

## **FORCE MAJEURE & FORBEARANCE**

A PRESENTATION BY:

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## OUTLINE OF SEMINAR:

### FORCE MAJEURE

1. What is force majeure?
2. General Analysis
3. Residential v. commercial real estate contracts
4. What are the rights of the buyer and seller if force majeure is invoked?
5. Alternatives to force majeure
  - a. Impossibility of performance
  - b. Frustration of purpose
6. Forbearance

## PART I

- “Force Majeure,” literally translated, means “superior force.” In contracts, force majeure clauses are designed to excuse, or allow a delay in, the performance of a party to a contract if an extraordinarily disruptive and unforeseeable event makes it impossible or impracticable for a party to perform their obligations under the contract.
- Otherwise, delay or non-performance would usually be a breach of the contract, entitling the other party to damages.
- Typically considered “boilerplate” and rarely negotiated; however, times have changed and everyone is reading them now.
- Everyone should now have a good understanding of the force majeure clauses in their contracts – whether under purchase and sale agreements, leases, construction contracts or other business agreements -- and how COVID-19 and any related government restrictions may affect their obligation (or other party to the contract) to excuse performance, delay performance or terminate a contract.
- **COVID-19 and Force Majeure**

Recent white paper from the legal department of the Florida Realtors Association

<https://www.floridarealtors.org/news-media/news-articles/2020/03/florida-realtors-white-paper-when-it-comes-contracts-coronavirus>

The short answer is that "force majeure" requires a party to show a very specific and compelling reason why they cannot perform as opposed to a more general sense that times are tumultuous.

Fear is not enough; being trapped in your home is not enough; market volatility is not enough; prices dropping are not enough.

Courts interpret force majeure clauses narrowly

General Rule under Florida law: A party seeking to invoke a force majeure clause must show that the force majeure event was unforeseeable and that the force majeure event occurred outside the party's control. In other words, the claiming party must show that the event could not have been prevented or overcome, and there additionally cannot be any fault or negligence on the part of the claiming party.

There are no cases in Florida addressing force majeure for epidemics or pandemics. Take care about giving advice in this area. There is no consensus among the legal community.

Items for consideration:

Is there a force majeure clause?

How does the force majeure clause read? Does it cover an epidemic, pandemic, or similar public health event?

If the clause can be read to include COVID-19, is the barrier to performance a direct result of COVID-19? Or something else?

And even if so, what is being prevented and what is the party claiming he/she is affected doing about it?

Cash deals v. mortgage contingent deals.

**Is Notice Required?**

Many force majeure clauses provide that the party whose performance is affected must notify the other party and often require an estimate of when performance is expected to resume. Failure to provide notice within the required time period may waive a party's claim for relief under the force majeure clause.

## **Is There an Obligation to Mitigate?**

Often, a party affected by force majeure must take steps to mitigate the force majeure event and, when possible, resume performance. Did the party claiming force majeure take reasonable steps to work around the force majeure event? **Or** did the party simply “sit on his hands” to allow the time periods to run.

## **Florida Realtors/Florida Bar “AS IS” Residential Contract for Sale and Purchase**

**Section 18(G) Force Majeure.** Buyer or Seller shall not be required to perform any obligation under this Contract or be liable to each other for damages so long as performance or non-performance of the obligation, or the availability of services, insurance or required approvals essential to Closing, is disrupted, delayed, caused or prevented by Force Majeure. “Force Majeure” means: hurricanes, floods, extreme weather, earthquakes, fire, or other acts of God, unusual transportation delays, or wars, insurrections, or acts of terrorism, which, by exercise of reasonable diligent effort, the non-performing party is unable in whole or in part to prevent or overcome. All time periods, including Closing Date, will be extended a reasonable time up to 7 days after the Force Majeure no longer prevents performance under this Contract, provided, however, if such Force Majeure continues to prevent performance under this Contract more than 30 days beyond Closing Date, then either party may terminate this Contract by delivering written notice to the other and the Deposit shall be refunded to Buyer, thereby releasing Buyer and Seller from all further obligations under this Contract.

## **Commercial Contract**

Each Party shall be excused from liability for the failure or delay in performance of any obligation under this Agreement by reason of any event beyond such Party's reasonable control including but not limited to Acts of God, fire, flood, explosion, earthquake, or other natural forces, war, civil unrest, accident, any strike or labor disturbance, or any other event similar to those enumerated above. Such excuse from liability shall be effective only to the extent and duration of the event(s) causing the failure or delay in performance and provided that the Party has not caused such event(s) to occur and continues to use diligent, good faith efforts to avoid the effects of such event and to perform the obligation. Notice of a Party's failure or delay in performance due to force majeure must be given to the unaffected Party promptly thereafter but no later than five (5) days after its occurrence which notice shall describe the force majeure event and the actions taken to minimize the impact thereof. All delivery dates under this Agreement that have been affected by force majeure shall be tolled for the duration of such force majeure. Notwithstanding the foregoing, should the event(s) of force majeure suffered by a Party extend beyond a four-month period, the other Party may then terminate this Agreement by written notice to the non-performing Party.

## **Other Options: Impossibility/Impracticability of Performance & Frustration of Purpose**

If a party is unable to successfully utilize a force majeure clause to excuse performance, or if a contract does not contain a force majeure clause, other options may still potentially be available to excuse performance.

These are common law defenses - there will not be specific clauses in the contract addressing these defenses.

## **Impossibility/Impracticability of Performance**

- Is it impossible or simply more difficult to perform?
- As a general rule, a party is not discharged from contractual performance simply because a contract turns out to be difficult or burdensome to perform.

- 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 (i) that is outside of a party's control; and (ii) the non-occurrence of which was a basic assumption on which the contract was made.
- As noted in the context of commercial leases, the Third DCA stated that "although impossibility of performance can include extreme impracticability of performance, courts are reluctant to excuse performance that is not impossible but merely inconvenient, profitless, and expensive to the lessor."
- Impossibility of performance refers to situations where the purpose of the contract has, on one side, become impossible to perform.
- Economic difficulty is not enough to establish that performance is impossible.
- Generally, the doctrine of impossibility of performance is a defense to nonperformance of a contract only where facts making the performance impossible were not available to the parties prior to execution of the contract. This doctrine is used with great caution if the relevant business risk was foreseeable at the inception of the agreement.
- Economic downturns and other market shifts do not truly constitute unanticipated circumstances in a market-based economy. *Ferguson v. Ferguson*, 54 So. 3d 553, 554 (Fla. 3d DCA 2011). In this particular case, the decline in the real estate market while marked and unfortunate, was not the sort of unanticipated circumstance that falls within the purview of the doctrine of impossibility.
- The reaction to COVID-19 will likely make performance under certain contracts impossible. This will depend on the contract, type of business at issue and the scope of performance required under the contract. While COVID-19 may render some performance impossible, it may simply make performance more difficult in other circumstances. As such, whether the doctrine of impossibility of

performance will provide a defense to contractual performance must be evaluated on a case-by-case basis.

### Frustration of Purpose

- The doctrine of frustration of purpose means that the purpose for which the parties entered into the contract has been frustrated and provides a defense to further performance. While the doctrine of impossibility of performance comes into play when it is impossible for one party to perform, the doctrine of frustration of performance applies to the underlying purpose of the contract being frustrated.
- Frustration of purpose occurs when one of the parties finds that the purpose for which it bargained, and which purposes were known to the other party, have been frustrated because of the failure of consideration, or impossibility of performance by the other party.
- This defense does not apply where the intervening event was reasonably foreseeable and could and should have been controlled by provisions of the contract.
- Frustration of purpose is a difficult defense to establish because “courts have been careful not to find commercial frustration if it would only result in allowing a party to withdraw from a poor bargain.” See *Valencia Center, Inc. v. Publix Super Markets, Inc.*, 464 So. 2d at 1269 (quoting *Perry v. Champlain Oil Co.*, 101 N.H. 97, 98, 134 A.2d 65, 67 (1957)).
- Examples where successful: In *La Rosa Del Monte Exp., Inc. v. G.S.W. Enterprises Corp.*, 483 So. 2d 472 (Fla. 3d DCA 1986): the court found that a lease was frustrated due to the fact that La Rosa Del Monte leased the premises for the purpose of operating a moving and storage business, the lease limited its activities to those “necessary to the operation of a moving and storage business” and “[i]t was uncontradicted at trial that the use of the property as prescribed in the lease was in violation of Miami’s zoning ordinances.”
- Frustration of purpose is usually attempted by the party required to make payment under a contract. This is because the ability to pay is rarely impossible, but the purpose for paying the money may be



frustrated. For example, a California court discharged a restaurant from its obligation to make lease payments for a neon sign and tubing after the government implemented emergency war measures, ordering the cessation of all outside lighting in the district where the restaurant was located. See *20th Century Lites, Inc. v. Goodman*, 149 P.2d 88, 92 (Cal. App. Dep't Super. Ct. 1944).

COVID-19 may frustrate the purpose of some contracts beyond the parties' control. However, whether the frustration of performance will be a successful defense will be evaluated on a case-by-case basis.

## PART II

### Forbearance

- Definition: temporary postponement of an obligation which is generally done through written agreement.
- Unlike force majeure or impossibility where one party is asserting a legal defense to performance – forbearance is the result of one party to an agreement allowing the other party to the agreement to suspend its obligations on a temporary basis via a mutual understanding.
- Can be applicable to any situation: purchase and sale agreements; leases; mortgage loans; other contractual arrangements.
- Example for real estate PSA: an amendment to the PSA that would allow the buyer a stated extension of time to perform its obligations with a contractual understanding of what would happen if the time period lapses.
- Example for mortgage payments:
  - Forbearance is temporary postponement of mortgage payments granted by the lender or creditor in lieu of forcing a property into foreclosure.
  - The terms of a forbearance agreement are negotiated between the borrower and the lender.

- The borrower must demonstrate the cause for repayment postponement, such as financial difficulties associated with a major illness or the loss of a job.
- Note: In residential settings, most servicers of loans have created broad COVID-19 forbearance programs; however, in the context of commercial loans, everything is on a case by case basis and borrowers are now learning lessons between dealing with local banks, national banks, life insurance companies and CMBS lenders.
- Local Banks – you probably paid a little higher interest rate or could only get a rate lock for 5 years - but now you can pick up the phone and call the banker you saw at your last chamber of commerce lunch.
- National Bank: Not sure if your smaller loan will get their attention now that there is a problem.
- Life Insurance Company: speak with the servicer and should be successful in the COVID-19 crisis.
- CMBS loans – the role of the master servicer and special servicer and the role of the Pooling and Servicing Agreement (PSA).
- A Pooling and Servicing Agreement (PSA) is the legal document that sets forth the rights and obligations of the parties over a pool of securitized mortgage loans.
- Deferred Payments under mortgage forbearance programs:
  - Interest only
  - Complete suspension of payments
  - Deferral of payments and when are deferred payments to be made
  - Beware of capitalization of interest.