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NEWSLETTER

Contractual Performance in Light of COVID-19

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The COVID-19 global pandemic has caused unprecedented restrictions on businesses and impacted the economy in such a way that many organizations are looking to terminate, modify, or postpone events, vendor, or other commercial contracts while minimizing or eliminating liability. Companies in this position need review their contracts and analyze state law principles of impossibility, impracticability, or frustration of purpose may apply.

A) Does COVID-19 trigger the *force majeure* provision in the contract?

Whether you can cancel or modify your performance under a contract on the basis of *force majeure*, primarily will depend on the interpretation of the specific language of the *force majeure* provision in the contract, along with an analysis of the context of your company's and the counterparty's actions and circumstances.

First, you will want to examine the list of specific events that your contract defines as a *force majeure event and see whether COVID-19 clearly (or at least arguably) fits into the items or categories listed. Most force majeure clauses specify a*cts of God (like earthquakes, hurricanes, and fires), acts of war or terrorism, civil disturbances, strikes, and labor disputes. While it is not common for a global pandemic to be specifically listed, some provisions will include governmental actions or orders, which could cover the travel restrictions, business shutdown orders, and social distancing requirements that have been issued in response to the COVID-19 pandemic. *Many contracts also include "catch-all" language that excuses performance upon the occurrence of "other events outside a party's reasonable control."* It is important to note, however, that most courts will distinguish between governmental ordered shutdowns and public health safety requirements (which generally will be considered

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a *force majeure* event) and an unforeseen financial crisis or an economic downturn (which generally will not excuse performance).

Second, if it can be established that the events caused by COVID-19 are covered in your contract's *force majeure* provision, then that is not the end of the inquiry. You next must be able to show that the occurrence of the event actually prevents, hinders, or delays your performance. Typical *force majeure* clauses require that a triggering event make performance "impossible," "illegal," "inadvisable," or "impracticable." The analysis of whether an event excuses performance depends on the degree of difficulty, expense, injury, and/or loss that would result if your company was required to perform under the circumstances.

For an unforeseen increase of cost to excuse performance, generally the increase must be substantial enough to rise to the level of being unjust and unreasonable. Performance also may be excused if the risk of injury (to your company or its personnel) is disproportionate to the expected contractual benefits. Of relevance to the current situation, some courts have held performance of a contract to be impracticable where the public would be exposed to potential health risks.

B) Applicable State Law: Impossibility/Impracticability and Frustration of Purpose

Even in the absence of a useful force majeure clause, most jurisdictions recognize principles of impossibility/impracticability, and frustration of purpose.

If an event (not caused by the party) makes it impossible for the party to perform its obligations under an agreement, then the party's performance will be discharged. This concept does not require that the performance literally be "impossible", but generally is interpreted to mean that the performance is impracticable. The Restatement (Second) of Contracts § 261 provides that "[w]here, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate to the contrary."

Related to the concept of impossibility/impracticability is the doctrine of "frustration of purpose." This applies generally *when a change in circumstances makes one party's contract performance worthless to the other party. The Restatement (Second) of Contracts § 265 provides that this defense contains three elements: (i) the party's principal purpose in making the contract is frustrated; (ii) an event occurred whose non-occurrence was a basic assumption underlying the contract; and (iii) the party invoking the defense was not at fault.*

C) *What actions should you take?*

Whether a *force majeure* provision, or any statutory or common law impracticability or frustration of purpose remedies, may apply to your situation will depend on (i) the written terms of any *force majeure* or similar provision in your agreement; (ii) the statutory and common law principles of the state law that governs the agreement; and (iii) the facts and circumstances of your situation, including the subject matter of the agreement, and each party's actions, reasonable expectations, and performance obligations in connection with the agreement and the circumstances that have led to the current situation.

In addition, pay close attention to whether: (A) there is a requirement for you to provide the counterparty with written notice of the event and/or your decision to terminate or otherwise suspend performance; (B) you have an obligation to take steps to minimize disruption or other steps to mitigate your losses; (C) *there is a distinction between excusing the performance of monetary vs nonmonetary obligations; and (D) the contract requires payment of* liquidated damages that is triggered/increased depending on the date of cancellation.