WHEN CAN CONTRACT DUTIES BE SUSPENDED OR TERMINATED BECAUSE OF THE COVID-19 PANDEMIC?

By W. Mark Mullineaux, Esq.

The COVID-19 pandemic has impacted the ability of businesses to perform contractual duties. Governments around the world, including the United States and individual U.S. states, have imposed prohibitions on going to work, leaving home, meetings, travel, eat-in restaurants, and other limitations. This article discusses when a party may have a legal defense if it elects to not perform contract obligations. The defenses of Force Majeure, frustration and impracticability are explored.

Force Majeure

A Force Majeure clause (French for "superior force") is a contract provision that allows a party to suspend or terminate the performance of duties under a contract. The scope of protection and remedies are established by the language of the contract. This is an example of a Force Majeure clause:

> **Force Majeure**. A party shall not be liable for any failure of or delay in the performance of this agreement for the period that such failure or delay is due to any strike, lockout, civil commotion, war like operation, invasion, rebellion, hostilities, military or usurped power, sabotage, governmental regulations or control, or through act of God ("FORCE MAJEURE"). Performance is not excused if performance resulted from general economic conditions.

As examples, other triggering events in a Force Majeure clause could be fire, flood, hurricane, typhoon, earthquake, lightning and explosion or pandemic. A Force Majeure clause may provide that a party must take steps to mitigate the impact. When it first becomes known that a party will rely on Force Majeure, that party should send a formal **written declaration of Force Majeure** to the other parties to the contract.

Under Pennsylvania law, the event alleged as an excuse must have been beyond the party's control and not due to any fault or negligence by the non-performing party. The non-performing party must show that they took action to attempt to perform the contract regardless of the Force Majeure event.

Many Force Majeure clauses in effect today do not list pandemic, epidemic or disease. Without that language at first blush it may appear that the Force Majeure defense does not apply to performance impacted by COVID-19. A defense may be available, however, if the clause covers governmental regulations and those regulations had a serious negative impact on performance. Further, the world-wide recognition of the need to control COVID-19 and government's "stay at home" orders may result in courts being more liberal in approving a Force Majeure defense.

Impracticability or Frustration

If there is no Force Majeure clause in a contract or if the clause does not provide protection, a party to avoid performance may rely on the common law doctrines of "frustration" or "impracticability." In Pennsylvania it is difficult to meet the requirements for those defenses. As a general principle, a party assumes the risk of incapacity to perform its contractual duties. To use frustration or impracticability as a defense for non-performance, the cost of performance must become so excessive and unreasonable that the failure to excuse performance would result in "grave injustice."

As soon as it is known, a formal written **declaration of frustration or impracticability** should be sent to the other parties to the contract.

Pennsylvania courts have said performance may be considered "impracticable" and excused because of extreme and unreasonable difficulty, expense, injury, or loss, such as severe shortage of raw materials or of supplies due to war, embargo, local crop failure or unforeseen shutdowns; or performance will involve a risk of injury to person or to property. Increases in costs unless well beyond the normal range, do not amount to impracticability. *Id.* citing *Restatement (Second) of Contracts* § 261. A party must establish that the act contemplated is incapable of being performed, rather than the fact that he or she is incapable of performing it.

The doctrine of frustration provides that the duty to perform is discharged when a party's principal purpose is substantially frustrated without his fault and there is a violation of a basic assumption on which the contract was made. The doctrine applies if events occur that result in a situation radically different from the contemplation of the parties when the contract was made. Courts typically require proof of "impossibility" of performance in order to allow the defense of frustration.

Although the standard is high, courts have provided relief under defenses of impracticability and frustration..

Parties will be urging courts to hold that the unique obstacles caused by COVID-19 support a defense of impracticality or frustration. Given the unprecedented impact of the disease, courts may feel compelled to allow those defenses.

Moving Forward

Any decision on whether to declare Force Majeure, frustration or impracticability requires a detailed analysis based on the particular facts faced by a company and the applicable law. As an example, a company should evaluate whether their counterparties to contracts may declare justifiable release from performance. Some companies will be on both sides of this issue, as the performing party in some cases and the receiving party in others. Companies should look at both possibilities before taking a formal position on whether to declare Force Majeure, frustration or impracticability. ■

W. Mark Mullineaux, Esq.
(mmullineaux@astorweiss.com)