

# STONE MAGNANINI

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## COMPLEX LITIGATION

### COVID-19 ALERT

**TO:** Friends of the Firm

**FROM:** Stone & Magnanini LLP

**DATE:** April 15, 2020

**SUBJECT:** COVID-19: What Claims Could Arise out of COVID-19 and What Actions Should Companies be Taking in these Difficult Times?

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The Coronavirus disease (“COVID-19”) Pandemic is a global event that will have unprecedented effects on public health, economic and social policy; the legal consequences of the pandemic are also expected to impact a broad range of laws and legal relationships, particularly contracts, insurance coverage and employment law.

Many of you have been inundated over the last few weeks with e-mail blasts regarding the legal consequences of COVID-19, which while helpful to frame the issue, are mostly devoid of substantive content. Much of this analysis was done in real-time, with little more than a top level summary. In contrast, our aim is to provide our clients with a more comprehensive discussion of the various legal issues raised by the pandemic that they are likely to face.

We are sending three separate alerts over the coming days. Each focuses a particular issue of concern: Commercial Contracts, Insurance Coverage, and Employment Issues. If you would like to discuss any of these concerns further or if our firm can be of help to you in any way, do not hesitate to call us at 973-218-1111, or email our managing partners at [dstone@stonemagnalaw.com](mailto:dstone@stonemagnalaw.com) or [rmagnanini@stonemagnalaw.com](mailto:rmagnanini@stonemagnalaw.com).

Please note that this alert is not intended to constitute legal advice, and is not a substitute for having a licensed attorney analyze your company’s particular contract and/or situation.

#### **I. Avoidance of Performance of Commercial Contracts**

Many of you are experiencing circumstances where your company, or one of your vendors, simply cannot provide contracted-for services or goods due to the disruptions caused by COVID-19. Here, we will endeavor to discuss some of the major contract terms and principles of law that will likely apply to these situations.

### ***A. Force Majeure***

One of the arguments vendors, distributors or insurance companies may raise for failure to perform is “force majeure”. This term of art is used in many contracts and generally refers to an unforeseen event beyond the control of either party, such as a natural disaster or “act of God,” war, terrorism, civil unrest, government action, work stoppage, disease, epidemic, pandemic or other public health crisis. The specific events triggering a force majeure clause are governed by the parties’ contract.<sup>1</sup>

Given the litany of governmental orders requiring the shut-down of non-essential businesses throughout the United States and the world, as well as the formal declaration of COVID-19 as a global pandemic per the World Health Organization (“WHO”),<sup>2</sup> a prudent company would revisit its various contracts to determine whether the COVID-19 crisis excuses performance under the contracts’ force majeure clauses.

Traditionally, Courts have strictly construed force majeure clauses and generally refused to enforce them, instead construing contracts in favor of performance.<sup>3</sup> An example from the SARS epidemic may be instructive here.

Shortly before the American Association for Cancer Research (“AACR”) was scheduled to hold its 2003 annual meeting in Toronto, the Ontario Government declared an emergency due to SARS. AACR had signed contracts with numerous hotels and a convention center and anticipated thousands of attendees — nevertheless, just three days before the conference was to start, AACR decided to cancel the event because of the risk of SARS. AACR rebooked the meeting for later in the year in Washington, D.C. In 2004, the Toronto Convention and Visitors Association brought suit seeking over \$6,000,000 in damages. AACR used the defense of commercial impracticability, caused by a force majeure event, based on the SARS epidemic. Ultimately, the litigation was resolved via mediation.<sup>4</sup>

A party seeking to invoke force majeure and excuse performance has a duty to prove what action it took to perform the contract regardless of the occurrence of the event of force majeure.<sup>5</sup> The party must prove that “the failure to perform was proximately caused by a contingency and that, in spite of skill, diligence, and good faith on the promisor’s part, performance remains impossible or unreasonably expensive.”<sup>6</sup>

If a force majeure provision contains no reference to an outbreak, epidemic, pandemic, or the like, a party may still argue that the COVID-19 pandemic is an “act of God” or “disaster,” but the law is far from settled on this point and different jurisdictions will likely arrive at different conclusions. The list of force majeure events also often includes government action, orders, or regulations. Such language could allow a party to invoke force majeure where a governmental decree has rendered performance impossible. But a governmental order alone will not always be considered enough to invoke force majeure.<sup>7</sup>

The list of force majeure events might also contain a catchall such as “any other event outside the parties’ control.” Courts generally construe these catchall provisions narrowly pursuant to the rule of *ejusdem generis*.<sup>8</sup> Thus, businesses should beware that courts may not find the

unprecedented economic effects of COVID-19 enough to invoke force majeure without specific, economic downturn related language in the parties' contract.<sup>9</sup>

This area of the law will surely develop rapidly in the wake of the ongoing pandemic, and courts may interpret force majeure provisions more liberally going forward. The application of force majeure provisions also varies by jurisdiction or choice of law provisions contained in a contract. Contracts may also contain specific notice provisions that require timely communications between parties when non-performance is imminent and before force majeure or other remedies can be invoked. An in-depth analysis by qualified counsel is advisable before making any decisions based on a force majeure provision in your company's contract(s).

### ***B. Changed Circumstances***

A party may also seek to avoid performance based on a claim that circumstances have changed since the contract was executed. This has met with limited success if the reason claimed is financial for the reasons outlined below. Basically, a "changed circumstances" term may excuse performance because one or both of the parties is no longer able to keep the promises made in the agreement due to circumstances that were either beyond their control or unforeseeable. This is an attempt by a contract drafter to memorialize the common-law/Uniform Commercial Code ("UCC") principles of impossibility, commercial impracticality, and frustration of purposes. Each of those will be discussed in turn, below.

### ***C. Impossibility, Frustration of Purpose, and Impracticality***

If a business is unable to perform its contractual obligations but the contract does not contain a force majeure provision, the company may still seek relief under the common-law or the UCC. Some jurisdictions provide for a defense of impossibility in certain situations where the performance of the contract is rendered objectively impossible by an event that is unforeseen and could not have been guarded against in the contract.<sup>10</sup> Some courts have found that one factor not considered is the economic or financial hardship of the non-performing party. Thus, where the impossibility of performance is due solely to financial or economic hardship, even where such hardship results in the party's insolvency or bankruptcy, some courts will not excuse performance of the contract.<sup>11</sup>

Another potential defense in the absence of a force majeure clause is frustration of purpose, which is closely related to impossibility. "The respective concepts of impossibility of performance and frustration of purpose are, in essence, doctrinal siblings within the law of contracts."<sup>12</sup> Indeed, "[b]oth the impossibility and frustration doctrines are concerned with '[a]n extraordinary circumstance [that] may make performance [of a contract] so vitally different from what was reasonably to be expected as to alter the essential nature of that performance.'"<sup>13</sup> Frustration of purpose arises when "the obligor's performance can still be carried out, but the supervening event fundamentally has changed the nature of the parties' overall bargain."<sup>14</sup> "The frustration must be so severe that it is not fairly to be regarded as the risks that [the party invoking the doctrine] assumed under the contract."<sup>15</sup> Relief from performance of contractual obligations on the theory of frustration of purpose "will not be lightly granted; the evidence must be clear, convincing[,] and adequate."<sup>16</sup> By comparison, under the related doctrine of impossibility of performance, a party is excused from having to perform his contract obligations "where performance has become literally

impossible, or at least inordinately more difficult, because of the occurrence of a supervening event that was not within the original contemplation of the contracting parties.”<sup>17</sup>

Other jurisdictions provide a similar defense where performance is merely impractical. Section 261 of the Restatement (Second) of Contracts explains:

Where, 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 the contrary.

For performance to be impracticable, the event must be unforeseeable and not caused by the party expected to perform. However, circumstances that make performance merely unprofitable or inconvenient usually are insufficient. Therefore, the application of the impracticability doctrine will depend upon the facts and circumstances of the contractual relationship. In most courts, proving that continued performance is impracticable is a very high bar.

Apart from common law, § 2-615 of the UCC similarly excuses performance where it has been made “impracticable” by the occurrence of an event:

(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.*

(Emphasis added).<sup>18</sup>

Accordingly, even in the absence of a force majeure or changed circumstances provision in a commercial contract, businesses can potentially rely on the common-law of their subject jurisdiction and/or the UCC to excuse their failure to perform. Again, if your company is considering these doctrines as an option – or facing off against another company that is invoking these legal theories – we highly recommend the retention of counsel who can survey the applicable law within your jurisdiction to determine the merit and strength of this potential defense as applied to the current pandemic.

To discuss any of these matters further or if our firm can be of help to you in any way, call us at 973-218-1111, or email our managing partners at [dstone@stonemagnalaw.com](mailto:dstone@stonemagnalaw.com) or [rmagnanini@stonemagnalaw.com](mailto:rmagnanini@stonemagnalaw.com).

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<sup>1</sup> *Acheron Med. Supply, LLC v. Cook Inc.*, 2019 WL 2574147, at \*2 (S.D. Ind. June 24, 2019) (quoting *Specialty Foods of Indiana, Inc. v. City of S. Bend*, 997 N.E.2d 23, 27 (Ind. Ct. App. 2013)) (“In other words, when the parties have defined the nature of force majeure in their agreement, that nature dictates the application, effect, and scope of force majeure with regard to that agreement and those parties, and reviewing courts are not at liberty to rewrite the contract or interpret it in a manner which the parties never intended.”).

<sup>2</sup> Tedros Adhanom Ghebreyesus, Director-General, World Health Org., *Opening Remarks at the Media Briefing on COVID-19* (Mar. 11, 2020), <https://www.who.int/dg/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020> (“We have . . . made the assessment that COVID-19 can be characterized as a pandemic.”).

<sup>3</sup> See, e.g., *Kel Kim Corp. v. Cent. Mkts., Inc.*, 70 N.Y.2d 900, 902 (1987) (holding that force majeure defense is narrow and excuses nonperformance “only if the force majeure clause specifically includes the event that actually prevents a party’s performance”).

<sup>4</sup> Martha Collins, *Cancellation and Force Majeure Issues in the SARS Era* (March 1, 2005) available at <https://www.meetingsnet.com/negotiatingcontracts/cancellation-and-force-majeure-issues-sars-era> (last visited April 10, 2020).

<sup>5</sup> See *Gulf Oil Corp. v. FERC*, 706 F.2d 444, 452 (3d Cir. 1983).

<sup>6</sup> *Pennington v. Cont’l Res., Inc.*, 932 N.W.2d 897, 902 (S.D. 2019) (quoting 30 *Williston on Contracts* § 77:31 (4th ed. 2004)).

<sup>7</sup> See *N. Ind. Pub. Serv. Co. v. Carbon Cty. Coal Co.*, 799 F.2d 265, 275 (7th Cir. 1986) (concluding government order denying request from a utility to pass increased coal prices to customers did not excuse utility from long-term contract to buy coal even though that order made the contract unprofitable).

<sup>8</sup> See, e.g., *Seitz v. Mark-O-Lite Sign Contractors, Inc.*, 510 A.2d 319, 321 (N.J. Super. Ct. 1986) (“Under this principle, the catch-all language of the force majeure clause relied upon by defendant is not to be construed to its widest extent; rather, such language is to be narrowly interpreted as contemplating only events or things of the same general nature or class as those specifically enumerated.”); *TEC Olmos, LLC v. ConocoPhillips Co.*, 555 S.W.3d 176, 182–83 (Tex. App. 2018) (finding that force majeure catch-all provision did not include events that were foreseeable, such as fluctuation in the oil and gas market that affects a party’s ability to obtain financing).

<sup>9</sup> *Route 6 Outparcels, LLC v. Ruby Tuesday, LLC*, No. 2413-09, 2010 WL 1945738, at \*4 (N.Y. Sup. Ct. May 12, 2010) (finding that even if a severe economic downturn could be a triggering event falling within force majeure catchall language, Ruby Tuesday “failed to demonstrate that it was prevented from complying with its obligations under the Lease due to events entirely outside of its control”); see also *Elavon, Inc. v. Wachovia Bank*, 841 F. Supp. 2d 1298, 1308–09 (N.D. Ga. 2011) (rejecting argument that 2008 financial crisis constituted force majeure event under parties’ force majeure provision, but even if it did, that performance would not be excused because no external event prevented the party from performing the contract).

<sup>10</sup> *Kel Kim Corp.*, 70 N.Y.2d 900 (“[T]he excuse of impossibility of performance is limited to the destruction of the means of performance by an act of God, vis major, or by law.”).

<sup>11</sup> *Sassower v. Blumenfeld*, 24 Misc. 3d 843, 846-847 (N.Y. Sup. Ct. Nassau County 2009) (performance of a contract is not excused where impossibility or difficulty of performance is occasioned only by financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy).

<sup>12</sup> *JB Pool Mgmt., LLC v. Four Seasons at Smithville Homeowners Ass’n*, 431 N.J. Super. 233, 245 (App. Div. 2013).

<sup>13</sup> *Ibid.* (second, third, and fourth alterations in original) (quoting *Restatement (Second) of Contracts*, ch. 11, intro. note at 309 (Am. Law. Inst. 1981)).

<sup>14</sup> *Id.* at 246.

<sup>15</sup> *Id.* at 247 (alteration in original) (quoting *Restatement (Second) of Contracts* § 265 cmt. a).

<sup>16</sup> *A-Leet Leasing Corp. v. Kingshead Corp.*, 150 N.J. Super. 384, 397 (App. Div. 1977).

<sup>17</sup> *JB Pool Mgmt.*, 431 N.J. Super. at 246.

<sup>18</sup> Likewise, certain international contracts may be governed by the United Nations Convention on Contracts for the International Sale of Goods (“CISG”). Article 79 of the CISG excuses performance when “the failure was due to an impediment beyond [its] control and that [it] could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.