant work. However, many commercial leases exclude monthly payment obligations, such as those for rent and common area maintenance, from the application of force majeure. So even if the COVID-19 situation invokes the force majeure clause, tenants subject to such terms will be unable to use the provision to justify nonpayment of monthly payment obligations.

A party who raises the force majeure clause to delay performance under a commercial lease is typically required to provide timely notice to the other party that the event has occurred. Therefore, if a party wants to avail itself of a force majeure provision, it must be sure to abide by the applicable notice requirements.

#### ***Use and Maintenance of Common Areas***

Commercial lease provisions regarding use of common areas and the responsibilities of a landlord for those common areas should be reviewed. A landlord that is responsible under

the lease for the maintenance and cleaning of the common area will likely have a duty of care to its tenants for enhanced cleaning during this period of the COVID-19 outbreak. Further, along with that duty of care, a landlord may need to assist with social distancing by preventing access to common areas such as food courts, bathrooms, workout facilities, and rest areas. Given the lack of access to these areas, a tenant may assert that its payment of operating expenses should be lowered. However, at the same time, the increased cleaning procedures will likely lead to increased operating expenses. The lease terms will govern whether a landlord can pass these costs along to a tenant and whether such increase has a cap.

Changes to how a common space may be used must be communicated to the tenant. Landlords should review the lease terms to determine whether such modifications trigger ramifications such as rent abatement, the landlord's default, or the tenant's termination rights. If the tenant requests modifications to the use or cleaning of the common areas, the parties should assess any relevant lease provisions that need to be followed or modified.

Complicating matters, a vendor who provides required maintenance to common areas may be unable to perform the work due to its status as a nonessential business under a governmental order. In such case, a landlord may use a force majeure clause to delay the maintenance but must keep in mind its general duty of care to tenants when deciding whether to invoke the clause.

Some leases give the tenant certain responsibilities for common areas. In this situation, a landlord may ask the tenant to clean the common areas more thoroughly. Landlords should make such requests directly to the tenant and in accordance with the lease.

#### ***Space Alterations to Decrease Density***

To further the social distancing efforts due to COVID-19, a tenant may want to alter the premises to decrease occupation density, which may require the landlord's consent. Alternatively, a governmental order can require that businesses allow a certain percentage of the workforce to work from home. The lease terms may have

specific notice provisions for obtaining landlord consent for such alterations and may require the tenant to provide the landlord certain items when making such a request, such as the plans and specifications for such work and the contractors who will perform the work.

Most leases do not have provisions for emergency alterations to be completed by a tenant. Nonetheless, before undertaking emergency alterations, a tenant should approach the landlord with any ideas or conceptual plans for emergency alterations. The landlord will want to weigh financial considerations resulting from less use of the premises against the potential economic benefits of helping to mitigate the spread of COVID-19.

#### ***Operational Issues***

Commercial leases routinely require tenants to operate for a certain number of hours per day or week and/or during set hours within a day. Also, the lease may not allow a tenant to abandon the premises. Yet despite such provisions, commercial leases typically have a "permitted use" clause that obligates a tenant to comply with all laws. Thus, if a governmental order mandates the closure of nonessential businesses, a tenant could be faced with conflicting lease requirements when it closes the premises to comply with a governmental order.

One solution is for the tenant to request a short-term accommodation from the landlord to allow for fewer employees, reduced in-person hours, and/or changes in operating hours to help combat the spread of COVID-19. The force majeure provision may allow for this accommodation. The landlord's goal should be to make sure that such accommodations are indeed short term, because continuing such accommodations may not be sustainable.

To allow tenants continued operations, commercial leases normally require landlords to provide tenants with access to the premises. Governmental closure orders may also affect the landlord's ability to provide the tenant the amount of premises access that is required under the commercial lease, which may result in a landlord running afoul of the lease. Here again, the force majeure clause may become operative to allow landlords to limit access.

Tenants facing decreased access should review the lease to determine whether they are entitled to withhold rent under such circumstances.

### **Construction Improvements**

A commercial lease may require a landlord to complete construction work before delivering property to a tenant. Additionally, a tenant may be required to make construction improvements to the premises after delivery of the premises. Such construction projects may run up against force majeure provisions in construction contracts that allow contractors to discontinue or slow down work due to shortages of labor or construction materials, or lack of a building permit. A contractor's use of a force majeure provision will have cascading effects to the other parties, potentially causing a landlord's delayed delivery of the premises to the tenant or a tenant's failure to timely complete its improvements before the rent commencement date.

Where a date for delivery of the premises to a tenant is not set a landlord may not face consequences. But if such a date is set, a landlord facing construction delays may be able to rely on the force majeure clause to allow for such delays.

If the premises are delivered to the tenant with incomplete construction due to a work stoppage or slow down, the tenant should evaluate whether the force majeure clause permits delayed rent.

### **Casualty**

The parties may also want to review the casualty provisions in the commercial lease. Those provisions cover the parties' obligations in the event of a casualty to the premises, such as the tenant's notice requirements to the landlord of the casualty, the landlord's determination whether to restore the premises, the parties' rights to termination, and rent abatement to the tenant during the restoration.

Normally, such provisions apply only to physical damage to the premises, so whether the presence of the COVID-19 virus constitutes physical damage is unresolved. Depending on the specific lease, premises closures due to COVID-19 concerns or stay-at-home orders could qualify as a casualty if they do constitute

physical damage where the casualty provision is expansive. Therefore, parties should review the applicability and notice requirements for casualties.

### **Quiet Enjoyment**

The quiet enjoyment clause in a commercial lease generally provides that a tenant's use of the premises will not be disturbed so long as the tenant abides by the lease provisions. Therefore, where a governmental order is not in place, if a landlord closes the premises and does not allow the tenant to enter due to COVID-19 concerns, a tenant may have a claim for breach of quiet enjoyment. If a landlord's closure is due to a governmental order, the landlord may be able to assert that a force majeure event prevents its compliance with a quiet enjoyment provision.

### **Hazardous Materials**

A hazardous material clause may cover the presence of the COVID-19 virus in the premises. Such a clause in a commercial lease normally requires a tenant to agree to not have hazardous materials on the premises and to indemnify the landlord from damages for the presence of such materials. A landlord may have the same duty to a tenant. Therefore, either party may be able to rely on the hazardous materials clause for relief from performance during the pandemic.

### **Co-Tenancy Provisions**

A tenant may be allowed to pay reduced rent or have rent abated if the co-tenancy clause in a commercial lease is violated. Such a provision generally provides that if a certain anchor store or a specified percentage of stores in a shopping mall close, the co-tenancy provision is violated.

With the current COVID-19 concerns and governmental orders, some anchor tenants may close down temporarily or permanently. In such case, a tenant may be allowed to terminate the commercial lease.

### **Condemnation**

A commercial lease may provide for rent abatement or termination if the premises are taken by the government. Depending on the wording of the specific lease provision, a taking might occur if the government temporarily takes the

premises for its use or, through a governmental order, bars access to the premises.

### **Options for Resolution**

Regardless of the issues affecting their commercial lease, parties should communicate as soon as issues arise and properly document all of their communications. Communication is key to obtaining an expedient and mutually satisfactory solution.

Parties will generally have multiple solutions at their disposal, either through the express terms of the lease or negotiations to agree on a separate solution. For example, a landlord can consider deferring rent until a tenant is allowed back in the space. Depending on the situation, this solution could require the landlord to obtain lender approval for a deferral in payments.

A landlord can also look at other payment options, such as reducing the amount of rent to be paid in a certain month or allowing the tenant to pay only the operational expenses for that month. Additionally, a landlord can agree to use the deposit amount to cover a month's rent with a tenant who agrees to replenish the security deposit by a certain time.

A commercial lease also has various late fee provisions related to late rent or operating expense payments. A landlord can waive fees that normally would be assessed against a tenant for late payments. In that event, a landlord is not formally deferring payments, but also is not penalizing a tenant for late payments.

### **COVID-19 and Real Estate Loan Documents**

Many commercial real estate lenders and borrowers are working through the impacts of the COVID-19 pandemic on their loan documents. Adding to the complex and evolving impact of the pandemic, federal regulators have advised banks to work constructively with borrowers affected by COVID-19 by, among other things, modifying or restructuring debt obligations and modifying loan terms due to temporary hardships resulting from COVID-19 related issues.<sup>28</sup>

Given the business and legal uncertainties, lenders must assess their options case-by-case and balance business and legal risks in

determining their next steps. There will likely be situations in which funding a loan or approving draw requests is simply not advisable. In most cases, the lender and the borrower should evaluate their loan documents and use the tools discussed below to manage the business and legal risks.

### **Financial Covenants**

Lenders and borrowers should assess the impact of COVID-19 on the borrowers' ability to comply with their financial covenants. Most commercial loan documents contain financial covenants including (1) cash flow covenants, (2) leverage ratios comparing total debt to cash flow, (3) liquidity covenants, and/or (4) net worth covenants.<sup>29</sup> Additionally, in commercial real estate lending, loans are typically subject to loan-to-value and/or loan-to-cost covenants, which limit the principal amount of the loan to a percentage of the fair market value of the encumbered real estate, or the cost of acquisition and completing improvements on such real estate.<sup>30</sup>

In the real estate loan context, cash flow covenants are typically based on a net operating income formulation, which is generally based on the gross revenue derived from the operation of the property less its operating expenses, management fees, and often capital reserves.<sup>31</sup> The measurement and reporting of financial covenant compliance is typically done on a quarterly basis and in some instances may be based on annualized quarterly results. It is likely that the economic effects of COVID-19 will manifest in many borrowers' quarterly results, which could compromise the borrowers' financial covenant compliance, placing them at risk of a default under their loan documents. Thus, borrowers who anticipate difficulties complying with financial covenants as a result of the pandemic's economic effects should consider approaching their lenders now to discuss obtaining waivers or permanent amendments to such covenants.

### **Addressing Defaults**

The operational disruptions and financial stresses on borrowers resulting from the COVID-19 pandemic substantially increase the risk of defaults under loan documents. Moreover,

borrowers whose real estate becomes devalued because of declining rental or operational revenues may have difficulty complying with financial covenants that require a minimum loan-to-value ratio to maintain the outstanding loan balance.

Events of default typically act as a "draw stop" with respect to the lender's obligation to fund subsequent committed borrowings under multiple draw facilities, enabling the lender to refuse to fund a committed loan at a time when the borrower is likely in most need of liquidity to fund working capital. Thus, it is important to understand exactly what constitutes an "event of default" under the loan documents in question.

Lenders should assess the loan documents and liens for any defects that could be significant in a default scenario and subsequent collection efforts and determine whether the defects can be addressed through a workout. As an inducement to the lender to enter into a workout arrangement, the borrower may be willing to provide guaranties, collateral, or other protections that were not included in the original deal. This is also a time to assess intercreditor arrangements. There may be agreements that require the lender to give notice before exercising remedies or stopping payments on subordinated debt.

The Reservation of Rights Letter is an important tool for lenders in the COVID-19 environment. Despite the advantages of a Forbearance Agreement, there usually are delays while forbearance terms are negotiated and documents are drafted, especially now when the economy has been severely impacted with large numbers of borrowers in distress. The Reservation of Rights Letter will help establish that the lender considers existing defaults to be material; is not waiving defaults or agreeing to forbear; and is providing continued funding as an accommodation to the borrower and not as a waiver or affirmation of an obligation to fund in the future. The letter can also encourage the borrower to comply with proposed reporting deadlines, such as providing projections or cash flows by a date certain. If the borrower does not meet the requirements, the letter can serve as a marker in the paper trail showing the lender's efforts and the borrower's failure to follow through.

### **Representations and Warranties**

Loan documents should be evaluated to determine to what extent representations and warranties are continuing or whether they are fixed as of a stated time. Most construction loan agreements require, as a condition to further advances, that representations and warranties be true and correct as of each borrowing event. However, with single funding obligations, representations and warranties may only be made or deemed made as of the closing date or funding date.

It is likely that the impact of COVID-19 on certain borrowers will invalidate a representation and warranty, create a MAC, or rise to the level of a default event, any of which would serve as a basis for a lender to suspend additional funding to a borrower under the applicable loan terms. It could also result in disclosure requirements and potentially trigger a default event resulting in the lender's right to accelerate the loan and declare all outstanding amounts immediately due and owing.

### **Notices Required of Borrowers**

Borrowers should monitor and assess whether and at what point a notification requirement has been triggered as a result of the pandemic. Generally, commercial loan documents require borrowers to provide notice of certain events or occurrences, including notice of pending or threatened litigation, any defaults or events of default that have occurred, or an existing MAC or any event that would result in a MAC, all or any of which may be implicated by the effects of COVID-19 on a borrower and its business, assets, or finances.

### **Force Majeure**

Loan documents may contain force majeure provisions that limit the borrower's required performance for certain specified events. Such force majeure provisions do not typically cover monetary obligations, nor do they excuse a borrower from making required payments. Such provisions are typical in construction loan agreements and excuse failures to continue construction or delays in completion of construction by a date certain as a result of certain specified events. Whether a pandemic

such as COVID-19 would qualify under a force majeure clause is the subject of much discussion and speculation, but the determination will depend on the specific language of the clause at issue. Some clauses may specifically contemplate pandemics, epidemics, public health emergencies, or declared national emergencies, each of which would appear to cover the current pandemic.

### **Default Avoidance and Relief under the CARES Act**

On March 29, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), a stimulus package designed to mitigate the effects of COVID-19.<sup>32</sup> Significant for real estate, the legislation (1) establishes forbearance, foreclosure, and eviction limitations for owners/lenders of certain properties secured by government-backed loans; (2) establishes a loan guarantee program to help small businesses retain employees and cover necessities; and (c) extends \$454 billion to businesses, states, and cities impacted by the coronavirus and not receiving loans through any other provision in the Act.

Section 4023 of the Act provides that during the “covered period” a “multi-family borrower” with a “federally backed multifamily mortgage loan” that was current on its payments as of February 1, 2020, may submit a request for forbearance under § 4023(a) to the borrower’s servicer affirming that the multifamily borrower is experiencing a financial hardship during the COVID-19 emergency. Section 4023(f) of the CARES Act defines “multifamily borrower” and “covered period”:

- “multifamily borrower” is “a borrower of a residential mortgage loan that is secured by a lien against a property comprising 5 or more dwelling units”; and
- “covered period” is “the period beginning on the date of enactment of this Act and ending on the sooner of (A) the termination date of the national emergency concerning the novel coronavirus disease (COVID-19) outbreak declared by the President on March 13, 2020 under the National Emergencies Act (50 U.S.C. 1601 et seq.); or (B) December 31, 2020.”<sup>33</sup>

It is presently unclear whether seniors housing fits within the definition of “multifamily” properties under § 4023 of the CARES Act, but it is notable that the Fannie Mae Multifamily Selling and Servicing Guide defines<sup>34</sup> “Asset Class” as the “type of Multifamily Property securing a Mortgage Loan (e.g., conventional, Seniors Housing, Manufactured Housing Community, Cooperative, etc.).”<sup>35</sup> Thus, it seems reasonable to expect that senior housing facilities should be afforded the benefits of the CARES Act. The CARES Act does not impose a blanket moratorium on foreclosures by lenders on multifamily or other commercial borrowers.

The Small Business Authority (SBA) Paycheck Protection Program (PPP) is a loan guarantee program incorporated into the CARES Act to help small businesses keep employees on the payroll and cover necessities such as rent and utilities. If certain conditions are met, the loans are forgivable. To be eligible for a PPP loan, a company must be either (1) a small business concern under the SBA regulations, or (2) a business concern, nonprofit organization, veterans’ organization, or Tribal business concern that employs no more than 500 employees whose principal place of residence is in the United States (or the number of employees in the size standard applicable to the borrower’s industry, which for some industries is up to 1,500 employees).

SBA defines “business concern” broadly to include any business entity organized for profit, with a place of business located in the US, that operates primarily in the US or makes a significant contribution to the US economy through payment of taxes or use of American products, materials, or labor.<sup>36</sup> Thus, most real estate asset classes, and most real estate owners, landlords, tenants, and borrowers that are based or operating primarily in the US will constitute “business concerns” for purposes of this prong of SBA loan eligibility. If a potential applicant cannot access relief under Title I because it employs more than 500 employees, there may be relief available pursuant to Title IV for “severely distressed” businesses.<sup>37</sup>

Additionally, under Title II of the CARES Act, a federal excise holiday applies to the use of alcohol and distilled spirits in the production

of hand sanitizer.<sup>38</sup> This could be meaningful for owners and tenants of restaurants, bar space, and other food and beverage operations. Title III will be relevant to owners/tenants in health care because it provides an extensive program to support the health care system in its response to COVID-19.<sup>39</sup> The CARES Act also provides \$1 billion for purchases under the Defense Production Act, which may be relevant for industrial logistics, warehousing, food storage, and similar assets involved in supply chain security. In its Fourth Interim Final Rule, the SBA amended its prior guidance for gaming businesses such that a business that is otherwise eligible for a PPP loan is not rendered ineligible due to its receipt of any legal gaming revenues.<sup>40</sup> This amendment could be meaningful for legal gaming businesses (such as casinos) impacted by COVID-19.

### **Potential Solutions for Lenders and Borrowers**

Both borrowers and lenders should review their loan documents and be proactive in addressing potential default and covenant compliance issues. Borrowers should particularly review what notices they may be required to give their lenders. Advance notice to the lender and an honest assessment of the situation by the borrower are key to developing a successful workout plan. Moreover, the lender must have confidence in the borrower’s financial reporting and the borrower’s management.

Even if anticipated issues are not currently required to be disclosed under the loan documents, borrowers should consider informing their lender of the likely impact COVID-19 may have on their business, to explore collaborative solutions to anticipated problems that may lie ahead. Such open discussions may encourage lenders to proactively address financial and cash flow stress with the borrower and search for mutually beneficial solutions. For example, lenders can amend financial covenants in advance, and to the extent borrowers have available cash, they may wish to consider whether to exercise equity cure rights, or to add such a cure right if none exists, to bring them into compliance in the event of a financial covenant breach. Lenders should also consider extending

time periods for a borrower to cure defaults, or amend the loan documents proactively to avoid anticipated defaults. Given the pervasive effect that COVID-19 has had on the global economy, the responses of creditors to borrowers for covenant and loan defaults should be measured and collaborative.

In the context of sales and acquisitions of real property, buyers may request and sellers should consider renegotiated purchase prices, extended diligence periods (to assess the impact of COVID-19), financing contingencies in light of the potential difficulties in obtaining financing, and delays in closing or termination of contracts based on force majeure or other closing con-

ditions. Purchasers who use financing should begin the process early given that it may be more difficult to obtain financing despite historically low interest rates.

### Conclusion

Given the current climate caused by the spread of COVID-19, parties to commercial leases and real estate loans should identify provisions in their documents that affect their abilities to perform. Understanding these provisions will allow parties to navigate contractual minefields during these uncertain times. In the end, cooperation may prove to be the parties' best weapon against the COVID-19 pandemic. CT



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### NOTES

1. *Black's Law Dictionary* (Thomson West 11th ed. 2019). See also 1 *Am. Jur. 2d*, Act of God § 13 (Lawyers Coop. Publ'g 2016).
2. *Gillespie v. Simpson*, 588 P.2d 890, 892 (Colo. App. 1978) (discussing whether the language in a lease's force majeure provision excused the tenant from paying rent due to government action).
3. *Moncrief v. Williston Basin Interstate Pipeline Co.*, 880 F.Supp. 1495 (D.Wyo. 1995).
4. *In re Cablevision Consumer Litig.*, 864 F.Supp.2d 258, 264 (E.D.N.Y. 2012).
5. *Pillsbury Co. v. Wells Dairy*, 752 N.W.2d 430, 440 (Iowa 2008) (citing *Black's Law Dictionary*).
6. See Lord, 30 *Williston on Contracts* § 77:31 (Lawyers Coop. Publ'g 4th ed. 2004) ("What types of events constitute force majeure depend on the specific language included in the clause itself").
7. *Kel Kim Corp. v. Cent. Markets, Inc.*, 70 N.Y.2d 900, 902 (N.Y. 1987) ("contractual force majeure clauses—or clauses excusing nonperformance due to circumstances beyond the control of the parties—under the common law provide a similarly narrow defense").
8. See Lord, *supra* note 6 at § 77:31 (noting that a party seeking the benefits of a force majeure clause must show that continued performance is impossible "in spite of skill, diligence, and good faith").

9. *Id.* ("Nonperformance dictated by economic hardship is not enough to fall within a force majeure provision").
10. *Pillsbury Co.*, 752 N.W.2d at 440.
11. See *Akorn, Inc. v. Fresenius Kabi AG*, 2018 WL 4719347 at \*53 (Del. Ch. Oct. 1, 2018).
12. See *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715, 738 (Del. Ch. 2008). See also *In re IBP, Inc. Shareholders Litig.*, 789 A.2d 14, 67 (Del. Ch. 2001) (the adverse event must be "consequential . . . over a commercially reasonable period, which one would think would be measured in years rather than months").
13. See *Alliance Indus., Inc. v. Longyear Holdings, Inc.*, 854 F.Supp.2d 321 (W.D.N.Y. 2012) (denying cross-motions for summary judgment on whether an MAE had occurred because although both parties had submitted expert opinions, neither party presented sufficient evidence to show the financial effect on the target's total assets and bottom line).
14. See *Hexion Specialty Chems.*, 965 A.2d at 738 ("A buyer faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close" and as of the date of this decision, "Delaware courts have never found a material adverse effect to have occurred," which "is not a coincidence.")
15. *Capitol Justice LLC v. Wachovia Bank, N.A.*,

- 706 F.Supp.2d 23, 26–27 (D.D.C. 2009).
16. *Id.* at 29–34.
17. *Id.* at 30.
18. *Id.* at 29 (citing *Hexion*, 965 A.2d at 738).
19. Chancery Blog, Delaware Corporate Litigation in the Time of Coronavirus, <http://chanceryblog.com/court-procedure/#covid-19-litigation>.
20. *Restatement (Second) of Contracts* (Am. Law Inst. 1981).
21. *Littleton v. Emps. Fire Ins. Co.*, 453 P.2d 810, 812 (Colo. 1969) (impossibility of performance); *Beals v. Tri-B Assoc.*, 644 P.2d 78, 80–81 (Colo. App. 1982) (frustration of purpose).
22. *Littleton*, 453 P.2d at 812.
23. *Beals*, 644 P.2d at 81.
24. *Littleton*, 453 P.2d at 812.
25. *Beals*, 644 P.2d at 81 ("The risk that economic conditions may change, or that government actions of the type involved here may impair the profitability of a real estate development, are not so unforeseeable that they are outside the risks assumed under the contract").
26. See *Ruff v. Yuma Transp. Co.*, 690 P.2d 1296, 1298 (Colo.App. 1984) (delay of approval from Interstate Commerce Commission is not so unforeseeable as to excuse performance). But see *UNCC Props., Inc. v. Greene*, 432 S.E.2d 699, 702–03 (N.C.Ct.App. 1993) (finding impossibility of performance where the county had condemned the real property to be sold).
27. *Beals*, 644 P.2d at 80–81 (finding that a party seeking to avoid contractual obligations under the doctrine of frustration of purpose must demonstrate total, or near total, destruction of the essential purpose of the transaction).
28. FDIC Statement on Financial Institutions Working with Customers Affected by the Coronavirus and Regulatory and Supervisory Assistance, <https://www.fdic.gov/news/news/financial/2020/fil20017a.pdf>.
29. Stern, *Structuring and Drafting Commercial Loan Agreements*, § 7.03 (Lexis Nexis rev. ed. 2019).
30. Uchill, *Anatomy of a Mortgage: Understanding and Negotiating Commercial Real Estate Loans* (ABA 2d ed. 2019).
31. Stern, *supra* note 29 at § 7.03.
32. H.R. 748.
33. H.R. 748 § 4032(f).
34. Multifamily Selling and Servicing Guide, <https://multifamily.fanniema.com/documents/forms/selling-servicing-guide> (effective Apr. 13, 2020).
35. *Id.* at 630.
36. 15 USC § 632. See also 13 CFR Part 120.
37. H.R. 748 § 4002(4).
38. H.R. 748 § 2308.
39. H.R. 748 §§ 3001 et seq.
40. <https://home.treasury.gov/system/files/136/Interim-Final-Rule-on-Requirements-for-Promissory-Notes-Authorizations-Affiliation-and-Eligibility.pdf> (issued Apr. 24, 2020).