New York Law Journal

SERVING THE BENCH AND BAR SINCE 1888

WWW.NYLJ.COM

An ALM Publication

MAY 15, 2020

COVID-19 and the Future of Business Contracts

In the context of the current pandemic, a discussion of the principles courts have traditionally looked to in addressing claims that nonperformance of contracts should be excused because of external events.

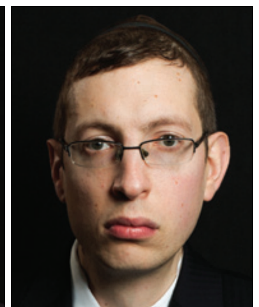
By Paul M. "Tad" O'Connor, Christian T. Becker and Jeffrey Ephraim Glatt

In the COVID-19 world of government-ordered shutdowns of nonessential trade and commerce, companies have found it impossible or impracticable to perform their contractual obligations, which will likely lead to a wave of breach of contract litigation. While the scale and nature of the COVID-19 pandemic appear to be unprecedented, this article highlights the principles courts have traditionally looked to in addressing claims that nonperformance of contracts should be excused because of external events.

Contractual Force Majeure Clause. Does the contract at issue include a force majeure clause? A force majeure clause "excuses nonperformance when events beyond the control of the parties prevent performance." *Harriscom Svenska, AB v. Harris*, 3 F.3d 576, 580 (2d Cir. 1993). Force majeure clauses vary in their specific language, but typically list such events as strikes, boycotts, war, governmental laws or regulations and, often as a catch-all for unforeseen events, "acts of God." If the contract does contain such a clause, it will determine the extent to which non-performance will be excused, subject to the standard rules of contract construction. *Kel Kim v. Central Markets*, 70 N.Y. 2d 900, 902-03 (1987) ("Ordinarily, only if the force majeure clause specifically includes the event that actually prevents a party's performance will that party be excused.").

PAUL M. "TAD" O'CONNOR

CHRISTIAN T. BECKER


JEFFREY EPHRAIM GLATT

Common Law Doctrine. If there is no force majeure clause and the contract is not a sales contract covered by the Uniform Commercial Code, are there any common law doctrines that excuse the party's performance? Under the common law doctrine of "impossibility," a party is excused from performing under a contract where the "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." *United States v. Winstar*, 518 U.S. 839, 904, 116 S. Ct. 2432, 2469, 135 L. Ed. 2d 964 (1996) (citing Restatement (Second) of Contracts §261). Moreover, the courts typically hold that to qualify as an event excusing performance, the event must have been unforeseeable to the parties at the time they entered

into the contract, because otherwise they could and should have provided for it in, for example, a force majeure clause. See *Winstar,* 518 U.S. at 904 & n. 53.

Uniform Commercial Code. Is the contract a sales contract covered by the Uniform Commercial Code? U.C.C. §2-615 allows a seller to avoid liability for breach of contract where performance has been made "impracticable" (1) "by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made," or (2) "by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid." See U.C.C. §2-615.

The widespread COVID-19 governmental orders, on the foreign, federal, state and local levels, qualify as "governmental interference" under §2-615, and thus provide suppliers who are thereby prevented from performing with a defense. Section 2-615 "recognizes as of equal significance either a foreign or domestic regulation and disregards any technical distinctions between 'law,' 'regulation,' 'order' and the like." Comment 10, U.C.C. §2-615. The key element is the "seller's good faith belief in the validity of the regulation." Id. Nevertheless, other issues may be relevant in particular cases, such

as whether nonperformance is excusable because of a non-binding government recommendation, and whether a purchaser is not excused where the seller is unaware that the goods were to be shipped to a destination barred by a government order. See *Harriscom Svenska,* 3 F.3d at 580 ("RF Systems established the affirmative defense of commercial impracticability because it complied in good faith with the government's informal requirements"); *E. Air Lines v. McDonnell Douglas*, 532 F.2d 957, 993 (5th Cir. 1976) ("informal" government rulings constitutes excuse); *Intl. Minerals and Chem. v. Llano*, 770 F.2d 879, 887 (10th Cir. 1985) ("government policy need not be explicitly mandatory to cause impracticability"), with *Wien Air Alaska v. Bubbel,* 723 P.2d 627, 630 (Alaska 1986) (distinguishing *E. Air Lines*, and holding that it never decided "whether the doctrine was, in fact, applicable" to informal rulings); *Power Eng'g & Mfg., Ltd. v. Krug Intern.,* 501 N.W.2d 490, 495 (Iowa 1993) ("Although the embargo prevents products from being shipped to Iraq, it does not prohibit a domestic purchaser from buying, from a domestic manufacturer, a machinery component part intended for shipment there," and the purchaser's nonperformance was not excused where the manufacturer was unaware that goods were to be shipped to Iraq).

Under §2-615, a seller would also be excused from liability for failure to deliver its goods to the purchaser where such delivery "has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contract-

ing." Comment 1, U.C.C. §2-615. While there is no "exhaustive expression of contingencies," the comments to the Section provide that contingencies covered under this Section may include war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, in addition to governmental interference. Comments 4 & 10, U.C.C. §2-615. For example, parties who do not perform because, as a result of COVID-19, they find themselves unable to purchase raw materials or parts at a price that makes the subsequent sale of a finished product profitable, may seek to rely on the Section.

Companies have successfully asserted this defense in the aftermath of previous unforeseen circumstances, including the Vietnam War, *E. Air Lines v. McDonnell Douglas*, 532 F.2d 957, 998 (5th Cir. 1976), forest fires, *Int'l Paper Co. v. Rockefeller,* 161 A.D. 180 (3d Dep't 1914), extreme weather conditions, *Cliffstar v. Riverbend Prods.*, 750 F. Supp. 81, 82 (W.D.N.Y. 1990), bankruptcy of a manufacturer, *Selland Pontiac-GMC v. King*, 384 N.W.2d 490, 491 (Minn. Ct. App. 1986), worker strikes, *Glassner v. Northwest Lustre Craft Co.*, 591 P.2d 419 (Oregon 1979), and loss of reserves, *Sunflower Elec. Co-op. v. Tomlinson Oil Co.*, 638 P.2d 963, 970 (Kan. Ct. App. 1981). Under the U.C.C., "increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance," Comment 4, U.C.C. §2-615, and an unforeseen contingency provides an excuse for nonperformance only where the party "show[s] that he can operate only at a loss and that the loss will be so severe and unreasonable that failure to excuse performance would result in grave injustice." *N. Illinois Gas Co. v. Energy Co-op.*, 461 N.E.2d 1049, 1061 (Ill. App. Ct. 1984); *Louisiana Power & Light Co. v. Allegheny Ludlum Industries*, 517 F. Supp. 1319 (E.D. La. 1981); *Gulf Oil v F. P. C.,* 563 F.2d 588, 599 (3d Cir. 1977).

We can expect to see numerous contract disputes where the purchaser, rather than the seller, desires to breach the contract, for any number of reasons relating to COVID-19, such as a decrease in demand has eliminated its need for the product. Courts have differed on whether these §2-615 defenses are limited to sellers, or may also be asserted by buyers; §2-615 refers only to sellers, but the comments appear to make the section applicable to buyers as well. *Compare N. Illinois Gas*, 461 N.E.2d at 1061 (interpreting Comment 9 to include buyers), *with Kentucky Util. Co. v. S. E. Coal Co.*, 836 S.W.2d 392, 396 (Ky. 1992) (limiting §2-615 to sellers and not buyers).

Conclusion

In sum, while the COVID-19 pandemic in general will likely be deemed unforeseeable, when it became "foreseeable" may very well be a key issue in many cases: for example, was the pandemic, whose emergence in China was apparently first reported in December 2019, foreseeable to parties contracting in January, February, or March? Cf. *Madeirense do Brasil S/A v. Stulman-Emrick Lbr. Co.*, 147 F.2d 399, 403 (2d Cir. 1945) (supplier not excused from nonperformance because risk caused by World War II was foreseeable to parties in U.S. and Brazil in 1940 even before those countries entered the war).

Paul M. "Tad" O'Connor *and* ***Christian T. Becker*** *are partners and* ***Jeffrey Ephraim Glatt*** *is an associate in the New York office of Kasowitz Benson Torres.*

KASOWITZ
BENSON TORRES

Reprinted with permission from the May 15, 2020 edition of the NEW YORK LAW JOURNAL © 2020 ALM Media Properties, LLC. All rights reserved. Further duplication without permission is prohibited. For information, contact 877-257-3382 or reprints@alm.com. # NYLJ-05212020-449617