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Coronavirus and contracts: Understanding rights, obligations, and protections

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The COVID-19 coronavirus (generally, coronavirus) outbreak has the potential to affect the global supply chain significantly. Businesses and their owners need to understand how the outbreak will affect them, including how it will affect their existing contracts. In addition to duties, liabilities, and defenses created by contract, businesses also need to be conscious of a number of common law duties and obligations that may arise as a result of what is happening around the globe. In this article, we will highlight several legal theories that may be relevant to this serious and fluid global situation.

Contractual *force majeure*

The right to demand performance, or be excused from performing, a contract because of coronavirus issues will depend, in many instances, on contract language, particularly the specific wording of any *force majeure* clause.

Many supply contracts and other commercial agreements contain such a clause excusing or suspending performance upon the happening of an exclusive (less typical) or non-exclusive (more typical) list of events or circumstances beyond the control of the parties. Some contracts provide that the event must be unforeseeable; others provide that an event can constitute *force majeure* that excuses performance "whether foreseeable or not." If the contract is silent on foreseeability, courts will usually require that the event have been unforeseeable when the contract was made. While some contracts contain a simple boilerplate *force majeure* provision, others may be tailored to the specific needs and geographic issues of the parties and provide detailed consequences that follow from invoking the provision.

The term *force majeure*—Latin for "superior force"—is being widely mentioned in discussing the coronavirus crisis. Although it might be unusual to see a specific reference to a "pandemic" or a "global health crisis" in a list of examples in a *force majeure* clause, it is typical to include in some way the disruption of a global supply chain as an event that would constitute *force majeure*.

Language that encompasses such an event is essential to the invocation of *force majeure*, because courts have been reluctant to find a common law theory of *force majeure* outside the four corners of an integrated contract. Thus, while it has been widely reported that China has issued *force majeure* "certificates" to businesses, such certificates may not be dispositive of contractual rights. Buyers

and sellers should review their contracts with the assistance of legal counsel to determine whether such unilateral pronouncements will actually support an argument of *force majeure* under any particular contract.

Buyers and sellers should also consider carefully the risk of improperly invoking *force majeure* and ceasing performance. Because *force majeure* clauses limit a party's liability (typically at the expense of the counterparty), courts tend to interpret such clauses strictly. Companies should consider their exposure in the event that a court finds that the provision was not applicable. The contract language may provide a buyer with certain rights upon declaration of a *force majeure* event, or require the supplier to take certain actions. Companies that receive a notice of a *force majeure* event must also consider their response and their own obligations to try to mitigate any damage, as well as their own ability then to invoke a *force majeure* clause in a contract with an upstream customer. Failure to enforce rights, or assert objections if such conditions are not satisfied, may be construed as a waiver of those rights, or an acceptance of the declaration of *force majeure*, depending on the contract wording. Under the current circumstances, parties may prefer to negotiate an adjustment of their obligations, even on an interim basis. Care should be taken to ensure that any resolution properly reflects the parties' agreement and includes any necessary reservation of rights.

There are other contract steps that businesses can (and probably should) take now in light of the coronavirus outbreak. For example, because of the prominence of the discussion about the coronavirus, if a party fails to make any allowance in new contracts for a disruption based on similar events (whether described as a pandemic, quarantine, health crisis, supply chain disruption, or more general language that would encompass such occurrences), it is more likely now that a court would conclude that the party accepted the risks of an inability to perform based upon events that are no longer unforeseeable.

Independent of the language of a contract, common law doctrines of frustration or impossibility may, in limited circumstances, also excuse performance because of the coronavirus outbreak. Frustration of purpose occurs where an unforeseen event outside the control of the parties radically changes the circumstances so that performance is significantly different than what the parties intended at the time the contract was made. The impossibility doctrine requires a situation where the destruction of the subject matter of the contract or the means of performance renders performance objectively impossible. The impossibility must result from an unanticipated, unforeseen event that the parties could not have anticipated or addressed in their contract, and which occurred without fault by the party invoking the defense. Impossibility does not apply as a defense where performance has merely become more difficult, expensive, or even unprofitable.

In some jurisdictions, the doctrine of impossibility has evolved to one of impracticability, so that the defense can include situations short of absolute impossibility. Some courts will excuse performance on the basis of impracticability where vastly increased difficulty is caused by circumstances that are not only unanticipated, but also inconsistent with what the parties assumed existed and would continue to exist. The important question is whether an unanticipated circumstance has made performance fundamentally different from what reasonably should have been within both parties' contemplation when they entered into the contract. If so, then the burden cannot be fairly borne by either party.

While it is easy to create arguments about impossibility or impracticability, these two doctrines are construed narrowly and typically reserved for extreme circumstances. For example, New York courts have required that a party seeking to be excused from performance for impossibility

demonstrate that the party took "virtually every action within his or her power to perform."[1] Companies without the contractual protection of a *force majeure* clause should, however, consider carefully whether they have the facts to support a valid defense of impossibility or impracticability if their performance has been disrupted by the coronavirus.

Sale of goods

There are special rules of impracticability in connection with the sale of goods covered by the Uniform Commercial Code (the "UCC") as adopted in slightly different forms in all 50 states and the District of Columbia. Section 2-615 of the UCC excuses performance where it has been rendered "commercially impracticable" by the occurrence of an event, the "nonoccurrence of which was a basic assumption on which the contract was made." Notably, the Official Comments to this Section contrast the use of a "commercial impracticability" standard with the separate doctrines of impossibility and frustration, although all three doctrines are related. The impracticability must result from a "the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made . . . ." The Official Comments also clarify that, while an increase in the cost of performing is not itself sufficient to justify non-performance, a "severe shortage" of raw materials or supplies caused by a contingency "such as" unforeseen shutdown of major sources of supply or the like would be within the contemplation of the Section.

Importantly, any seller considering invoking the UCC provision on commercial impracticability should consider that, where such an event impacts the seller's ability to perform only in part (as would apply in a case of constrained capacity), the seller must allocate production among customers (although it may do so "in any manner which is fair and reasonable"). Equally important, the seller must provide "seasonable" notice to customers regarding delay or non-delivery, as well as any allocation.

Article 79 of the United Nations Convention on the Contracts for the International Sale of Goods ("CISG"), which applies to the sale of goods between counterparties located in countries that have ratified the convention (and may supplant the UCC), provides a similar basis for non-performance. It excuses a failure to perform 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." Businesses should consult with counsel concerning questions about the applicability of the UCC or CISG.

Other considerations

Companies should also assess their obligations to take reasonable actions to protect their customers, visitors, or employees from injury caused by the coronavirus independent of any contract. Please see Nixon Peabody Alerts addressing the rights and obligations of employers.[2] Businesses may be held to a duty to exercise due care to also avoid injury to customers who come into contact with their employees, or their premises, or even their products. Businesses that do not consider and develop contingency plans and make adequate preparations may encounter claims by these constituents as well as their own shareholders.

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[1] *MG Ref. & Mktg., Inc. v. Knight Enters., Inc.*, 25 F. Supp. 2d 175 (S.D.N.Y. 1998) (quoting *J.J. Cassone Bakery, Inc. v. Consol. Edison Co.*, 168 Misc. 2d 272 (Supr. Ct. N.Y. Cty. 1996).

[2] "COVID-19: Occupational safety and health update," March 04, 2020; "Public health emergency: Managing global workforce during Coronavirus outbreak," February 03, 2020; and "Employers have responsibilities as coronavirus exposure and transmission-related fears grow," January 29, 2020.

Insurance

Parties should also examine their insurance portfolios to determine whether business interruption insurance, or other policies, provide coverage. There may be coverage (or exclusions) for viruses, communicable diseases, epidemics, or pandemics that require careful analysis of the terms of coverage and the language of all policies. Some policies have specific notice and other procedural requirements that must be followed strictly, so an advance understanding of the potential for coverage—and how and when it must be claimed—is an important consideration.

Conclusion

Businesses dependent on the global supply chain face potentially serious impacts from the coronavirus. Even businesses that seem at first glance to be local only may experience challenges if the virus spreads in the United States. The following is a non-exclusive checklist of factors to consider when evaluating the extent of possible commercial impacts of a disruption caused by the current global heath situation:

- Which commercial relationships are at risk of disruption and are they subject to contracts that contain a *force majeure* clause? What types of events are covered by any contractual *force majeure* provisions?
- What is the effect on performance of the contract? Remember that, absent contract language specifically addressing price in this context, it probably is not enough that performance has become more expensive. Look to see if performance has been rendered fundamentally different than the parties' expectations.
- What is the consequence of invoking a *force majeure* provision? Will performance be suspended for some period of time, or will the entire contract terminate, which in some cases may have other significant consequences?
- What notice is required to invoke the protection of any *force majeure* provision? What response is needed if you receive a notice of *force majeure* from a counterparty?
- If there is no contractual *force majeure* clause, are there other theories that can or may be invoked to alter performance?
- What efforts, if any, may be required to try to find an alternate way to perform the contract, such as locating an alternate source of supply?
- What other efforts do both parties have to make to find alternate sources of supply or otherwise mitigate their situation?
- If you can invoke the UCC or CISG provisions on commercial impracticability, what should you do to provide notice and, if necessary, allocate performance among different customers?

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