

Coronavirus and Contractual Performance Disputes—Does a Pandemic Excuse Performance of Contractual Obligations?

by Kent J. Schmidt

The daily headlines are reminders of the far-reaching economic ripple effects of the 2019 Novel Coronavirus (COVID-19) outbreak. The pandemic is forcing companies to abruptly alter strategies and business plans that seemed certain even at the beginning of the year. These types of changes prompt a question relating to whether this unprecedented health crisis alters existing contractual obligations. *Can a company suspend performance of a contract or even terminate the agreement altogether because of the impacts of the coronavirus?*

In many instances, the answer to this question is in the affirmative, and unequivocally so. A party to a contract may argue that, as a result of the outbreak, performance of its contractual duties is now impossible, impractical or at least economically infeasible. But applicable law, contractual provisions and the parties' course of dealing before and since the outbreak will in some cases make the answer far from clear, in which case the dispute may escalate to litigation. With the possibility of litigating these sensitive issues on the horizon, it is useful to examine the legal principles that govern contract disputes stemming from the current health crisis.

Impossibility and Impracticability of Performance

American contract law has long recognized and accommodated situations in which one party's contractual performance is made impossible or impractical by intervening and unforeseeable events such as the outbreak of a war or a similar catastrophic event.¹ The law recognizes that it would be unfair and inequitable to hold a contracting party to their contractual duties when the circumstances interfering with their performance are extraordinary and beyond their control.

Reflected in both the Uniform Commercial Code (governing sale of goods)² as well as the Restatement (Second) of Contracts, the rule is generally referred to as the doctrine of *impossibility of performance*.³ Every state recognizes some form of the law of impossibility, either in the common law of contracts or by code. California has codified

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the law as follows: “The want of performance of an obligation, or of an offer of performance, in whole or in part, or any delay therein, is excused by the following causes, to the extent to which they operate: (2) When it is prevented or delayed by an irresistible, superhuman cause, or by the act of public enemies of this state or of the United States, unless the parties have expressly agreed to the contrary.”⁴ Even if not entirely impossible to perform, if it is utterly impractical to perform, the same result obtains—performance of contractual duties may be excused.

Mere Delay in Performance

One of the threshold questions in these cases is whether the circumstances merit only a delay in performance rather than a complete termination of all contractual obligations. As is common in California jurisprudence, one of the seminal cases that addresses this issue involved a dispute between an actor and movie studio. In *Autry v. Republic Productions, Inc.*,⁵ the court held that Gene Autry was released from his contractual obligation to a movie studio because of the outbreak of World War II and the actor’s enlistment in the military. The parties disputed whether a provision in the contract merely suspended Mr. Autry’s obligation during wartime or effectively terminated his performance obligations thereafter. The court agreed with the Singing Cowboy who had served his country well, concluding that time was of the essence in the contract. It held that, by the time the war was over, the economic conditions had changed to such a degree that he was excused from performance entirely.⁶

Lack of Foreseeability is Key

The bar for proving impossibility is high and requires that the condition purportedly interfering with performance be entirely unforeseeable. In *Mitchell v. Ceazan Tires, Ltd.*⁷ (another case triggered by the outbreak of war), a tenant which had leased commercial space for an auto parts and tire store contended that the war triggered governmental regulations on the sale of new tires making performance impossible. The California Supreme Court rejected this argument, not only because the contract was entered into when the country was debating entry into the war, making this not entirely an unforeseeable or remote possibility, but also because the contract still retained value notwithstanding the limitation.⁸

Assuming that the contractual obligations were assumed before December 2019 (when the first cases were reported in mainland China), the foreseeability should not be a bar to this argument as the nature and spread of the epidemic is unprecedented. For contracts that have been negotiated in more recent weeks, the widespread reports of the outbreak will make the foreseeability argument a contested issue.

Contract Terms are Key

These principles of contract law operate as an exception to the principle that courts will enforce the parties’ expectations. Instead, of focusing on the contractual intent, these cases are resolved based on the equity or fairness of the situation. Notwithstanding this principal focus, it would be a mistake to conclude that the terms of the parties’ written

contract are immaterial to the question.

Several types of contract provisions become paramount in these cases. First, where the parties' written agreement manifests an intent to address these types of contingencies, those terms will control. One such provision is a *force majeure* clause.

A *force majeure* provision seeks to identify the types of circumstances which will suspend a performance obligation.⁹ But such clauses may be a double-edged sword for the party seeking to avoid the contractual obligation. If the *force majeure* clause lists a variety of events excusing performance—e.g., war, terrorists attacks, labor disputes—but does not contain language suggesting that this list is non-exclusive, the party seeking to enforce the contract may point to its omission as a reason to enforce the parties' obligations. Other contract provisions that are of paramount importance in these types of contract disputes are termination clauses, choice of law provisions and liquidated damages provisions.

Frustration of Purpose

A closely-related legal doctrine that may be invoked by a party whose business plans are impacted by the pandemic is frustration of purpose. "Where, after a contract is made, a party's principal purpose is substantially frustrated 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 remaining duties to render performance are discharged, unless the language or circumstances [of the contract] indicate the contrary."¹⁰ This doctrine may be invoked where performance is not impossible but, due to the significant change in circumstances, a basic assumption in the parties' agreement has not materialized.

Suppose, for example, a company has a contract obligating it to provide ancillary services at a major trade show that is now canceled due to the coronavirus outbreak. The vendor can still perform the services (hence, not impossible), but the entire point of the transaction was that there would be thousands of attendees at the event. In this instance, frustration of purpose, not impossibility of performance is a better argument.

How these Legal Issues Play Out in Litigation

Typically, the party seeking to avoid the contract will be a defendant in a claim for damages brought by the party seeking to enforce the contractual obligations. But it may be prudent or procedurally advantageous for the party seeking to be excused to be the plaintiff by affirmatively seeking an adjudication of the issue through a declaratory judgment action rather than waiting for a lawsuit to be filed.

Regardless of which party arrives first at the courthouse steps, the burden remains the same—the party seeking to avoid the contract through these legal principles and doctrines will bear the burden of proof.¹¹ It should also be understood that, under California law, impossibility of performance is a question of law for the court to decide, not a factual question that goes to the jury.¹²

Five Questions to Ask

Whether a party should be excused from a contractual obligation involves an intensely factual inquiry with the law offering relatively few guideposts. This leaves courts with a wide degree of latitude to achieve an equitable result. Every case will turn on its own unique contract provisions and the evidence of the parties' course of dealings.

Notwithstanding these vagaries, those contemplating these issues and wishing to obtain an early assessment of how the matter might be sorted out in litigation should consider five questions:

1. **What law controls?** Although each U.S. jurisdiction has adopted some form of these doctrines, there are nuances in the law that may prove critical in the dispute. It is important to assess what law will control by considering a choice of law provision in the contract or determining where the contract was created. Choice of law is an even more important preliminary question for contracts involving international parties.
2. **Is there a *force majeure* clause in a contract?** In many contractual relationships, a review of the terms and conditions will reveal that a *force majeure* clause is broad enough to cover the situation or may otherwise be dispositive of these issues. In addition, termination provisions may also control as well as liquidated damages clauses.
3. **How close is the nexus between the claimed performance and the pandemic?** The more direct the impact, the stronger the argument will be that these principles apply to excuse non-performance. But even contracts that are impacted by intermediate causes that trace back to the pandemic may be subject to an excused performance.
4. **Does the pandemic merely make the contract more difficult to perform, rather than rising to the level of impossibility?** Performance of a contract may be more challenging and the profits may be less than what was initially expected, but this does not necessarily render performance impossible or impracticable.
5. **Is a delay in performance rather than a suspension of the entire contract merited?** From an objective standpoint, a delay in performance is far less drastic than a termination of all contractual rights. It may be more plausible to take that position, at least at the outset as events unfold, reserving the right to seek to be excused from the entire obligation.

We all hope that the pandemic will be a temporary crisis and that cures and preventive measures will be effective. But litigation relating to these contractual disputes will likely drag on long after the world has returned to business as usual.

¹ The roots of this doctrine are in English common law and *Taylor v. Caldwell*, 3 B. & S. 826, 122 Eng. Rep. 309. One of the earliest cases to recognize the rule was *Stewart v. Stone*, 127 N.Y. 500, 28 N.E. 595 (1891).

² Uniform Commercial Contract § 2-615 provides in part: "Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance: (a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract

was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.”

³ Restatement (Second) Contracts § 261. See also 2 Matthew Bender Practice Guide: California Contract Litigation § 22.65 (2020).

⁴ Cal. Civ. Code § 1511.

⁵ 30 Cal. 2d 144 (1947).

⁶ *Id.* at 156.

⁷ 25 Cal. 2d 45 (1944).

⁸ *Id.* at 48.

⁹ *Horsemen's Benevolent & Protective Ass'n v. Valley Racing Ass'n*, 4 Cal. App. 4th 1538, 1564-65 (1992), citing *Pacific Vegetable Oil Corp. v. C. S. T., Ltd.* 29 Cal. 2d 228, 238 (1946).

¹⁰ Restatement (Second) of Contract 265. See also *Lloyd v. Murphy*, 25 Cal. 2d 48, 54, 153 P.2d 47, 50 (1944).

¹¹ *Oosten v. Hay Haulers Dairy Emps. & Helpers Union*, 45 Cal. 2d 784, 788 (1955).

¹² *Id.* at 48.