



March 2020

Follow @Paul\_Hastings



## COVID-19: Contracting, Performance and Litigation Risks

By [Kevin P. Broughel](#), Arielle Dragon, Anna Faber & Michael Fisher

COVID-19 has already caused disruption to expected workflows and global supply chains. Vessels have been restricted from entry into and departure from certain ports. Suppliers and vendors are indicating delays in delivery and in some instances, inability to perform. Just in Time inventory methods are under severe stress. Physical and financial markets are unquestionably disrupted.

With this upheaval comes a great deal of legal uncertainty. Among the uncertainties is how companies should address the contractual duties and obligations that are being displaced by COVID-19. Below we address some of the most pertinent considerations contractual parties should consider to assess their legal risk and to best position themselves to weather the ongoing, and potentially worsening, COVID-19 storm.

### Force Majeure and Other Excuses for Non-Performance

Businesses should review with counsel the terms of any existing contracts that may be impacted by COVID-19, especially those that call for the delivery of goods and/or rely on adjustable pricing mechanisms. Parties that find themselves contractually disadvantaged by the effects of COVID-19 may seek to invoke *force majeure* or “act of God” clauses to excuse continued contractual performance.

In general, *force majeure* provisions excuse parties from nonperformance when an “act of God” makes performance impossible, impractical, or illegal. Typically, for *force majeure* to apply, the event that triggers enforcement of the clause must fall within the scope of contractually defined *force majeure* events, be out of the parties’ control, and not be caused by a party’s own fault or negligence.<sup>1</sup>

Common examples of *force majeure* events include natural disasters, political acts, or terrorism. When an intervening act occurs, the party invoking the *force majeure* clause as a defense for nonperformance bears the burden of proving that the event was actually beyond its control.<sup>2</sup> Accordingly, a party invoking the *force majeure* provision in this environment would likely have to show that the specific contractual *force majeure* provision encompasses the COVID-19 epidemic<sup>3</sup>, that the contract could not be performed because of COVID-19, that COVID-19 was outside its control, and that it occurred without the asserting party’s fault or negligence.

If COVID-19 does not constitute a *force majeure* event under the particular agreement at issue, parties can still potentially claim impossibility, impracticability, or frustration of purpose. The availability of these contractual defense doctrines will vary by jurisdiction. For example, in New York, “the 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>4</sup> In turn, impracticability generally requires a showing that the non-occurrence of the event was a basic assumption of the contract, continued performance is not commercially practicable, and that the party claiming discharge did not expressly or impliedly agree to performance despite the impracticability.<sup>5</sup> Similarly, frustration of purpose is available where there is substantial frustration of the principal purpose of the contract, the non-occurrence of the frustrating event was a basic assumption underlying the contract, and the party invoking the doctrine is not at fault.<sup>6</sup> These and other defenses should be carefully researched under the appropriate jurisdiction to determine whether there is a reasonable basis for their applicability.

## **Increased Performance Costs and Pricing Concerns**

Importantly, the mere occurrence of unfavorable economic conditions or market shifts may not qualify as *force majeure* or other events that excuse performance.<sup>7</sup> In the same vein, difficulties in performance due to circumstances outside of a party’s control may not lead to recoverable damages. Courts have observed that “the parties to any contract to be performed over a term normally assume that the cost of performance may fluctuate during the term, and, as a result, courts ordinarily do not conclude that an increase in the cost of performance is an event the non-occurrence of which was a basic assumption of the contract.”<sup>8</sup> An example of this principle in practice is found in *Transatlantic Financing Corp. v. U.S.*<sup>9</sup> In *Transatlantic*, the D.C. Circuit Court of Appeals affirmed a finding that there was no commercial impracticability where one party sought to recover damages because its wheat shipment was forced to be re-routed due to the closing of the Suez Canal. The Court of Appeals held that because the contract was not rendered legally impossible and it could be presumed that the shipping party accepted “some degree of abnormal risk,” there was no basis for relief.

Despite the foregoing, there is some precedent for the proposition that a party’s continued performance can be excused as impracticable where there is a substantial difference in the expected versus actual cost of performance because of an extraordinary intervening event.<sup>10</sup> As a result, parties should examine their agreements to determine the increased cost impact from COVID-19 and, if the impact is significant, potentially discuss with their counterparties adjustments that can be made if the performance costs no longer reflect the intentions or expectations of the parties. In addition, buyers faced with notification of a material or indefinite delay that substantially impairs the value of the whole contract may be able to terminate and discharge any unexecuted portions of the contract or modify the contract by agreeing to a substituted performance.<sup>11</sup>

## **Notice Requirements**

All contractual notice provisions should be carefully scrutinized to determine whether COVID-19 triggers any notice requirements. For example, if a party invokes *force majeure*, the contract provision might require that they send notice within a set time period to the other party regarding the impossibility or impracticability of performance. Anticipated delays in shipments and payments may also contractually require advance written notice. Likewise, non-breaching parties may be obligated to provide written notice of breaches to their counterparties before cure periods start, termination rights are exercised, or damages rightfully are claimed. Even if notices are not contractually required, they may be advisable so that a counterparty is on notice to mitigate any potential damages and offer alternative methods of performance.

Caution should be exercised, however, to avoid inadvertently delivering a notice that anticipatorily breaches a contract. While varying by jurisdiction, anticipatory breach of contract is generally defined as “a repudiation of the obligations of a contract by a party to it before the time has come for



performance on his or her part.”<sup>12</sup> If a party’s communication expressly or impliedly<sup>13</sup> indicates that it will not perform under the contract, the non-breaching party can elect a number of different remedies, including rescinding the contract or treating the repudiation as a complete breach.<sup>14</sup> Thus, any communications concerning difficulties or anticipated delays in performance should be carefully vetted so the communicating party avoids mistakenly suggesting that it does not intend to perform under the agreement.

## Contractually Addressing Potential Future Effects

Disruption in financial markets in response to the spread of COVID-19 will certainly affect companies’ general business expectations as well as planned and proposed financings and investment operations. The New York Times recently reported that “as the coronavirus outbreak spreads, the world’s biggest companies have begun painting a bleak picture of broken supply chains, disrupted manufacturing, empty stores and flagging demand for their wares.”<sup>15</sup> Indeed, the level of U.S. business activity for the month of February hit a six-year record low as companies reacted to predictions of a global economic slowdown.<sup>16</sup> Reduced demand for consumer goods and energy consumption due to self-quarantine is expected to curb companies’ earnings and disrupt long-term financial projections.<sup>17</sup> Additionally, companies may suffer investment challenges because investors may be less likely to extend loans and banks may begin to impose lending restrictions.<sup>18</sup>

Looking forward, contractual provisions should be drafted with these potential effects in mind. Parties may wish to draft more expansive *force majeure* clauses to capture a wider array of natural and political acts that could arise from COVID-19 becoming a pandemic. In addition, parties might desire more flexibility with termination provisions through shorter notice periods and more lenient termination requirements. Pricing arrangements are yet another area where change may be necessary. Variable pricing provisions may be scrapped in favor of fixed prices or constrained with caps or mandatory renegotiation thresholds. Even choice of law and venue provisions, often lightly negotiated, will take on new importance and interest as parties consider which jurisdictions may be more receptive to certain contractual defenses and claims. In sum, parties will need to continuously monitor the impact COVID-19 has on their businesses and adjust their future contractual expectations and goals accordingly to mitigate risk and provide as much flexibility as possible.



*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

### New York

Kevin P. Broughel  
1.212.318.6483  
[kevinbroughel@paulhastings.com](mailto:kevinbroughel@paulhastings.com)

Anna S. Faber  
1.212.318.6095  
[annafaber@paulhastings.com](mailto:annafaber@paulhastings.com)

Arielle J. Dragon  
1.212.318.6061  
[arielledragon@paulhastings.com](mailto:arielledragon@paulhastings.com)

Michael J. Fisher  
1.212.318.6044  
[michaelfisher@paulhastings.com](mailto:michaelfisher@paulhastings.com)

### Washington, D.C.

Scott M. Flicker  
1.202.551.1726  
[scottflicker@paulhastings.com](mailto:scottflicker@paulhastings.com)

Charles A. Patrizia  
1.202.551.1710  
[charlespatrizia@paulhastings.com](mailto:charlespatrizia@paulhastings.com)

---

<sup>1</sup> See, e.g., *Gulf Oil Corp. v. Fed. Energy Regulatory Comm’n*, 706 F.2d 444, 452 (3d Cir. 1983).

### Paul Hastings LLP

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2020 Paul Hastings LLP.



- 
- <sup>2</sup> 30 Williston on Contracts § 77:31 (4th ed.).
- <sup>3</sup> It is important to distinguish between the COVID-19 epidemic itself and other political or economic acts that flow from the epidemic when evaluating if the claimed event falls within the scope of the *force majeure* provision.
- <sup>4</sup> *407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp.*, 23 N.Y.2d 275, 281 (1968).
- <sup>5</sup> See *J & G Associates v. Ritz Camera Centers, Inc.*, No. 9811, 1989 WL 115216, at \*4 (Del. Ch. Oct. 3, 1989); Restatement (Second) of Contracts § 261 (1981). The Uniform Commercial Code's (U.C.C.) impracticability of performance doctrine (U.C.C. § 2-615) can discharge a promisor from performance under a contract when an event causes the performance to become "impracticable" and the contracting parties could not have reasonably expected or contemplated its occurrence.
- <sup>6</sup> *Chase Manhattan Bank v. Iridium Afr. Corp.*, 474 F.Supp.2d 613, 620 (D. Del. 2007).
- <sup>7</sup> *OWBR LLC v. Clear Channel Communications, Inc.*, 266 F.Supp.2d 1214, 1222 (D. Haw. 2003); Restatement (Second) of Contracts § 261 (market shifts are always basic assumptions on which contracts are made).
- <sup>8</sup> See, e.g., *Friedco of Wilmington, Del., Ltd. v. Farmers Bank of the State of Del.*, 529 F.Supp. 822, 827 (D. Del. 1981).
- <sup>9</sup> 259 F.Supp. 725, 728 (D.D.C. 1965), *affirmed*, 363 F.2d 312, 319-320 (D.C. Cir. 1966); see also *CRS Proppants LLC v. Preferred Resin Holding Co., LLC*, No. N15C-08-111, 2016 WL 6094167, at \*6-9 (Del. Super. Sept. 27, 2016) for a brief discussion of *Friedco, Transatlantic*, commercial impracticability and frustration of purpose.
- <sup>10</sup> See, e.g., *Aluminum Co. of America v. Essex Group, Inc.*, 499 F.Supp. 53, 70-71 (W.D. Pa. 1980) (holding that under Indiana law seller was entitled to reformation of contract under doctrines of impracticability and frustration of purpose where price provision formula in contract dramatically increased seller's cost of performance due to OPEC actions to increase oil prices and unanticipated pollution control costs).
- <sup>11</sup> U.C.C § 2-616; 30 Williston on Contracts § 77:22 (4th ed.).
- <sup>12</sup> 23 Williston on Contracts § 63:28 (4th ed.).
- <sup>13</sup> Anticipatory breaches can be express (usually through a statement by the obligor to the obligee) or implied through an action that makes the obligor unable to perform the contract. See, e.g., *Norcon Power Partners v. Niagara Mohawk Power Corp.*, 92 N.Y.2d 458, 463 (1998).
- <sup>14</sup> 23 Williston on Contracts § 63:33 (4th ed.).
- <sup>15</sup> Peter Eavis, *How Bad Could It Get? Companies Gauge the Coronavirus Impact*, N.Y. Times, Feb. 28, 2020, <https://www.nytimes.com/2020/02/28/business/economy/companies-coronavirus-economy.html> (last visited Mar. 1, 2020).
- <sup>16</sup> Paul Hannon and Amara Omeokwe, *Coronavirus Hits U.S. Business Activity*, Wall St. J., Feb. 21, 2020, <https://www.wsj.com/articles/coronavirus-impact-on-global-economy-more-muted-than-expected-11582285372> (last visited Mar. 1, 2020).
- <sup>17</sup> Charles Riley and Julia Horowitz, *The coronavirus is already hurting the world economy. Here's why it could get really scary*, CNN BUSINESS, Feb. 10, 2020, <https://www.cnn.com/2020/02/08/business/coronavirus-global-economy/index.html> (last visited Mar. 3, 2020); See Eavis, *supra* note 15.
- <sup>18</sup> See Eavis, *supra* note 15.