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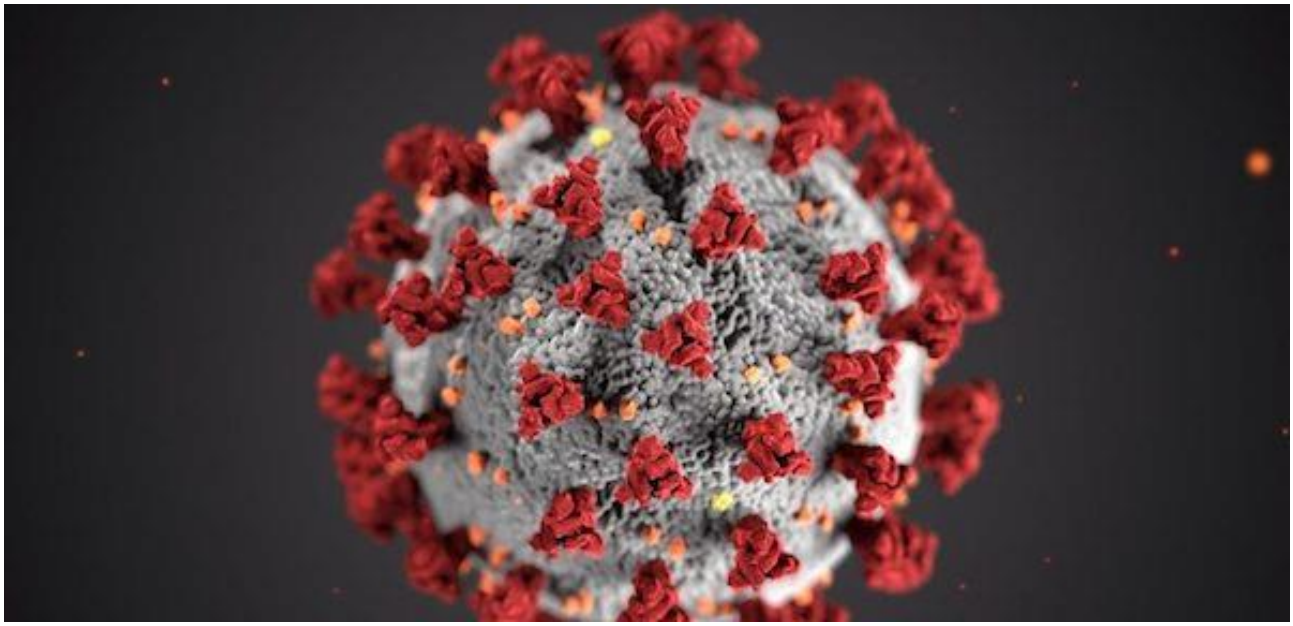
COVID-19 AND LEGAL CONSIDERATIONS FOR THE HOSPITALITY INDUSTRY



INTRODUCTION

The COVID-19 outbreak has been described as "*the most serious crisis this country has faced since Independence*"[1]. These words ring especially true for the hospitality and tourism industry, which has seen free-falling room occupancy rates, closing hotel floors, shortening service hours, and now, many hotels (save for those which have been engaged to house individuals serving out their Stay Home Notice period) have had to shut their doors.

In this climate, it is particularly apposite for hotels and other players in the hospitality industry to examine their contractual rights and obligations, to see what may be renegotiated or restructured. This may help to alleviate the bleak and grave situation that the industry now finds itself in.

Hotels may be able to obtain relief from their contractual obligations by relying on: (a) a force majeure clause in the contract; (b) the doctrine of frustration; and/or (c) the COVID-19 (Temporary Measures) Act.

Force majeure clauses

The World Health Organization (WHO) has declared the COVID-19 outbreak to be a pandemic, and this may constitute a force majeure event.

Typically, a force majeure clause would provide that upon the occurrence of certain events over which the parties have little or no control (e.g. acts of nature, war, riots, strikes, epidemics, government action), which prevent or impede the performance of obligations under the contract, the parties may be excused from performing their obligations.

The scope and extent to which a party may rely on a force majeure clause to excuse itself from performance depends on the precise language and construction of the clause[2].

A party who seeks to rely on a force majeure clause has the burden of showing that it falls within that clause. It must also show that it has taken all reasonable steps to avoid its operation or mitigate its results[3].

Doctrine of frustration

A *force majeure* clause is conceptually different from the doctrine of frustration. While a *force majeure* clause is an agreement as to how outstanding obligations should be resolved upon the onset of a **foreseeable** event, the doctrine of frustration concerns the treatment of contractual obligations from the onset of an **unforeseeable** event[4].

A contract is considered 'frustrated' when a supervening event which has not been expressly provided for in the contract takes place, such that the nature of the parties' (or one party's) obligations is so fundamentally or radically altered that the contract can no longer be said to be the same as that which was originally entered into by the parties[5]. If a contract is frustrated, then it is automatically terminated.

The Courts are inclined to uphold parties' commercial expectations and the sanctity of contract. As such, it is only in truly exceptional circumstances that the Courts will find that a frustrating event has occurred. In considering whether a frustrating event has occurred, a Court will consider, among other things:

(a) whether the subject matter has been destroyed by a supervening event[6] or the subject matter is no longer available[7];

(b) the length of time which the subject matter cannot be used for a particular purpose[8];

(c) whether the supervening event results in a mere increase in costs (in which case the contract would unlikely be frustrated)[9].

COVID-19 (Temporary Measures) Act 2020 (the "Act")

The Act provides temporary cash-flow relief to those who are unable to perform their contractual obligations, by suspending certain actions to enforce those obligations for a prescribed period not exceeding 6 months (the "**Prescribed Period**"). The Prescribed Period may be shortened or extended by the Minister of Law.

Hotels may be able to obtain relief under the Act where:

(a) the contract in question is a "***scheduled contract***". For hotels, the following types of "*scheduled contract[s]*" under the Act may be relevant:

  (i) leases or licenses for immovable property;

  (ii) event contracts (e.g. venue or catering for MICE events);

  (iii) tourism-related contracts (e.g. hotel accommodation bookings);

(b) the hotel is **unable to perform an obligation in the contract**, and the obligation is "*to be performed on or after 1 February 2020*";

(c) the inability to perform the contract is to a material extent **caused by the COVID-19 pandemic** or a law that is made in connection with COVID-19; and

(d) the hotel serves a **notification for relief** on (i) the other parties to the contract; and (ii) any guarantor or surety for the hotel's obligation in the contract; and (iii) such other person as may be prescribed.

In these circumstances, the non-defaulting party will not be able to commence certain litigation against the hotel and/or the hotel's guarantor or surety. We note though that there is no prohibition against the commencement of international arbitration proceedings under the International Arbitration Act; there is also no prohibition against a non-performing party applying to Court for declaratory relief (e.g. a declaration that a contract has been frustrated).

However, the Act does not extinguish the contractual obligation. Further, if parties have rights under the doctrine of frustration, the Frustrated Contracts Act or under a force majeure clause, those rights are unaffected by the Act and could be still pursued.

ANALYSING THE IMPACT OF COVID-19 ON HOTEL RELATED CONTRACTS

We now turn to how *force majeure* clauses, the doctrine of frustration and the Act may apply to the specific hotel-related contracts and issues.

Contracts for room / MICE event bookings

Under the Act, contracts for MICE event venue bookings are likely to be considered as "*event contracts*"; whereas contracts for hotel room bookings are likely to be considered as "*tourism-related contracts*". Hotels should be mindful that their cancellation policies do not contravene the provisions of the Act – in this regard, the Act provides that:

(a) the non-defaulting party (likely to be the hotel in this instance) cannot forfeit any part of the deposit placed, unless the hotel obtains a determination from an assessor that it would be just and equitable to do so (Section 7(2));

(b) if the hotel has already forfeited the deposit (or part thereof) after 1 February 2020, the hotel may be bound to restore the deposit (Section 7(3)); and

(c) the hotel cannot charge cancellation fees if the defaulting party is unable to perform the obligation due to a COVID-19 event (Section 7(4)).

Hotel Management Agreements

With the implementation of the circuit breaker in Singapore, many hotels have had to close their doors. The multi-million dollar question is: with no hotel to operate, is there still an obligation for the owner to pay the operator its fees under a hotel management agreement?

If the fees to be paid by the owner to the operator are purely a percentage of the revenue or profit earned, then the answer is clear – since the hotel must close and no revenue or profit can be earned, the fees to be paid would be zero.

For other cases, the answer may lie in the *force majeure* clause drafted into the hotel management agreement. If there is no applicable *force majeure* clause, then the question is whether the hotel management agreement has been frustrated. It is arguable that with the mandated closure of hotels, it has become impossible for the hotel operator to perform its contractual obligations to operate and/or manage the hotel, and the hotel management agreement is thus discharged by frustration.

Be that as it may, hotel management agreements are typically for a long operating term, and can range from 10 to 15 years. Given the long-term commercial relationship between the parties, and the reality that parties would want to resume the relationship after the COVID-19 situation settles, the parties may be reluctant to prematurely terminate the contract at this stage.

Hotel Lease Agreements

For hotels which operate under a lease structure, a major pain point is the obligation to pay rent. One possible argument that hotels may raise is that the lease agreement has been frustrated.

There are hurdles to overcome though. Hotel lease agreements commonly provide for a reduction in rent only where the property in question is "*destroyed*" or "*damaged*". These words suggest that there must be some kind of physical damage to the property, and would not extend to cover the 'damage' wrecked by the COVID-19 pandemic. We have also come across lease agreements which provide that the landlord is not to be held responsible for any loss or damage suffered as a result of *force majeure* events.

In any case, as the consequence of a frustrating event is that the lease agreement would be terminated, this is a nuclear option and should not be taken lightly.

Not all is doom and gloom. If the hotel is unable to pay rent under the lease, and this is to a material extent caused by a COVID-19 event, the hotel can serve a notification for relief on the landlord to preclude the landlord from commencing litigation for the non-payment of rent during the Prescribed Period.

Notwithstanding the relief provisions in the Act, even if hotels do not pay, rent will continue to accrue and become due and payable after the Prescribed Period. In addition, if the hotel does not pay rent, interest may become due and payable on the sum owed (if contractually provided for). Further, as most (if not all) lease agreements provide for a security deposit to be paid to the landlord, if rent is not paid, the landlord may be entitled to set off the security deposit.

Some breathing room may also be afforded via the property tax rebate under the FY2020 Supplementary Budget (which for hotels is 100%).

Whether a claim may be made under insurance policies

Naturally, hotels may look to their insurers for recovery in this climate. Ultimately, whether a claim for business interruption losses can be made will depend on the precise terms of the policy. We note that business interruption insurance policies generally cover loss of profit suffered as a result of *physical* damage to the insured property by specified insured perils. Even if the hotel premises are 'contaminated' by the presence of persons diagnosed with COVID-19, it is unlikely that the courts will regard this as causing physical damage to the property.

Moving forward, hotels may wish to consider procuring additional cover for 'loss of attraction', i.e. the loss suffered by the hotel as a result of a diminution/cessation of trade due to a loss of potential customers, caused by the outbreak of an infectious disease.

Employment issues

If notwithstanding other cost-cutting measures, termination of employment contracts becomes necessary, then hotel employers may wish to consider the following options:

(a) termination by relying on a *force majeure* clause or the doctrine of frustration; and/or[10]

(b) retrenchment (i.e. dismissal on the ground of redundancy or by reason of reorganisation of the employer's business).

If retrenchment is inevitable, the retrenchment exercise should be carried out responsibly and fairly. Among other things, hotel employers should be aware of the following:

(a) employers should not discriminate against any particular group on grounds of age, race, gender, religion, marital status and family responsibility, or disability;

(b) employers are encouraged to adopt a longer notice period, to provide retrenched employees with more time to prepare and look for alternative arrangements[11];

(c) employers who employ at least 10 employees are required to notify the Ministry of Manpower if 5 or more employees are retrenched within any 6-month period. Failure to notify is an offence; and

(d) there is generally no legal obligation to provide retrenchment benefits. However, employers are encouraged to pay a retrenchment benefit of between 2 weeks to 1 month salary per year of service[12].

DISPUTE RESOLUTION IN THE TIME OF COVID-19

If the doctrine of frustration, *force majeure* clauses and/or the Act cannot provide the desired relief, then affected parties should reach out to their business partners and counterparties to see if they might renegotiate the commercial terms due to COVID-19 and reach a mutually acceptable solution. Mediation may also be a good alternative.

If the dispute concerns the applicability of the Act, another mode of dispute resolution is available. Parties may refer the matter to an independent assessor for determination:

(a) the assessor may consider the party's ability and financial capacity to perform the contractual obligation, and must seek to achieve an outcome that is just and equitable in the circumstances of the case;

(b) parties are not allowed to be represented by an advocate and solicitor. However, lawyers can still help to gather evidence and prepare for the hearing;

(c) each party will bear their own costs;

(d) the assessor's determination is binding on all parties to the application, and is non-appealable; and

(e) the assessor's determination may be enforced in the same manner as a judgment or an order of court, if leave of court is obtained.

These are unprecedented and uncertain times that we live in. While the hospitality industry may be struggling to stay afloat, there are legal tools available which can help affected parties manage their risk and liabilities. We would encourage hotels and other hospitality business owners to review their contractual documentation.

We would be happy to work with you to explore the possibilities in which your contractual obligations can be managed.

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[1] The Second Reading Speech on the COVID-19 (Temporary Measures) Bill, the Minister for Law, Minister K Shanmugam on 7 April 2020.

[2] *RDC Concrete Pte Ltd v Sato Kogyo (S) Pte Ltd and another appeal* [2007] 4 SLR(R) 413 ("***RDC Concrete***") at [54]; *Magenta Resources (S) Pte Ltd v China Resources (S) Pte Ltd* [1996] 2 SLR(R) 316 at [60] (affirmed on appeal).

[3] *RDC Concrete* at [64] and [65].

[4] *Glahe International Expo AG v ACS Computer Pte Ltd and another appeal* [1999] 1 SLR(R) 945 ("***Glahe***") at [26]; *RDC Concrete* at [56].

[5] *Glahe* at [26].

[6] See *Taylor v Caldwell* (1863) 3B & S 826, which concerned a contract for the rental of a music hall and surrounding gardens for the purpose of holding concerts and parties. The Court held that it was frustrated when the music hall was destroyed by fire.

[7] See *Re an arbitration between Shipton, Anderson & Co and Harrison Brothers & Co* [1915] 3 KB 676, which concerned a contract for the sale of a specific parcel of wheat. The English High Court held that it was frustrated when the wheat was requisitioned by the UK government pursuant to legislation that had been enacted on account of World War I. See also *Lim Kim Sam v Sheriffa Taibah bte Abdul Rahman* [1994] 1 SLR(R) 233, where a contract for the sale of landed property was frustrated when the Singapore government compulsorily acquired the property in question pursuant to the Land Acquisition Act.

[8] See *National Carriers Ltd v Panalipina (Northern) Ltd* [1981] AC 675, where a warehouse could not be used as such for a period of about 2 years as the only road to the warehouse was closed by the government. The Court held that losing 2 years of use out of a 10-year lease was not significant enough to amount to a frustrating event. Also see *Li Ching Wing v Xuan Yi Xiong* [2004] 1 HKC 353, where the Hong Kong court held that a 2-year lease was not frustrated by an order made by the Department of Health in response to the SARS outbreak that a residential block be isolated for 10 days and that the residents be evacuated – it was found that 10 days out of 2 years was "*quite insignificant*".

[9] See *Glahe*, which related to a contract for the purchase of computers intended for the then-USSR market. The increase in customs duty on goods imported into Russia and inflation in Russia were not frustrating events; although they made the contract less profitable, they did not prevent the import of computers into Russia.

[10] Note that in the Canadian case of *Valdivia v Lony G Inc*. [2007] O.J. No. 5207, the Court held that the outbreak of SARS and the warnings issued by WHO against travelling to Toronto did not frustrate an employment contract – thus, the company was not entitled to terminate without first giving the employee reasonable notice.

[11] Tripartite Advisory on Managing Excess Manpower and Responsible Retrenchment ("**Tripartite Advisory**").

[12] Tripartite Advisory.