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COVID-19 and Contracts: Potential Impacts of the Pandemic on Private Agreements?

Coronavirus Disease (COVID-19) has disrupted "business as usual" leaving many companies evaluating their commercial relationships. As more state governments mandate closures of businesses and federal government agencies recommend practicing social distancing, there is growing uncertainty regarding performance obligations under existing commercial agreements. Various contract-law principles, including force majeure, impracticability/impossibility, and frustration of purpose, that rarely apply under normal circumstances are now crucial to consider when assessing the vitality of certain agreements.[1]

In considering whether you or your counterparty's performance obligations are impacted by the various disruptions caused by COVID-19, it is not advisable to cease performing your obligations or accept nonperformance of your counterparty's obligations without first seeking legal advice. Determining whether a force majeure clause or performance doctrine applies to the circumstances your business is facing due to COVID-19 is a fact specific inquiry that may also be impacted, and even determined, by certain provisions in your agreements. For example, some agreements may contemplate and designate the party that bears the risk of certain unforeseen events.

Force Majeure

A force majeure clause is a provision in an agreement that excuses performance of contractual obligations created by circumstances outside of the impacted party's control. Force majeure clauses vary widely but many excuse performance due to natural disasters, acts of war, or government actions, orders or laws.

When considering whether force majeure may apply to you or your counterparty's obligations, first consult your agreement to determine if it contains a force majeure provision. Force majeure provisions are not implied and must be expressly provided for in an agreement although several other common law doctrines that excuse performance may apply whether or not they are expressly addressed in the written contract.

There are several factors to consider when analyzing the applicability of force majeure clauses, including:

- Level of Impact. Is performance rendered impossible or more burdensome because of some disruption brought on as a result of COVID-19?
- Mitigation Efforts. Is the impacted party required to try to mitigate the disruption? Are there alternative methods to performance, such as working remotely?
- Notice Requirements. Is the impacted party required to notify the other party(ies) before declaring a force majeure event?
- Long Term Consequences. What are possible long-term effects to declaring a force majeure event? How will a force majeure event impact your other commercial agreements?
- Disputes. Are there force majeure dispute procedures in place? If the parties do not agree about a declaration of a force majeure event how is such disagreement resolved?
- Terms. What are the express terms of the force majeure clause? Is the provision broad or limited to specific events?

For an example where a force majeure clause excused performance see *Facto v. Pantagis*, 915 A.2d 59 (N.J. Super. Ct. App. Div. 2007) (Affirming trial court's finding that force majeure clause excused defendant's obligation to perform after an area-wide power outage caused a reception to be cancelled).

Impracticability/Impossibility

Performance obligations may also be excused if events deem performance impractical or impossible. Whether this affirmative defense may be employed is dependent upon the specific contract terms and applicable laws.

Impracticability may excuse or delay performance if an event causes performance to become substantially more difficult, complex or challenging, such as an excessive or unreasonable increase in performance costs or if increased costs make performance commercially senseless. Similar to impracticability, performance may be excused if an event causes performance to no longer be possible.

For an example where a contract was rendered impossible see *Kolodin v. Valenti*, 979 N.Y.S.2d 587 (N.Y. App. Div. 2014) (Holding that a "so-ordered stipulation, agreed upon by plaintiff and defendant Valenti in Family Court and which precludes all contact between them except by counsel, renders impossible the performance of two prior contracts between plaintiff and Jayarvee, Inc., Valenti's artist management company.") For a case discussing the doctrine of impracticability see *M.J. Paquet, Inc. v. N.J. Dept. of Transp.*, 794 A.2d 141 (N.J. 2002) (Promulgation of federal regulations subsequent to contract execution rendering bridge painting task impractical and was rightfully eliminated by N.J. Department of Transportation).

Frustration of Purpose

Frustration of purpose may also excuse performance. Frustration of purpose does not deem performance impossible or impractical and parties may still be able to perform. Frustration of purpose comes in to play when a party will no longer receive the benefits that prompted such party to enter into an agreement because of a superseding unforeseeable event.

For an example where performance was excused due to frustration see *Unihealth v. U.S. Healthcare, Inc.*, 14 F.Supp.2d 623 (D. N.J. 1998) (Hospital brought action against health maintenance organization for breach of hospital services contract. Following bench trial, the District Court held, in part, that the contract was frustrated by abolition of state regulatory system that had required hospitals to bill for inpatient services at prices set by New Jersey Department of Health.)

Illegality of Contract

Illegality of contract may also excuse performance if a change in law renders previously legal performance illegal. Businesses should seek legal advice to determine whether mandated business closures or other government actions relating to sheltering in place will effectively deem performance of certain obligations illegal. As with the above mentioned doctrines, illegality of contract is dependent upon the specific terms and conditions of a particular agreement and applicable laws.

For an example where performance was excused due to illegality see *Lucas Games Inc. v. Morris AR Associates, LLC*, 197 So. 3d 1183 (Fla. Dist. Ct. App. 2016) (Defendant tenant's business became illegal to perform because of a subsequently enacted statute which caused defendant to cease conducting its business and vacate the premises.)

General

Do not wait for the disruptions from COVID-19 to have their effects. If you have not already done so, review your key contractual relationships in light of the potential disruptions. Consider which are likely to be impacted either by some effect on your ability to perform or on your counterparty's ability. Consider if there are alternatives. Then consider if you should reach out now to the counterparties. However, before reaching out to the counter party it may be prudent to seek legal advice and discuss the potential legal ramifications. For example, will your action or the response of your counter party rise to the level of "anticipatory breach" giving a party the right to seek assurances of performance and potentially its own excuse to non-performance?

This is a unique time. We all see the various draconian disruptions including the government mandated closures of businesses and hope they are short lived but do not know how long they will last. As businesses are hit with and need to deal with the new disruptions and their legal ramifications, Day Pitney attorneys are ready to assist you.

[1] This advisory is not intended to provide any opinion on insurance coverage or the interpretation of such clauses in insurance policies.

For more Day Pitney alerts and articles related to the impact of COVID-19, as well as information from other reliable sources, please visit our COVID-19 Resource Center.

COVID-19 DISCLAIMER: As you are aware, as a result of the COVID-19 pandemic, things are changing quickly and the effect, enforceability and interpretation of laws may be affected by future events. The material set forth in this document is not an unequivocal statement of law, but instead represents our best interpretation of where things stand as of the date of first publication. We have not attempted to address the potential impacts of all local, state and federal orders that may have been issued in response to the COVID-19 pandemic.

Authors

Daniel L. Schwartz
Partner

Stamford, CT | (203) 977-7536

New York, NY | (212) 297-5800

dlschwartz@daypitney.com

Glenn W. Dowd
Partner

Hartford, CT | (860) 275-0570

gwdowd@daypitney.com

Heather Weine Brochin
Partner

Parsippany, NJ | (973) 966-8199

New York, NY | (212)-297-5800

hbrochin@daypitney.com

Jeffrey P. Mueller
Partner

New Haven, CT | (860) 275-0164

New York, NY | (212) 297-5800

jmueller@daypitney.com

R. Scott Beach
Partner

Greenwich, CT | (203) 862-7824

Stamford, CT | (203) 977-7336

rsbeach@daypitney.com

Richard P. Colbert
Partner

New Haven, CT | (203) 977-7375

Stamford, CT | (203) 977-7300

rpcolbert@daypitney.com

Richard D. Harris
Of Counsel

Hartford, CT | (860) 275-0294

New Haven, CT | (203) 752-5094

rdharris@daypitney.com

Stanley A. Twardy, Jr.
Of Counsel

Stamford, CT | (203) 977-7368

satwardy@daypitney.com