Coronavirus as Force Majeure Event – What Hotel Owners and Operators Should Consider

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Coronavirus continues to be of global concern, and remains an issue the hospitality industry should be tracking, both for economic and legal reasons. Bob Braun discusses whether the virus may trigger a force majeure event for hotel operators and owners, and what that might mean for a property’s performance obligations and other operations.

— Jim

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What Hotel Owners and Operators Should Consider
by
Robert Braun

Coronavirus (COVID 19) has been a leading news item for more than a month now, competing and often pre-empting other national and international news items. For the hospitality industry, the virus has created severe disruptions in the largest single source of tourists. Hotel companies, both inside and outside of China, have warned of reductions in revenues, and as the virus continues to spread, the trend does not bode well. Like the SARS virus of 2002-2003, coronavirus has the potential to disrupt travel for months, and the travel industry will take time to recover.

Performance Tests and More
The most immediate effect will be seen by hotel companies when they review upcoming financial statements and see shortfalls. This could, among other things, cause some hotels to fail their performance obligations, giving owners the right to terminate a management agreement (unless the hotel operator exercised a right to cure the shortfall). At that point, hotel operators are likely to claim that the impact of the virus constitutes a force majeure event, which would require performance tests to change the performance obligations. For more details on performance tests, see our article on Hotel Management Agreement Performance Standards.

But limiting the focus to financial performance terms would be a mistake – force majeure clauses affect not only financial performance, but virtually every aspect of a manager’s duties – management agreements typically provide that the manager’s performance “shall be modified or suspended to the extent Manager shall be delayed or hindered in or prevented from the performance of any act required by reason of Force Majeure.” If a force majeure exists, it could influence staffing, reporting, marketing, quality assurance, repairs and maintenance – virtually every aspect of hotel operations. Understanding what constitutes a force majeure, and how to react, is essential for hotel owners.

What is Force Majeure?
Force majeure often falls into the category of “I don’t know what it is, but I know it when I see it.” That said, almost every hotel management agreement includes a definition of force majeure, often along the following lines:
“Force Majeure” shall mean any act of God, strikes, lockouts or other labor dispute, shortage of labor or materials, earthquake, hurricane, flood, fire or other casualty, taking, civil commotion, riot, mob violence, insurrection, malicious mischief, sabotage, rebellion, act of public enemy, act of terrorism, epidemic, invasion, embargo, governmental preemption in the case of national or local emergency security or health risk, suspension of governmental operations or other event beyond the reasonable control of the party claiming the benefit of the event, including acts of declared or undeclared war and acts of terrorism.

Along with the definition of a force majeure event, hotel management agreements commonly include the following language:

Manager’s performance under this Agreement shall be modified or suspended to the extent Manager shall be delayed or hindered in or prevented from the performance of any act required by reason of Force Majeure.

As written, a hotel manager can recast its contractual obligations in the case of a force majeure. And when it comes to proving the existence of a force majeure, various governmental and quasi-governmental entities in China have issued force majeure certificates to Chinese companies, allowing the recipients to claim relief from contractual clauses that would otherwise lead to breach and penalties.

Is Coronavirus a Force Majeure Event?
Even in light of force majeure certificates and the inclusion of “epidemic” in the definition, hotel managers and owners should not assume that the coronavirus completely exonerates a manager’s performance. Hotel owners look to managers to reduce their risk, not ignore it. A force majeure is not an excuse for the affected party to take reasonable steps to avoid or mitigate the force majeure negative consequences. The goal should be for all parties to act with diligence and responsibility.

Other Owner Concerns
Hotel owners should also be aware of the broad impact of the coronavirus and a claim of force majeure. While the immediate focus may be on financial performance, a force majeure event can affect a broad level of hotel operations beyond occupancy. Consider the following:

- Disruptions in the supply chain can make it difficult to complete a property improvement plan or upgrade hotel operations. Owners enter into property improvement plans in order to maintain a hotel’s standing with its franchisor; owners may need to raise these issues with their franchisors to avoid a default.
- Restrictions on travel can impact not only guests, but also changes in personnel. If a hotel is relying on a new manager, financial officer, director of sales or other key executives, their arrival may be delayed.
- Operating costs can be affected. If the virus continues to spread, will it be necessary to provide basic protections (think face masks and hand sanitizer) to guests?
- Is a hotel prepared for a contagion? As recently as August 2019, the Sheraton Atlanta Hotel was forced to evacuate guests due to an outbreak of Legionnaires’ disease. Does the hotel have emergency procedures in place to deal with the need to isolate or evacuate guests? Does the hotel have crisis PR available to explain their story?
Is the hotel taking steps to counter the loss of income from travelers coming from China and other areas with outbreaks of the virus? The Los Angeles Tourism Authority recently announced that it is directing funds to non-Chinese sources of tourism as a reaction to the sudden drop in Chinese tourism to Los Angeles.

JMBM Can Help

At this time, it is essential for hotel owners and managers to be proactive and prepare for the fallout from this and other events that can disrupt hotel operations. JMBM’s Global Hospitality Group has, since its inception, worked with hotel owners and managers to address key management issues and to provide the many specialties that hotels need, and to plan for and respond to the unexpected.

For more information or assistance . . .

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Click here for the latest articles on the coronavirus and here for the latest on force majeure. Select individual articles on these topics are listed below for your convenience.

- Coronavirus COVID-19 force majeure: Contract provisions and governing law are important
- COVID-19 coronavirus as force majeure contract defense: history and origins
- Coronavirus as Force Majeure Event – What Hotel Owners and Operators Should Consider
- Coronavirus & the Hotel Industry – Responsibilities, Liabilities, Implications

Bob Braun is a Senior Member of JMBM’s Global Hospitality Group® and is Co-Chair of the Firm’s Cybersecurity & Privacy Group. Bob has more than 20 years experience in representing hotel owners and developers in their contracts, relationships and disputes with hotel managers, licensors, franchisors and brands, and has negotiated hundreds of hotel management and franchise agreements. His practice includes experience with virtually every significant hotel brand and manager. Bob also advises clients on condo hotel securities issues and many transactional matters, including entity formation, financing, and joint ventures, and works with companies on their data technology, privacy and security matters. These include software licensing, cloud computing, e-commerce, data processing and outsourcing agreements for the hospitality industry.

In addition, Bob is a frequent lecturer as an expert in technology, privacy and data security issues, and is one of only two attorneys in the 2015 listing of SuperLawyers to be recognized for expertise in Information Technology. Bob is on the Advisory Board of the Information Systems Security Association, Los Angeles chapter, and a member of the International
This is Jim Butler, author of www.HotelLawBlog.com and founding partner of JMBM and JMBM’s Global Hospitality Group®. We provide business and legal advice to hotel owners, developers, independent operators and investors. This advice covers critical hotel issues such as hotel purchase, sale, development, financing, franchise, management, ADA, and IP matters. We also have compelling experience in hotel litigation, union avoidance and union negotiations, and cybersecurity & data privacy.

JMBM’s Global Hospitality Group® has been involved in more than $87 billion of hotel transactions and more than 3,900 hotel properties located around the globe. Contact me at +1-310-201-3526 or jbutler@jmbm.com to discuss how we can help.

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