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LEGAL UPDATES

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How COVID-19 Affects Contractual Obligations

A SUMMARY OF FORCE MAJEURE AND RELATED LEGAL DOCTRINES

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Overview

As supply chains for both goods and services become more and more disrupted with the current COVID-19 crisis, vendors and customers are contemplating delays, reductions or cancellations of performance. Determining an appropriate course of action is dependent not only upon legal rights and remedies under contract terms or applicable law, but also upon a number of other factors, including the essential or critical nature and purpose of the supplies or services, the specific and underlying cause of the interruption in the ability to supply or receive the affected goods and services, the implications upon related operations and upstream or downstream obligations, governmental actions, and the broader impact upon longstanding or critical relationships.

From the legal perspective, specific terms of applicable contracts will need to be examined, which may include clauses addressing *force majeure* or impossibility of performance, limitation or disclaimers of liability, termination, default, liquidated damages or other remedy clauses, and governing law, among others. There are certain legal doctrines available to excuse delay in performance or non-performance of contractual obligations that may have directly or indirectly resulted from the COVID-19 crisis; however, these doctrines can vary among different jurisdictions (whether federal, state, local or foreign) whose law may apply, whether specified in the contract or applicable for other reasons such as place of performance. Their application to a specific situation is then further dependent upon the specific

facts and circumstances involved, such as the non-legal factors mentioned above.

The following are three legal doctrines generally recognized within the United States, whether under common law or in some form by a specific state statute:

Force majeure through contractual clauses, or as may be provided by statute or under *force majeure* exceptions under civil law

Impracticability/Impossibility of performance

Frustration of commercial purpose

Subject to other considerations, a common theme of each of the foregoing is that performance may be excused or delayed when some unforeseen event beyond the parties' control either delays or renders performance nearly impossible or defeats the purpose on which the contract was based.

Force majeure

Typically, any analysis may first start with a review of the contract and whether it contains a *force majeure* clause excusing delays in or failures of performance. Unless civil law or other specific statutory provisions apply (which may be the case in limited circumstances), the express terms of the *force majeure* clause will specify to some degree under what circumstances performance may be excused. In conjunction with other provisions of the contract, the risks will be allocated among and the rights and liabilities of the respective parties will be defined in the event performance becomes delayed or prevented by the occurrence of an unanticipated event encompassed within the scope of the *force majeure* clause.

The *force majeure* clauses should specify events that may be relied upon as the basis for delayed or excused performance, so long as such an event is either the sole or primary cause of such delayed or otherwise excused performance. In some contracts there is only a reference to traditional *force majeure* events such as acts of God, war, fire, etc., along with a catch-all provision capturing any and all events beyond the control (or reasonable control) of the delayed or non-performing party (when not caused by its own actions or omissions). In other contracts the *force majeure* clauses may address a litany of other customarily noted events (strikes, interruption of transportation, etc.) and also other specific events tailored to the specific facts and circumstances applicable to the parties and specific nature and purpose of the applicable goods and services.

Other terms that may be addressed in such a *force majeure* clause and relevant to any analysis and (or in related clauses of the contract, such as limitation of liability, termination, default and liquidated damages) may include time periods after which a party may terminate, required notices by the affected party specifying the cause and anticipated effect of the delay or nonperformance, and specific

allocation and remedies beyond termination. Unfortunately, some contracts are silent as to these specific issues.

Force majeure contracts generally require that the *force majeure* event in question be beyond a party's control and not caused by its actions, and that the delayed or nonperforming party must undertake reasonable efforts to overcome or mitigate the effects of a delay or nonperformance. In some instances, if these terms are not express requirements of the contract, a court may not imply such terms; however, a party is normally not excused merely because performance would be difficult, burdensome, or economically disadvantageous. By way of example, worsening economic conditions or the inability to purchase a commodity at a certain price do not normally excuse delay or performance unless specified in the contract.

In cases of mere economic hardship, the party failing to deliver goods or services may be required to pay costs for replacement goods or services, if it is reasonable to find such replacements; however, if a contract limits consequential damages, these are not recoverable. Conversely, in a true *force majeure* event where performance is impossible, a party may be fully excused from performing and not liable for any damages.

If the *force majeure* event is not expressly enumerated within the *force majeure* clause, many jurisdictions will require the event must also have been "unforeseeable." Also, in order to determine whether an event is covered by a "catch-all" provision referencing any other events beyond a party's reasonable control, the surrounding language and intent of the contract will be relied upon to determine whether the particular event in question is the same type or class of events as those that are specifically enumerated in the contract. Ultimately, whether or not a contract provides for excusing delay or nonperformance, or whether there may alternative remedies or relief to either party, will depend on the specific language and the non-legal factors noted above.

Impracticability and/or impossibility of performance

Reliance upon the doctrine of impracticability and/or impossibility of performance (each may be considered interchangeable with the other in many respects) may be applicable to excuse performance if there is no *force majeure* clause in the contract, or it is not otherwise available to excuse performance under the specific facts and circumstances. Simply put, it may apply where performance is made impracticable due to an unforeseeable event through no fault of the affected party. The non-occurrence of that event must be a basic assumption of the contract in question, although not specified as such in the contract. This doctrine applies to both sale of goods (UCC § 2-615) and sale of services (where courts generally apply Restatement (Second) of Contracts § 261, or common law principles).

The doctrines of impracticability and impossibility clauses and that of *force majeure* are similar in many respects, including that specific contract language may determine whether specific facts and circumstances may justify reliance upon either as an excuse to performance. Some jurisdictions apply a "common law *force majeure*" doctrine that operates similar to the doctrine of impracticability and impossibility. Thus, one should always consider the specific jurisdiction involved, and determine whether there may be specific statutes or court decisions that apply to protect a certain industry or otherwise provide relief or defenses in a given factual scenario.

Like *force majeure* clauses, impracticability and impossibility clauses generally cover "acts of God" or acts of third parties and must be both unforeseeable and beyond the control of the affected party. For example, governmental regulations or laws preventing or substantially adversely affecting performance could be considered events supporting a claim of impracticality or impossibility, so long as the regulation or law was passed after entering the contract. On the other hand, the continued existence of certain market conditions is generally not considered a basic assumption of contracts. As such, a disruption in market conditions, in isolation, may not justify a claim of impracticability or impossibility.

While performance does not need to rise to the level of impossibility, impracticability requires that a party must show more than a mere increase in difficulty or cost to perform; this theory is normally available only to excuse performance by sellers or those performing the service since courts recognize that rarely is it impracticable or impossible to provide payment for goods and services provided. Impracticability and impossibility may each constitute grounds for termination without liability of the affected party. If, however, impracticability is only temporary, then the obligations may only be suspended, not terminated, unless performance after the event would be more burdensome than had there been no impracticability.

Non-legal factors that were noted at the outset are vitally important to determining if one may rely on impracticability or impossibility to excuse performance. If the parties are sophisticated and considered to have superior knowledge with respect to their commercial dealings, a court may find that certain events affecting performance are considered "business risks" and part of the negotiated terms of a contract, resulting in the doctrine being inapplicable and the court holding that the affected party assumed the risk of the occurrence of such event when it entered into the contract.

Frustration of purpose

The frustration of purpose doctrine applies to the both the sale of goods and performance of services and may excuse performance where the party seeking to be excused no longer has the motivation to perform which originally induced its participation in the contract. Stated another way, if the principal purpose in entering the contract is frustrated through the occurrence of an event (and not due to the actions of such party) so that continuing performance of the contract would make little sense, then the

affected party may be excused from performance. This doctrine may apply when relief from performance may not be obtainable through application of *force majeure* or impracticability or impossibility of performance; however, there typically is a high bar to demonstrate that the frustrated purpose truly was a primary purpose of and incentive to entering into the contract.

As with impracticability and impossibility, the non-occurrence of the frustrating event must have been a basic assumption on which the contract is made. Further, the frustration of purpose must be so severe that it is not fairly to be regarded as within the risks assumed under the contract. By way of example, a "leading case" on this theory involved an instance where an individual rented hotel suites in order to watch the coronation of Edward VII in June 1902. Unfortunately, the ceremony was delayed until August due to a bout of appendicitis, with very short notice provided to the public regarding the change of plan. The renter was excused from the contract because the purpose in renting the rooms was no longer present.

Frustration of purpose can be considered a counterpart to impracticability or impossibility in that it generally may be relied upon to protect buyers, where impracticability and impossibility generally (although not exclusively) may be relied upon to protect sellers or service providers. Like impracticability, however, when the frustration is merely temporary, obligations may be merely suspended and not fully excused or terminated.

Conclusion

Aside from the obvious public health consequences of the COVID-19 crisis, significant economic and financial disruptions are occurring and continuing to evolve as a result of the outbreak and the countermeasures that have been undertaken and will continue to be implemented to mitigate the risk to public health and the economy. As noted earlier, mere economic hardship generally forms an unsatisfactory basis for seeking a remedy through *force majeure*-like theories, but every circumstance is different. It is painfully apparent that the current COVID-19 is creating exceptional circumstances, whether due in whole or in part to governmental orders or recommendations in the attempt to limit the spread of the disease, to operational and market disruptions caused by staffing issues resulting from those affected with the disease or precautionary quarantine, or to public reaction in general. With the current and rapidly evolving environment we are experiencing from the COVID-19 crisis and its broad impact within the United States and internationally, we will encounter (and have already encountered) many novel and differing interpretations and proposed applications of these legal doctrines.

While many commercial partners will and should have good reasons to work together to mitigate the impact upon their respective contractual obligations, litigation undoubtedly will ensue from time to time to resolve significant issues arising from the disruption in the supply of (and need for) certain goods and services across the spectrum of every industry, both foreign and domestic. Given the vast

differences in governing law and contract language, it is wise to consult with experienced legal counsel in assessing options, both for parties seeking a delay or excuse for non-performance, as well as for parties that are on the receiving end of such assertions.

Contact us

For more information regarding how COVID-19 affects contractual obligations, please contact David Agee, Natalie Holden or your Husch Blackwell attorney.

Husch Blackwell has launched a COVID-19 response team providing insight to businesses as they address challenges related to the coronavirus outbreak. The page contains programming and content to assist clients and other interested parties across multiple areas of operations, including labor and employment, retailing, and supply chain management, among others.