Force Majeure and Contractual Obligations in the Midst of Coronavirus

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As COVID-19 (coronavirus) continues to spread globally and governments and companies take efforts to slow and contain the virus, no company is able to continue "business as usual." These disruptions are causing businesses to consider their ability to excuse the nonperformance of contractual obligations under force majeure clauses. In short, force majeure clauses excuse a party's obligations to perform under a contract when extraordinary circumstances beyond the party's control prevent it from performing. Although the specific language of a force majeure clause will control, below is a brief summary of how courts in Illinois, California, and New York have addressed force majeure clauses. Also included is a brief summary of some common law defenses that may be raised in addition to, or in the absence of, a force majeure clause.

I. The Contract's "Four Corners" Govern. Force Majeure Fills In The Gaps.

When interpreting force majeure provisions in contracts, courts will generally look to the "four corners" of the contract and will apply the common law doctrine of force majeure only to interpret any gaps in the contract. The common law doctrine of force majeure relies on the foreseeability of the force majeure event to determine whether a party's performance under a contract may be excused. As such, merely reciting "force majeure" in a contract, or including in the contract a standard, boilerplate, or catch-all force majeure provision, invokes a body of common law doctrine interpreting the term, which may not provide the desired relief from performance of the contract. Courts are more likely to enforce provisions that address the specific situation at issue, such as a pandemic, if it is identified in the contract as a cause to be excused from performance rather than a general provision. Going forward, in order to ensure your business is excused from performance under a contract's force majeure provision, parties should be specific in drafting the force majeure clause, rather than utilizing tempting catch-all phrases.

Parties may also use the term "acts of God" in a similar way to extend the scope of the force majeure clause. Some jurisdictions, such as Illinois, New York, and California, may not interpret this phrase to include events of which the parties were aware at the time of contracting but did not specifically protect against or risks that are dissimilar to the risks listed in the contract. If the relevant event was "foreseeable at the time the contract was negotiated" and a party was "on notice of the possibility of a problem" the party cannot then rely on a force majeure provision to excuse performance. *Comprehensive Bldg. Contractors, Inc. v. Pollard Excavating Inc.*, 251 A.D.2d 951 (3d Dep't 1998); *Watson Laboratories, Inc. v. Rhone-Poulenc Rorer, Inc.*, 178 F.Supp.2d 1099 (C.D. Cal.

2001). For example, it may be argued that COVID-19 or a similar pandemic was foreseeable based on the recent history of the 2009 H1N1 pandemic and similar public health crises.

Alternatively, references in a force majeure clause to "disease" or "health crisis" may help advance a party's argument that performance is excused under the clause. For example, when the terms of an agreement specifically list classes of persons or things, and then immediately use language that embraces "other" persons or things, courts generally read the word "other" as "other such like" (for example, not of a quality superior to or different from those specifically listed). *Stepnicka v. Grant Park 2 LLC*, 2013 WL 3213061, at *15 (Ill. App. Ct. 1st Dist. June 21, 2013); *Team Marketing USA Corp. v. Power Pact, LLC*, 41 A.D.3d 939, 942-43 (3d Dep't 2007; *Kel Kim Corp. v. Central Markets, Inc.*, 70 N.Y.2d 900, 903 (N.Y. 1987); *Watson Laboratories*, 178 F.Supp.2d at 1099. This rule, however, is not a rule of mandatory application, but a rule of construction. *Stepnicka*, 2013 WL 3213061, at *15; *Kel Kim Corp.*, 70 N.Y.2d at 903. Therefore, the specific language of the force majeure clause is of paramount importance and will be used to determine the intent of the parties.

For example, in *Kel Kim Corp.*, Kel Kim was unable to obtain public liability insurance and sought to be excused from the parties' lease agreement under its force majeure clause. The clause read:

If either party to this Lease shall be delayed or prevented from the performance of any obligation through no fault of their own by reason of labor disputes, inability to procure materials, failure of utility service, restrictive governmental laws or regulations, riots, insurrection, war, adverse weather, Acts of God, or other similar causes beyond the control of such party, the performance of such obligation shall be excused for the period of the delay.
The force majeure clause did not specifically include the inability to "procure and maintain insurance," nor did that inability fall within the catch-all phrase "or other similar causes beyond the control of such party." Because the event at issue was Kel Kim's inability to procure and maintain public liability insurance, the New York court declined to excuse performance under the force majeure clause. The Court reasoned that such an event could have been anticipated and addressed by the parties in their agreement.

When thinking about whether an event such as coronavirus may be excused under an existing force majeure clause, consider the following:

- The language of the clause itself: Does the force majeure clause specifically list events like an epidemic or pandemic?
- Whether the precipitating event is specifically stated or of the same kind or nature as those listed in the clause: Does the force majeure clause list a similar event, that the coronavirus could arguably be considered as?
- Whether the precipitating event was unanticipated and unforeseeable: Was the coronavirus a foreseeable event at the time the parties negotiated the contract?
- Is the subject matter of the contract or means of performance now impossible, due to the coronavirus: Did the coronavirus make it impossible for the parties to perform under the contract? And if so, what is your jurisdiction's definition of legal impossibility?

Courts will also consider whether performance is legally impossible when determining whether performance should be excused under a force majeure clause. Different jurisdictions have different definitions for legal impossibility. In New York, for example, impossibility occurs "only when the

destruction of the subject matter of the contract or the means of performance makes performance objectively impossible." *Kel Kim Corp. v. Central Markets, Inc.*, 70 N.Y.2d 900, 902 (N.Y. 1987). In California, however, courts consider performance "legally impossible when it is impracticable." *Emelianenko v. Affliction Clothing*, 2011 WL 13176614 at *23 (C.D. Cal. June 7, 2011). Impracticable performance can include performance that is "so difficult and expensive" that it might be considered "impracticable." *Id.*

II. Courts Look To Parties' Intent To Transfer Risk.

Courts will also look at the overall objectives of the parties when they entered into the contract. The Seventh Circuit Court of Appeals has held that a force majeure clause is not intended to buffer a party against the normal risks of a contract. For example, in examining a fixed-price contract, the Seventh Circuit noted that the normal risk of a fixed-price contract is that the market price will change. If it rises, the buyer gains at the expense of the seller; if it falls, the seller gains at the expense of the buyer. The purpose of a fixed-price contract is to allocate risk in this way. A force majeure clause interpreted to excuse the buyer from the consequences of the risk expressly assumed in the contract would nullify a central term of the contract. *North Indiana Pub. Serv. Co. v. Carbon Cty. Coal Co.*, 799 F.2d 265, 275 (7th Cir. 1986). Accordingly, while COVID-19 is forcing businesses to seek new sources of materials and restructure their work forces to remain operational through government and company-instituted quarantines and travel bans, these circumstances may not be ones that excuse performance in the case of a fixed-price contract.

III. Common Law Defenses of Impracticability, Impossibility and Frustration of Purpose May Apply.

If COVID-19 does not constitute a force majeure event under a contract, parties may still attempt to claim the affirmative defenses of impossibility of performance, commercial impracticability, or frustration of purpose. As with force majeure, courts generally reserve these affirmative defenses for extreme events and circumstances. Arguably, COVID-19 may give rise to these defenses.

Impossibility

The doctrine of impossibility excuses performance of a contract when performance is rendered objectively impossible. *YPI 180 N. LaSalle Owner, LLC v. 180 N. LaSalle II, LLC*, 403 Ill. App. 3d 1, 6 (2010); *Kel Kim Corp. v. Central Markets, Inc.*, 70 N.Y.2d 900, 902 (N.Y. 1987). A party asserting a defense of impossibility must show: (1) an unanticipated circumstance, (2) that was not foreseeable, (3) to which the other party did not contribute, and (4) to which the party raising the defense has tried all practical alternatives. *Bank of Am., N.A. v. Shelbourne Dev. Grp., Inc.*, 732 F. Supp. 2d 809, 827 (N.D. Ill. 2010).

Impracticability

The commercial impracticability defense, an off-shoot of the impossibility doctrine, is available under Illinois common law only if "the circumstance causing the breach has rendered performance so vitally different from what was anticipated that the contract cannot be reasonably thought to govern." *Id.* at 827. Contract performance may be excused under the commercial impracticability defense when performance becomes impracticable due to some extreme and unforeseeable circumstance rather than it actually being impossible. *Emelianenko v. Affliction Clothing*, 2011 WL 13176614 at *23 (C.D. Cal. June 7, 2011).

Frustration of Purpose

Similarly, frustration of purpose will render a contract unenforceable "if a party's performance under the contract is rendered meaningless due to an unforeseen change in circumstances." *Sunshine Imp & Exp Corp. v. Luxury Car Concierge, Inc.*, No. 13 C 8925, 2015 WL 2193808, at *5 (N.D. Ill. May 7,

2015); *see also United States v. General Douglas MacArthur Senior Village*, Inc., 508 F.2d 377, 381 (2d Cir. 1974); *FPI Dev., Inc. v. Nakashima*, 231 Cal.App.3d 367, 398 (Cal. Ct. App. 1991). The frustration of purpose defense is generally asserted when a change in circumstances makes one party's performance virtually worthless to the other party to the contract.

There are a number of COVID-19-created circumstances to which these common law doctrines may apply. Any argument, either for or against the application of these doctrines, however, will need to be based on the facts specific to the situation.

IV. State Commercial Codes Recognizes A Defense For Failure To Perform Due To "Presupposed Conditions."

The commercial codes in Illinois, California, and New York all recognize a defense for performance of a contract for the sale of goods in those instances where performance is excused by the failure of "presupposed conditions." 810 ILCS 5/2-615(a); Cal.Com.Code § 2615; N.Y. U.C.C. Law § 2-615.

The provisions provide that a seller is not in breach for failure to perform if performance has been made impracticable by the occurrence of a material unanticipated event. 810 ILCS 5/2-615(a); Cal.Com.Code § 2615(a); N.Y. U.C.C. Law § 2-615(a). In the event that only a part of the seller's capacity to perform is affected, the seller must still perform to the extent possible. 810 ILCS 5/2-615(b); Cal.Com.Code § 2615(b); N.Y. U.C.C. Law § 2-615(b). In any case, the seller must notify the buyer that there will be delay and non-delivery, and provide an estimated quota in the case of partial performance. 810 ILCS 5/2-615(c); Cal.Com.Code § 2615(c); N.Y. U.C.C. Law § 2-615(c).

V. Strategic Considerations.

It is critical for companies to assess their position and when and how they may assert force majeure clauses. After all, many companies may find themselves on both sides of the issue. Moreover, the applicable legal standards may be broadened or narrowed by a court to reach a desired outcome. A decision may have an "outsized" precedential value in the current legal environment. Therefore, a well-developed legal strategy is paramount.

As COVID-19 is an ongoing global epidemic, we cannot fully ascertain the extent of the disruptions to business and the economy. Continue to assess your litigation risks and contractual obligations as the COVID-19 outbreak continues. Kelley Drye will provide any updates and further information on our COVID-10 Response Resource Center as this situation develops. If you have concerns about managing your workforce or your insurance coverage in light of COVID-19, please refer to our other advisories.