

## A How-To Guide: Navigating Contractual Obligations During COVID-19

The COVID-19 pandemic has introduced risks and uncertainty into business agreements that may have seemed like a safe bet, or even routine, a few weeks ago. As the economy remains largely shutdown, you may be deciding how to terminate or, conversely, enforce your contractual obligations. This “how-to” guide provides factors to consider.

### A Brief Primer on the Legal Framework

There are several contractual defenses that come into play with an unprecedented, unexpected event like the COVID-19 pandemic. These defenses are rooted either in the contract itself or in basic legal principles.

**Force Majeure:** Force majeure, or “act of God,” provisions are commonly, but not always, included in contracts.<sup>1</sup> These provisions range in specificity and can cover war, natural disasters, and government orders, which the stay-at-home executive orders may trigger.<sup>2</sup> Courts generally find that economic hardship alone does not qualify as a force majeure event and some agreements specifically excise payment as a type of performance subject to force majeure.<sup>3</sup> These provisions typically excuse non-performance under the contract, though partial performance or already completed work may not be excused.<sup>4</sup>

**MAC Provisions:** Contracts may also include a provision addressing “material adverse changes,” or a MAC provision. These provisions allow a party to identify changes that materially and adversely affect the original conditions of an agreement.<sup>5</sup> Typically, a MAC provision does not automatically excuse performance but instead first allows the other party to attempt to cure;<sup>6</sup> however, with COVID-19 and its related consequences, such a cure may not be achievable, which could allow termination of the contract.

**Representations & Warranties:** Many contracts include “reps and warranties” that must be maintained through the contract term (and may even survive after performance). Though these provisions may not excuse performance on their own, they may trigger a party’s default or inability to perform under the contract, excusing performance, and requiring return of consideration.<sup>7</sup>

**Doctrine of Impracticability (or Impossibility):** The doctrine of impracticability (or impossibility) is a contractual defense that automatically attaches to any contract (state law permitting).<sup>8</sup> Under this doctrine, if, at no fault of its own, a party’s ability to perform under an already formed contract becomes impracticable, performance is excused,<sup>9</sup> or delayed while the impracticability exists.<sup>10</sup> The party asserting impracticability generally must demonstrate that it undertook “reasonable efforts” to overcome the obstacle to performance.<sup>11</sup>

**Frustration of Purpose:** The doctrine of frustration of purpose applies when the principal purpose of the contract can no longer be performed and without it, the transaction no longer makes sense.<sup>12</sup> This change must make one party’s performance virtually worthless to the other, frustrating the reason for the agreement.<sup>13</sup> Though a party’s performance may be excused under this doctrine, performance may also be delayed if the party’s purpose can be achieved in the future.<sup>14</sup>

<sup>1</sup> See, e.g., *Emelianenko v. Affliction Clothing*, 2011 WL 13176615, at \*4, n.40 (C.D. Cal. June 7, 2011).

<sup>2</sup> *Id.*; see also *OWBR LLC v. Clear Channel Commc'ns, Inc.*, 266 F. Supp. 2d 1214, 1224 (D. Haw. 2003) (“The Court recognizes that September 11 was an extreme, unforeseeable occurrence which is of the magnitude to trigger a force majeure clause.”).

<sup>3</sup> See, e.g., *Butler v. Nepple*, 54 Cal. 2d 589, 598-99 (1960).

<sup>4</sup> See, e.g., *Emelianenko*, 2011 WL 13176615, at \*4, n.40.

<sup>5</sup> See, e.g., *IOP Cast Iron Holdings, LLC v. J.H. Whitney Capital Partners, LLC*, 91 F. Supp. 3d 456, 471 (S.D.N.Y. 2015).

<sup>6</sup> See *id.*

<sup>7</sup> See *Woodberry v. Graham*, 2017 WL 151617, at \*2 (S.D.N.Y. Jan. 13, 2017).

<sup>8</sup> Restatement (Second) of Contracts § 261; see also *Butler*, 354 P.2d at 245.

<sup>9</sup> *Id.*; see also *Dixon v. Salvation Army*, 191 Cal. Rptr. 111, 114 (Ct. App. 1983).

<sup>10</sup> Restatement (Second) of Contracts § 269.

<sup>11</sup> See, e.g., *Emelianenko*, 2011 WL 13176615, at \*28.

<sup>12</sup> Restatement (Second) of Contracts § 265; see also *Century Sur. Co. v. 350 W.A., LLC*, 2007 WL 2688488, at \*4 (S.D. Cal. Sept. 7, 2007); *LECG, LLC v. Unni*, 2014 WL 2186734, at \*7 (N.D. Cal. May 23, 2014), *aff'd*, 667 F. App'x 614 (9th Cir. 2016).

<sup>13</sup> See *LECG, LLC*, 2014 WL 2186734, at \*7.

<sup>14</sup> Restatement (Second) of Contracts § 269.

## What Are Your Options?

Knowing these potential contractual defenses and sources of relief allows you to identify which might apply to your situation and select those most helpful to advancing your goal, whether that is to terminate, or materially change a deal, or enforce one.

## Are You Trying to Invoke COVID-19 to Terminate or Materially Modify a Deal?

First, look to the primary source: the contract. Review the agreement to identify clearly applicable provisions (e.g., force majeure, MAC clauses, reps and warranties), as well as additional provisions that may affect or trigger these provisions (e.g., maintaining business or operations, conditions of the other party's default). Identify which state law applies and determine if that state, like California, recognizes doctrines of impracticability and frustration of purpose and under what circumstances.

Second, even if not required, provide prompt, written notice of all identified issues to the other party. Providing notice will protect and preserve your rights, and formal notice also may be required under your agreement. Check the agreement for how and when to provide notice, as some agreements require that notice be revised on a periodic basis. When communicating with the other side, note the following:

- Provide some details but be mindful not to box yourself into a position, particularly in light of the current uncertainty. Include language that does not create absolutes and allows for modification, such as “at this time,” “including, but not limited to,” or a disclosure statement about reserving your rights. Emphasize the unprecedented and unforeseeable nature of the disruption.
- Cite specific laws and regulations, identify relevant contract provisions, and state your intended purpose, while reserving the right to modify or supplement your position in the future.
- Avoid framing the issue in terms of pure economic frustration or economic hurdles, because such economic hardship generally does not excuse performance.<sup>15</sup> It may be relevant, for example, if you can no longer secure funding that the parties intended to complete the deal under any circumstances.<sup>16</sup>
- Ask specific questions of the other side to elicit facts that will support your position that the current state of affairs is different than what the parties expected and intended. For example, in a deal concerning residential real estate, you can ask about the changes in sales/leases, operations, defaults, or evictions.

Third, take notes and follow up. Create an internal record of any disruption relating to the deal and take note of any changes and when they occurred. Stay aware of notice and cure deadlines and follow up as needed.

Fourth, set firm and reasonable deadlines. In your communication with the counterparty, provide for specific dates by which the other side must respond. These dates can come either from your contract (e.g., a date by which breach must be cured or a notice of default must be addressed) or can be unilaterally imposed. Keep pressure on the other side.

Finally, be mindful of your language. Remember you are creating a record that may ultimately be used in court. You will want the factfinder to view you as the reasonable party that is not taking advantage of a pandemic but is rightly exercising its rights.

---

<sup>15</sup> See *OWBR LLC*, 266 F. Supp. 2d at 1224 (rejecting the defendant's argument that economic forces, such as consumers' subjective preference not to fly after 9/11, triggered the parties' force majeure provisions).

<sup>16</sup> See *Butler*, 354 P.2d at 244-45 (“[M]ere increase in expense does not excuse the performance unless there exists extreme and unreasonable difficulty, expense, injury, or loss involved, expense, [or] injury.”)

## Are You Trying to Respond to Invocation of COVID-19 to Preserve a Deal?

First, be in the know. Knowing what can be used against you is important to knowing how to respond. Review the contract for potentially applicable provisions (e.g., force majeure, MAC clauses, reps and warranties), as well as other provisions outlining your contractual obligations (e.g., maintaining business or operations, conditions of your default).

Second, monitor your operations. If there is some disruption, expressly note the temporary nature of it and the expectation that it will be resolved in the short-term. Similarly, consider alternative methods for maintaining operations/performance.

Third, respond promptly to the other side. If the other party provides you notice to terminate or materially modify your deal, consider the following in your response.

- Does the notice allege impossibility or frustration of purpose?
  - Determine whether the state law governing your contract recognizes those defenses. Also, determine whether their performance is only temporarily “frustrated,” allowing for performance to be delayed rather than excused.
- Is the party relying on financial issues or market shifts to excuse performance?
  - If so, and if the contract does not provide otherwise, these changes are insufficient under the law to excuse performance.
- What is their position?
  - If the party’s position is not crystal clear, ask questions and demand specifics. Lock them into a position.
- Rebut their “facts”
  - If the party is saying that events specific to your deal have occurred that require termination, rebut their allegations with your own specifics.
- Consider Business Issues
  - Examine how much risk you are willing to take on as the COVID-19 pandemic continues. It may be worth considering concessions to ensure a timely deal rather than a delayed or defunct deal.
  - Be mindful that language you use to enforce a deal with one party may be used against you if you are trying to terminate or modify a deal with another. So make your response specific to the facts at hand rather than broad.

Fourth, express flexibility. Document your willingness to be flexible where appropriate, including potentially postponing performance. In the event of litigation, this flexibility can be used to show the factfinder that terminating the contract altogether is not necessary in light of the other options (i.e., delay).