PERFORMANCE ANXIETY:
COVID 19'S LINGERING IMPACT ON CONTRACTUAL OBLIGATIONS

Paul M. Robertson, Esq.
Kenneth J. DeMoura, Esq.
DeMoura | Smith LLP

Empty Streets are a sign of the times.

Stable businesses like predictability and growth, and tend to suffer amidst disruption and unpredictability. The COVID-19 pandemic presents just such a disruption and lack of predictability. Not only are there no clear answers as to when life will return to "normal," it is not particularly clear what contractual obligations and rights will continue on during and after the shutdown. Who bears the burden of the loss?

Clients are increasingly asking us such questions as:

> "My shop is shut down, but must I still pay commercial rent?"
>
> "We've been forced to shut-down the school's campus – what parts of payments for room, board, activities and tuition may we retain?"

"Our resort had scores of weddings under contract. Does the law require that we refund all of the deposit? Some?"

"Our construction project is going forward, but the virus is causing substantial delays. Who is responsible for that delay?"

The answer to these questions? It depends! -- upon the language of the contract; upon the nature of the disruption; upon the immediate responsive actions of the parties; and upon just where the contract is being performed. There is, unfortunately, no one-size fits all answer to these questions. In the face of this uncertainty, however, there is a systematic, step-by-step approach you can take to best position yourself going forward, and diminish the uncertainties. That approach follows:

Step One: Familiarize yourself with the legal basics. There is no need to become an expert -- leave that to the lawyers. But you can empower yourself by gaining a general understanding of the concepts at play. The law in this area, especially as relates to pandemics, is not particularly developed. Society and the global economy have not (thankfully!) seen a shut-down of this caliber and length in the past. There are, however, some touchstone cases that have addressed the issue. Those cases seek to strike a balance between two ancient principles: *pacta sunt servanda* – the concept that "agreements are to be honored," and *ribus sic stantibus* -- so long as "things stay the same." In other words, parties will generally be held to their promises, but no party should be made to perform were it to lead to an absurd and unanticipated result.

The law centers around one contractual and three common law defenses to performance. The former is known as the law of force majeure, and the latter as the doctrines of impossibility, impracticability, and frustration of purpose. Although neat and tidy definitions don't always apply, each of these defenses to performance can in conceptualized separately, as follows:

- A contract can become impossible to perform when the underlying object is destroyed.
- Performance can become impracticable when the path to performance is economically impeded.
- The contract's purpose can be frustrated if the agreement was *related to* an event that is no longer likely to occur or a subject matter that is no longer relevant.

- Force majeure is purely a creature of contract, and can involve any one of these common law principles, a blend of them, or none.

The balance discussed above – enforce the agreement absent absurd results – plays out in the cases in the guise of two additional considerations: parties seeking to be excused from performance must demonstrate that the disruption was both (1) beyond their control, and (2) unanticipated.

One of the early cases in this area is *Krell v. Henry*, 2 K.B. 740 (C.A. 1903). The setting in that English case, involving frustration of purpose, puts a little bit of anecdotal flesh on these concepts.

In *Krell,* a party paid for the use of an apartment overlooking the Pall Mall to watch King Edward VII's coronation. But the king-to-be got sick, the coronation was called off, and the parties fought over the obligation to pay the contract price.

The Court held that the obligation to pay for the room was excused. It found that the room was to be let for a "special purpose" – the view of the coronation -- and that the coronation was itself an *implied but unstated* condition in the contract. The Court further reasoned that, because no coronation had taken place on the rental date, the contract's purpose had been frustrated, the implied condition had not been met, and there was no obligation to pay.

We can change the facts of the case slightly to gain an understanding of the other concepts. Assume that the coronation had not been postponed, but that instead that the apartment had burned down. One might then say that the contract was impossible to perform. If it snowed three feet in London on the day of the coronation, rendering it commercially impracticable to travel to the Mall, there might be an argument of impracticability.

Force majeure, on the other hand, would depend upon what the parties had agreed upon at the time of contracting. They may have wished to exercise some amount of control over the risk created by the common law principles. They could have agreed, for example, that "in the event that coronation is delayed, the parties agree that this rental shall be continued to the rescheduled date," or that because "the apartment is being rented for the purpose of the coronation, the renter shall be entitled to a full refund if the

coronation does not take place." Perhaps they should have been expected to do have done so. In fact, one of the concurring judges in the *Krell* case said that he had some *doubt* as to whether it was proper to excuse the renter's payment, because the renter could well have anticipated postponement, and could have included a protection in the contract to protect his rights. That tension – between what the parties could have and should have foreseen – has continued to echo in the cases decided since *Krell.*

<u>Step Two</u>: **<u>Read the contract. Then read it again</u>.** The cases are *intensely* fact dependent. The same disruption upon a similar kind of obligation can play out radically differently depending upon: (a) what the contract says; (b) how the disruption actually impacts performance; (c) what the parties do in response to the disruption; and (d) what the controlling law says. In seeking to control these variables, the first stop *must* be (a), the contractual language.

When all else fails . . . .

Another old case, *Baetjer v. New England Alcohol Co.,* 319 Mass. 592 (1946), is particularly instructive. In *Baetjer,* a German submarine patrolling the waters off of Puerto Rico *sank* the ship delivering product (440,689 gallons of molasses) to the ordering party. The underlying contract had a force majeure provision that excused the ordering party for just such a type of disruption. Done deal, right? Not quite! The party that had ordered the molasses was *not* excused from payment because, based on the language in the contract, delivery took place *before* the ship had even been loaded.

So bury yourself in the contract. Keep in mind, too, that you're looking not only for a provision with the big, bold heading "**<u>FORCE MAJEURE</u>.**" Some contracts contain terms instead labeled "Excusable Delay," for example. And if you do (or don't)

find such a term, don't limit your attention there – read *all* of the terms, especially any related to the method of performance, notice, and mitigation.

Step Three: Consult with legal counsel. If you don't have a trusted legal advisor to whom you can quickly turn in situations like these, now is the perfect time to develop just such a relationship. Being able to rely upon someone who understands the law, takes time to understand your industry, values your business and its ideals, and nourishes the relationship between you, can be pay tremendous dividends. Especially here, where the law us not particularly straightforward, a 30-minute conversation now can save you considerable time, money, and aggravation down the road, and can also minimize the likelihood of an unfavorable outcome.

Step Four: Understand your immediate rights and obligations. With the contract having been read, and legal counsel consulted, determine what *must* be done in the short term. In particular, consider the following:

> (a) Notice: Whether you will proceed under contractual or common law theories, there is a uniform obligation to provide "prompt" notice that an outside event has impacted, or threatens to impact, performance. Notice is required to permit the opposing party both to (i) collect evidence of the event and its impact, and (ii) mitigate any harm caused by the disruption.
>
> (b) Mitigation: There is also an obligation to take steps to mitigate harm caused and losses incurred. Consider whether, for example, you can delay performance, partially perform, or otherwise work with the opposing party to minimize the impact caused.

Step Five: With an understanding of your obligations and leverage points, plan to move towards a win-win solution where possible. This particular disruption – the pandemic – has left few businesses and individuals unscathed**.** It is reasonable to assume that the party with whom you have contracted is facing similar challenges itself, and recognizes that the playing field has changed.

With a full understanding of your legal rights and obligations in mind, consider an approach that allows for a win-win solution, or, at least, causes as little harm as possible. Consider that if performance by one particular party has been thwarted by the shut-down, it is not likely that a replacement can be found. Perhaps both parties can agree to delay or postpone performance. Consider, too, that you may wish to continue to do business with

this party in the future, or with other parties in the same or a similar industry. Your actions here may impact your own future business profile.

Step Six: As soon as is as practicably possible, reach out to the other party to provide notice, mitigate harm, and seek resolution. Defenses to performance such as frustration of purpose and force majeure are not arguments to be saved until the filing of a formal court pleading. There are numerous cases where the courts have rejected such defenses out of hand where the party seeking an excuse to performance sat on its rights. The time to act is now.

Furthermore, you'll be in a much better place if you propose a solution that is reasonably within the parameters of your contractual rights and obligations. And even if you fail, courts often point to the reasonableness (or unreasonableness) of the post-disruption behavior of the parties as a key determinant of whether performance is excused.

Step Seven: Escalate as necessary. Hopefully, by following these six steps, you will resolve or narrow the matter in dispute. If not, consider more formal measures, such as a letter from counsel or, as a last resort, seeking relief from court. It bears repeating that involving counsel early in the game will make you *less* likely to end up in court than if you go it alone. A trusted advisor can help you understand your rights and obligations from the outset, and lessen the chance that you take a position that is later found to be indefensible.

Step Eight: Take forward the lessons you have learned by revisiting the force majeure provisions in your current contractual agreements. We started above by noting that uncertainty is anathema to effective business planning. While it is true that pandemics, acts of terrorism, and 100-year storms cannot be predicted with pin-point accuracy, it is also the case that such events are increasingly common. Terror attacks, both domestic and foreign, have become a sad part of our current existence. The current pandemic was in fact anticipated by many insurers who, after the SARS epidemic of 2002-2004, included exclusions for "epidemics" and "pandemics" from their business disruption polices. And "100-year" storms now come in bunches, with the result that

some jurisdictions no longer permit construction in areas susceptible to repeat flooding. Climate change is a real thing.

Coastal disruption is the new normal

In this light, take a look at your agreements. Many force majeure provisions are an afterthought, at best, or thoughtlessly copied from an ancient contract, at worst. Even the uniform language of popular model contracts available in, for example, the construction industry – such as are created by the American Institute of Architects (the "AIA"), the Engineers Joint Contract Documents Committee (the "EJCDC") and "ConsensusDocs" – are not sufficient to address the needs of most contracting parties. The force majeure language often contains a mélange of concepts and legal principles, resulting in an imprecise definition of the term force majeure, coupled with a partial laundry list of events that only scratch the surface of potential disruptions. (The language provided by the Federal Acquisition Regulations, or "FAR," is, on the other hand, considerably more thoughtful and comprehensive, and is a very good starting point.)

So now is a good time to take stock of any force majeure provisions in your contracts. Certainly, for contracts entered into after the start of 2020, global pandemics that shut down considerable swarths of industry can no longer be seen as "unforeseeable" events. And even though you can't really prevent the next disruption from happening, you can be contractually prepared for it.