

CONTRACTS UNDER QUARANTINE

WHAT TO CONSIDER WHEN COVID-19 DISRUPTS PERFORMANCE

By Alec Solotorovsky and Sarah Catalano

With many business functions having slowed or stopped due to the COVID-19 pandemic, companies are evaluating how to enforce contracts—or be excused from performing under contracts—given changed circumstances that prevent performance or make performance more expensive. This article discusses three arguments commonly made for excusing performance: (1) contractual **force majeure** clauses; (2) the common-law doctrines of **impracticability** and **frustration of purpose**; and (3) **Section 2-615 of the Uniform Commercial Code**. Whether performance is excused on any ground is highly fact specific and the discussion below reflects a general survey of the law, not the law of any particular jurisdiction.

I. FORCE MAJEURE

a. Overview

Force majeure clauses are designed to allocate risk when events that are outside the parties' control cause one or both parties to be unable to perform under the contract. A typical force majeure clause includes the following components:

1. Excuse From Performance. One or both parties are excused from performing under the contract if a specified force majeure event occurs.

2. Force Majeure Events. The parties negotiate a list of force majeure events, which generally are events beyond the control of the parties that prevent performance under the contract.¹ Unless otherwise specified, courts typically interpret the clause as applying only to the specific events listed.²

¹ *Beardslee v. Inflection Energy, LLC*, 31 N.E.3d 80, 81–82 (N.Y. 2015).

² See, e.g., *Kel Kim Corp. v. Cent. Mkts., Inc.*, 519 N.E.2d 295, 296 (N.Y. 1987) (“Ordinarily, only if the *force majeure* clause specifically includes the event that actually prevents a party’s performance will that party be excused.”).

Parties may include catch-all language, such as “all other acts outside the parties’ reasonable control” or “acts of God,” but courts generally construe such catch-all provisions narrowly.³

3. Excluded Events. The parties may list certain events that are explicitly not covered by the force majeure clause, such as business downturns or economic conditions or “the unavailability of any utilities because of failure to pay utility bills.”

4. Impacted Party’s Obligations. The clause may require that the impacted party notify the other party of its inability to perform and attempt to mitigate the problem, if possible. In a contract for the sale of goods, if a force majeure event affects only part of a seller’s capacity, the seller may be required to allocate reduced production among all customers.

5. Other Party’s Remedies. The clause may provide remedies for the other party if a force majeure event occurs, such as the option to terminate the contract if the force majeure event persists beyond a certain period.

b. Key Considerations

1. Contract Language. Some force majeure clauses explicitly list pandemics, epidemics, and quarantines as force majeure events. If the clause does not list those events in particular, courts may nevertheless find that the COVID-19 pandemic constitutes an “act of God” or falls within a clause’s catch-all language, such as “any other contingency outside either party’s reasonable control, which would make performance commercially impracticable.”⁴ Whether COVID-19 falls within a catch-all provision may depend on how exhaustively the parties listed other natural disasters (the more exhaustive the list, the more likely a court would exclude pandemics) and whether the court considers the COVID-19 pandemic to be foreseeable.⁵ Depending on the circumstances, performance may also be excused by another listed event, such as:

- i. Governmental action, law, ordinance or regulation;
- ii. Supply shortages caused by government rationing, allocation, or supply programs;
- iii. Inability to obtain on reasonable terms electricity or other type of energy, raw or

³ See, e.g., *URI Cogeneration Partners, L.P. v. Bd. of Governors for Higher Educ.*, 915 F. Supp. 1267, 1286 (D.R.I. 1996) (declining to extend force majeure clause’s catch-all provision including any “causes beyond the reasonable control of” the parties to inability to obtain zoning approval); *Kel Kim Corp.*, 519 N.E.2d at 296–97 (catch-all provisions in force majeure clauses “are not to be given expansive meaning; they are confined to things of the same kind or nature as the particular matters mentioned”).

⁴ See, e.g., *Rexing Quality Eggs v. Rembrandt Enters., Inc.*, 360 F. Supp. 3d 817, 841 (S.D. Ind. 2018) (contrasting avian-flu epidemic as example of type of event that would “plausibly constitute an unforeseeable event precipitating a dramatic change in market conditions” that might fall within force majeure clause, as opposed to “change in purchaser demand,” which “is a foreseeable part of doing business”).

⁵ See, e.g., *In re Cablevision Consumer Litig.*, 864 F. Supp. 2d 258, 264 (E.D.N.Y. 2012) (“[F]orce majeure clauses are aimed narrowly at events that neither party could foresee or guard against in the agreement.”); *Rochester Gas & Elec. Corp. v. Delta Star, Inc.*, No. 06-CV-6155-CJS-MWP, 2009 WL 368508, at *8 (W.D.N.Y. Feb. 13, 2009) (catch-all language “including acts of God” in force majeure clause refers to unforeseeable events); *Watson Labs., Inc. v. Rhone-Poulenc Rorer, Inc.*, 178 F. Supp. 2d 1099, 1113 (C.D. Cal. 2001) (catch-all language in force majeure clause referring to “regulatory, governmental . . . action” does not excuse performance caused by FDA’s “entirely foreseeable” shutdown of manufacturing plant).

finished materials from normal sources of supply, labor, equipment, transportation, or storage and/or manufacturing facilities.

2. Reason for Non-Performance. Courts will be more likely to excuse performance if the inability to perform was directly caused by the pandemic or governmental actions taken in response to the pandemic, as opposed to the economic fallout from the same. That is particularly true if the force majeure clause explicitly excludes business downturns or economic reasons as a justification for non-performance.

3. Timing of Non-Performance. Given uncertainty over how long the COVID-19 pandemic and associated shutdowns may last, many businesses are considering when to invoke a force majeure clause in contracts for future performance. Declaring force majeure with respect to a performance due sooner (e.g., a conference at a hotel in April) will more likely be accepted by courts than with respect to a performance due later (e.g., a conference at a hotel in July).⁶

4. Contract Date. If the force majeure clause does not explicitly list pandemics, courts may be more willing to find that the COVID-19 pandemic falls within the catch-all provisions if the contract was entered into before the current outbreak. Now that disruptions caused by COVID-19 have become a reasonable foreseeability, any party that fails to include pandemics in a force majeure clause going forward may be presumed to have done so knowingly, particularly in jurisdictions that narrowly construe force majeure clauses.

5. Notice and Mitigation Requirements. The party invoking the force majeure clause should ensure that it follows any notice requirements and, if possible, any requirements to mitigate the situation.

II. IMPRACTICABILITY AND FRUSTRATION OF PURPOSE

If a contract does not contain a force majeure clause, there are two common-law contract doctrines that may excuse performance.

a. Impracticability – Overview

Under the common-law doctrine of impracticability (sometimes referred to as “impossibility”), where, after a contract is made, a party’s performance is made impracticable without its fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, performance is excused.⁷

⁶ See, e.g., *OWBR LLC v. Clear Channel Commc'ns, Inc.*, 266 F. Supp. 2d 1214, 1224 (D. Haw. 2003) (concluding that force majeure clause does not apply to convention scheduled in Hawaii five months after 9/11 attack “when there was no specific terrorist threat to air travel,” but noting that had the “event been scheduled for the weeks immediately following September 11,” the case for applying the force majeure clause would be “much stronger”).

⁷ See Restatement (Second) of Contracts § 261 (1981).

For impracticability to apply, the non-occurrence of the supervening event must have been a basic assumption on which both parties made the contract. The mere fact that the parties discussed an issue while contracting does not mean that it became a basic assumption of the contract.⁸ Typically, courts will find that unforeseeable events were a basic assumption of the contract, but an event need not be completely unforeseeable.⁹ Normally, a subsequent government action or regulation making performance impracticable is a basic assumption of a contract, unless that action was reasonably foreseeable.¹⁰ Moreover, the supervening event must be due to an “act of God” or to acts of third parties. Unlike force majeure clauses, which are limited to the specific events listed in the contract, the principle of impracticability applies broadly to any contingency that makes performance impracticable.

b. Impracticability – Key Considerations

Although most courts would find the COVID-19 pandemic, and the government response including widespread stay-at-home orders, to be an unforeseeable event or act of God beyond the control of the parties, that does not end the inquiry.

1. Direct Effect on Performance? For impracticability to apply, the supervening event must directly affect the party’s performance. It is not enough that it makes performance more burdensome. For example, in *Centex Corp. v. Dalton*,¹¹ the court held that a bank’s performance—payment of a finder’s fee to an executive who helped close a deal—was excused because performance was rendered impossible when the Federal Home Loan Bank Board subsequently prohibited the payment of such finder’s fees. In *Prusky v. Reliastar Life Insurance Co.*,¹² the court held that performance was not excused by regulatory changes that made performance more burdensome but did not render it impracticable. Performance is impracticable—as opposed to merely more difficult—if it involves extreme and unreasonable difficulty, expenses, injury, or loss to one of the parties, or it involves a risk of injury to person or to property that is disproportionate to the ends to be attained by

⁸ See, e.g., *Short Bros., PLC v. United States*, 65 Fed. Cl. 695, 786 (Fed. Cl. 2005) (“The mere fact that the parties discussed the means that would be required does not support an inference that the means became a ‘basic assumption.’”).

⁹ See, e.g., *Opera Co. of Bos., Inc. v. Wolf Trap Found. for Performing Arts*, 817 F.2d 1094, 1100–01 (4th Cir. 1987) (occurrence of supervening event “must be unexpected but it does not necessarily have to have been unforeseeable”); *Ala. Football, Inc. v. Wright*, 452 F. Supp. 182, 185 (N.D. Tex. 1977) (doctrine of impossibility applies where event “does not seem to have been expected by either party” and “could not have [been] reasonably foreseen”).

¹⁰ See Restatement (Second) of Contracts § 264 (1981). See also *United States v. Winstar Corp.*, 518 U.S. 839, 905–07 (1996) (non-occurrence of regulatory changes was not basic assumption of contract between government and participants in regulated industry, where numerous statutory and regulatory changes had been made over the years); *Pure Wafer Inc. v. City of Prescott*, 845 F.3d 943, 957 (9th Cir. 2017) (non-occurrence of regulatory changes was not a basic assumption on which contract was made).

¹¹ 840 S.W.2d 952, 956 (Tex. 1992).

¹² 445 F.3d 695, 701 (3d Cir. 2006); see also *E. Capitol View Cmty. Dev. Corp., Inc. v. Robinson*, 941 A.2d 1036, 1040 (D.C. 2008) (“The party asserting the defense of impossibility bears the burden of proving ‘a real impossibility and not a mere inconvenience or unexpected difficulty.’” (quoting *Bergman v. Parker*, 216 A.2d 581, 583 (D.C. 1966))).

performance.¹³ Courts generally assess whether performance is impracticable using an objective standard without regard to the particular party who is to perform.¹⁴

2. Impact of Economic Downturn. While the non-occurrence of a pandemic or government-imposed stay-at-home order likely would be held a basic assumption of most contracts, courts are less likely to conclude that the non-occurrence of an economic downturn was a basic assumption. Continuation of existing market conditions and of the financial situation of the parties are not ordinarily considered basic assumptions of a contract.¹⁵

3. Alternative Performance? If a party can perform under a contract in more than one way, its performance will not be excused under the contract as long as an alternative means of performance remains practicable.¹⁶ For example, if a manufacturer can shift production to another facility without violating a governmental order, performance will not be excused.

¹³ See *In re Anchor Glass Container Corp.*, 345 B.R. 765, 772 (M.D. Fla. 2006) (applying California law) (“Impossibility means not only strict impossibility but impracticability because of extreme and unreasonable, difficulty, expense, injury or loss involved.” (quoting Restatement (First) of Contracts § 454 (1932))); *Conner Bros. Const. Co., Inc. v. United States*, 65 Fed. Cl. 657, 686 (Fed. Cl. 2005) (“A contract is commercially impracticable when performance would cause ‘extreme and unreasonable difficulty, expense, injury, or loss to one of the parties.’” (quoting *Raytheon Co. v. White*, 305 F.3d 1354, 1367 (Fed. Cir. 2002))).

¹⁴ See, e.g., *Opera Co. of Bos., Inc.*, 817 F.2d at 1099 n.8 (“Impossibility or impracticability may not be ‘subjective’ but must be ‘objective,’ and the difference between the two concepts has been summarized in the phrases ‘the thing cannot be done’ (this being objective impossibility or impracticability) and ‘I cannot do it’ (classified as subjective impossibility or impracticability).”); *Hollis v. Gallagher*, No. 03-11-00278-CV, 2012 WL 3793288, at *6 (Tex. App. Aug. 28, 2012); see also *Oak Adec, Inc. v. United States*, 24 Cl. Ct. 502, 506 (Cl. Ct. 1991) (“The objective standard is . . . not intended to be a ‘sword’ for plaintiffs alleging impossibility, but rather a ‘shield’ to be used by defendants to deflect such charges by a contractor whose own inability was the cause of non-performance.”).

¹⁵ See, e.g., *W.R. Grace & Co. v. Local Union 759, Int’l Union of United Rubber, Cork, Linoleum & Plastic Workers of Am.*, 461 U.S. 757, 768 n.12 (1983) (“Economic necessity is not recognized as a commercial impracticability defense to a breach of contract claim.”); *407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp.*, 244 N.E.2d 37, 41 (N.Y. 1968) (“[W]here impossibility or difficulty of performance is occasioned only by financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy, performance of a contract is not excused.”). See also *Ner Tamid Congregation of N. Town v. Krivoruchko*, No. 08 C 1261, 2009 WL 10696538, at *11 (N.D. Ill. July 9, 2009) (economic downturn caused by 2008 global financial crisis “may have been uncertain, but it was not unforeseeable, as that turn is used in the cases dealing with supervening impracticability”); *Great Lakes Gas Transmission Ltd. P’ship v. Essar Steel Minn., LLC*, 871 F. Supp. 2d 843, 852–53 (D. Minn. 2012) (collecting authority from four jurisdictions, three of which found 2008 financial crisis was not force majeure event, and one finding it was under force majeure clause that “specifically included ‘change to economic conditions’ as an enumerated event that could excuse a default”).

¹⁶ See, e.g., *Mass. Bay Transp. Auth. v. United States*, 254 F.3d 1367, 1373–74 (Fed. Cir. 2001) (party asserting impossibility “has the burden to prove that it explored and exhausted alternatives before concluding that the contract was legally impossible or commercially impracticable to perform” (quoting *Blount Bros. Co. v. United States*, 872 F.2d 1003, 1007 (Fed. Cir. 1989))); *In re Bicoastal Corp.*, 600 A.2d 343, 351 (Del. 1991) (“[T]he doctrine of impossibility does not apply to ‘contingent alternative promises’ where only part of an obligor’s performance is impracticable.”); *Luria Bros. & Co., Inc. v. Piolet Bros. Scrap Iron & Metal, Inc.*, 600 F.2d 103, 112 (7th Cir. 1979) (even where party asserting impracticability “expected to fulfill its obligation in a particular way, it had a duty to ‘employ any practicable alternative means of fulfilling the contract’” (quoting *Chemetron Corp. v. McLouth Steel Corp.*, 381 F. Supp. 245, 257 (N.D. Ill. 1974))).

c. Frustration of Purpose – Overview

A party's performance may be excused under the common-law theory of frustration where, after a contract is made, the party's principal purpose is substantially frustrated without its fault by the occurrence of an event if the non-occurrence of that event was a basic assumption on which the contract was made.¹⁷ Frustration differs from impracticability because there is no impediment to performance by either party. Rather, frustration applies when a change in circumstances makes one party's performance virtually worthless to the other. For example, while it may still be possible for a vendor to supply goods or services to an event space during a pandemic, those goods or services would be worthless to the host if the event has been canceled due to a government ban on all large gatherings.

"...frustration differs from impracticability ..."

d. Frustration of Purpose – Key Considerations

1. Principal Purpose? It is not enough that one party had a particular purpose in mind at the time of contracting. For something to be the principal purpose of the contract, it must be so completely the basis of the contract that both parties understood that the contract would not have been made but for that purpose. For example, in *Viking Supply v. National Cart Co., Inc.*,¹⁸ frustration excused a shopping-cart manufacturer's performance under a distribution contract after a major retailer became unwilling to buy its shopping carts from the distributor, because both parties understood that the retailer's willingness to buy carts from the distributor was "the basic assumption upon which the contract was made and without which the contract would make no sense." But in *Rembrandt Enterprises, Inc. v. Dahmes Stainless, Inc.*,¹⁹ the court denied summary judgment for an egg producer seeking to get out of a contract to purchase equipment for a new facility after its plans to build that new facility were frustrated by the 2015 avian-flu epidemic, because it was not "clear cut" whether the primary purpose of the contract was to purchase equipment to be used at only the new facility or to purchase equipment that could be used at one of the producer's other facilities.

2. Substantial Frustration? Similar to impracticability, frustration does not excuse performance just because a supervening event makes the contract less valuable to one party. Rather, performance must become virtually worthless.²⁰ For example, in *7200 Scottsdale Road General Partners v. Kuhn*

¹⁷ See Restatement (Second) of Contracts § 265 (1981).

¹⁸ 310 F.3d 1092, 1096–97 (8th Cir. 2002).

¹⁹ No. C15-4248-LTS, 2017 WL 3929308, at *8–9 (N.D. Iowa Sept. 7, 2017); see also *7200 Scottsdale Rd. Gen. Partners v. Kuhn Farm Mach., Inc.*, 909 P.2d 408, 415–16 (Ariz. Ct. App. 1995) (rejecting frustration defense of company that canceled convention at resort after European attendees cancelled because of perceived risk of terrorism during Gulf War in Iraq because resort did not enter into contract with understanding that attendance of company's European personnel was the principal purpose of the contract).

²⁰ See, e.g., *McReynolds v. Trilantic Capital Partners IV L.P.*, No. 5025-VCL, 2010 WL 3721865, at *4 (Del Ch. Sep. 23, 2010) ("The doctrine [of supervening frustration] is generally limited to cases where 'a virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party.'" (quoting *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 872 A.2d 611, 620 n.35 (Del. Ch. 2005))).

Farm Machinery, Inc.,²¹ the court rejected a company's argument that its contract to host a convention at a resort was substantially frustrated because of a perceived threat of terrorism during the Gulf War in Iraq made domestic air travel unreasonably dangerous. The court conceded that if the Gulf War had "effectively precluded domestic air travel," the resort's services would have been essentially "valueless" and the contract would be "substantially frustrated." But the facts did not show such travel preclusion. On the contrary, although several dealers canceled, there were still over one hundred dealers registered to attend. The court concluded that "the frustration was not so severe that it cannot fairly be regarded as one of the risks assumed by [the company] under the contract."

III. UCC SECTION 2-615 (EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS)

A seller of goods may be excused from performance under the Uniform Commercial Code (UCC), which applies to all contracts for the sale of goods, i.e., "things . . . which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid."²² Under UCC Section 2-615, a seller's delay in delivery or non-delivery is not a breach if its performance has been made impracticable by (1) the occurrence of a contingency, the non-occurrence of which was a basic assumption on which the contract was made; or (2) compliance in good faith with any applicable foreign or domestic governmental regulation or order regardless whether it later proves to be invalid.²³ The parties may deviate from this default rule by assigning the seller greater or lesser liability for such contingencies in the terms of the contract.²⁴ A court may also find that a seller implicitly agreed to bear the risk of the contingency through the parties' usage of trade if, for example, the seller previously had assumed the risk of such contingencies when they happened in the past.²⁵

If the seller's capacity to perform is only partially affected, the seller must allocate production and deliveries among its customers. The seller must promptly notify the buyer that there will be delay or non-delivery and, when allocation is required, of the estimated quota made available for the buyer.

Because UCC Section 2-615 essentially codifies the common-law doctrine of impracticability, many of the same considerations apply. Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency that alters the essential nature of the performance.²⁶ The rise or collapse of the market is not a sufficient justification, but a severe shortage of raw materials or supplies due to

²¹ 909 P.2d at 416–17.

²² UCC Section 2-105.

²³ UCC Section 2-615.

²⁴ UCC Section 2-615 & cmt. 8.

²⁵ See UCC Section 2-615 cmt. 8; *E. Air Lines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957, 991 (5th Cir. 1976) ("Even in the absence of detailed wording, trade usage and the circumstances surrounding a particular agreement may indicate that the parties intended to accord the seller an exemption broader than is available under the U.C.C.").

²⁶ See UCC Section 2-615, cmt. 4.

unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in costs or altogether prevents the supplier from obtaining supplies necessary to perform may excuse performance.²⁷

IV. CONCLUSION

Whether your business is seeking to enforce or excuse performance under a contract, the first place to look is the text of the contract itself and the force majeure clause, if there is one. If the contract lacks a force majeure clause, then impracticability, frustration of purpose, or UCC Section 2-615 may provide a basis to excuse performance. Going forward in light of COVID-19, courts will be more likely to treat pandemics and resulting governmental restrictions affecting work as foreseeable. Therefore, businesses should consider expressly allocating the risks of those disruptions in future contracts, either by providing for pandemics in a force majeure clause or by expressly excluding them.



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²⁷ *Id.*