

CLIENT ALERT

Precedent in Unprecedented Times: Contractual Performance and Defenses in the Age of COVID-19

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OVERVIEW

As the world's governments grapple with the public health crisis arising from the recent coronavirus (COVID-19) outbreak, clients understandably are focused on how COVID-19 will impact their operations, particularly their performance obligations under contracts. Given the disruptions to supply chains, the volatility of the global markets, factory closings, employment issues, travel restrictions, quarantines, and uncertainty engendered by the COVID-19 outbreak, the concept of force majeure will play an important role as parties navigate their contractual rights, remedies, and responsibilities.¹ This memorandum is not intended to address all the legal issues that COVID-19 will trigger, but clients should rest

¹ The COVID-19 outbreak has already disturbed global supply chains, causing shortages of products ranging from auto parts to generic medicines, and delaying production of iPhones and Diet Coke. Austin Goolsbee, *Why the Coronavirus Could Threaten the U.S. Economy Even More Than China's*. THE NEW YORK TIMES, Mar. 6, 2020, [here](#). As of March 3, the Chinese government issued 4,811 force majeure certificates to Chinese businesses due to the epidemic, affecting contracts totaling \$53.79 billion. Huileng Tan, *China invokes "force majeure" to protect businesses—but the companies may be in for a "rude awakening,"* CNBC, Mar. 6, 2020, [here](#). Although such certificates may be enforceable within China's domestic markets, it is unlikely that the certificates will be applicable abroad, as many contracts between Chinese and international parties are governed by English law, which allows parties to assert force majeure only under very specific circumstances. *Id.*

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assured that Willkie has a team of experts that are dedicated to providing timely and practical advice on the myriad issues that COVID-19 is creating.

We address below one of the principal questions that many clients are now facing: What does the COVID-19 outbreak mean for my contractual obligations and rights? From the French for “superior force,” force majeure is a contract provision that excuses a party’s nonperformance when an “act of God” or some other extraordinary event prevents a party from fulfilling its obligations.² Ultimately, whether the COVID-19 outbreak constitutes a force majeure event under a particular contract will depend on the (1) language of the contract at issue, (2) the relationship between the outbreak and nonperformance, and (3) the applicable law governing the contract.³ This is a fact-specific inquiry that will turn on the particular reasons that the outbreak and its effects have inhibited or prevented performance, as well as the law of the particular jurisdiction.

In the absence of, or in addition to, a written force majeure provision, parties may also rely on the common law defenses of impossibility, impracticability, and frustration of purpose. Some jurisdictions have collapsed these defenses, but there are distinctions among them. Impossibility applies where performance is no longer objectively possible because of a supervening event. Impracticability refers to a supervening event that changes the inherent nature of performance, causing it to become more difficult, complex, or challenging, thereby contravening a basic assumption of the parties’ agreement. Such a change may render performance commercially senseless and excuse it.⁴ Finally, frustration of purpose may arise when one party’s known purpose for entering a transaction has been destroyed or obviated by a supervening event.⁵ Traditionally, these defenses have been narrowly enforced. Again, whether these legal doctrines excuse contract performance in light of the COVID-19 outbreak will turn on the specific reasons that performance was rendered impossible or impracticable, as well as on the applicable law.

In addition, there is a considerable body of law, mainly in Delaware, that determines whether a party to a merger contract can walk away based upon a “material adverse effect” or “MAE.” Under Delaware law, the impact of the MAE must be,

² TRACEY BATEMAN ET AL., 77A CORPUS JURIS SECUNDUM, SALES § 370 (2020); MARIE K. PESANDO, AMERICAN JURISPRUDENCE 2D, ACT OF GOD § 13 (2020). Common force majeure events include: natural disasters, war, government acts (i.e., eminent domain), labor activities (i.e., strikes), power shortages, epidemics, and quarantines.

³ RICHARD A. LORD, 30 WILLISTON ON CONTRACTS § 77:31 (4th Ed.) (2019) (noting that a party seeking the benefits of a force majeure clause must typically show that performance is impossible “in spite of skill, diligence, and good faith” to perform).

⁴ See also RESTATEMENT (SECOND) OF CONTRACTS ch. 11, § 261d *Impracticability* (AM. LAW INST. 1981) (October 2019 update) (“A severe shortage of raw materials or of supplies due to war, embargo, local crop failure, unforeseen **shutdown of major sources of supply**, or the like, which either causes a marked increase in cost or prevents performance altogether may bring the case within the rule stated in this Section. **Performance may also be impracticable because it will involve the risk of injury to person** or to property, of one of the parties or of others, that is disproportionate to the ends to be attained by performance.”) (emphasis added).

⁵ See *id.* at ch. 11, § 265 *Discharge by Supervening Frustration*.

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among other things, “durationally significant” to the other party’s business prospects. Given the many uncertainties surrounding the overall impact of the COVID-19 outbreak, it is too early to tell whether that doctrine can be invoked by a party seeking to avoid closing on a deal or how the common law doctrines identified above may be applied in the face of clear and unambiguous MAE language. Further, many standard MAE provisions include carve-outs for epidemics, general market downturns and “acts of God.” In those circumstances, the party seeking to terminate the agreement would have to demonstrate that the adverse impact of the COVID-19 outbreak is disproportionately affecting its counterparty.

Notwithstanding this uncertainty, we have laid out below some key considerations and practice points for our clients based upon our experience and expertise with these issues, with the one caveat that we have not witnessed circumstances like these in our lifetime.

GENERAL CONSIDERATIONS & PRACTICES

Based on the tendency of courts to construe force majeure provisions narrowly, and given the limited recourse afforded by the common law defenses of impossibility, impracticability, and frustration of purpose, contracting parties must draft their force majeure provisions carefully. Listed below are some practices to consider when assessing performance obligations under a contract.

1. Scrutinize the language of the contract at issue. Does it include a force majeure clause? If so, does the clause address an event like the outbreak of COVID-19? Does the clause include language such as “disease,” “epidemic,” “pandemic,” “outbreak,” “quarantine,” or “acts of government”?
2. If the contract lacks a force majeure provision, do the circumstances render it impossible or impracticable to perform?
3. Consider the applicable law and jurisdiction governing the contract when determining obligations and potential nonperformance risks.
4. Document and monitor the efforts taken to perform under the contract. Even if these steps are unsuccessful in avoiding the need to declare a force majeure, a company’s effort to mitigate risks in advance will be relevant to a court’s determination of whether reasonable steps were taken to perform and whether performance was truly impossible.
5. Document and monitor how the COVID-19 outbreak has specifically affected the ability to perform. For example: Did a governmental authority impose a quarantine or other restrictions? Has it banned the importation of certain goods and products from a particular jurisdiction? Was a party to the contract forced to halt operations because of the outbreak?

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6. Consider the various outcomes that may follow a force majeure event. For instance, the party may be relieved of liability deriving from its nonperformance or the parties may renegotiate and modify the contract.
7. Assess any business interruption insurance policy to determine whether coverage may be provided for losses due to business interruptions arising from COVID-19. In the wake of the SARS outbreak in 2002–2003, many insurers have since excluded viral or bacterial outbreaks from standard business interruption policies. Nevertheless, it is important for companies to closely review the terms and conditions of their governing insurance policies to assess whether interruptions from COVID-19 would be covered.

We at Willkie remain committed to providing legal advice and services to all of our clients. We are available should you wish to discuss any of the above-contractual defenses as well as any other legal concerns or issues you may face in light of this unprecedented public health crisis. Please feel free to reach out to any of us with any questions you may have.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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