



# Contract Performance or Excuse During the COVID-19 Pandemic

By Ronald J. Campione, Esq., *Bressler Amery & Ross, P.C.*

Industries throughout the world will experience contract issues as a result of the effects of COVID-19, whether described as a stand-still, shutdown, self-isolation, or quarantine. On March 11, 2020, the World Health Organization characterized COVID-19 as a pandemic. In the United States, governors have invoked their state's constitutional authority to enact social distancing measures, and, in some instances, have shut down businesses defined as "non-essential." Government leaders throughout the world have taken actions ranging from similar non-essential business closures to strict lockdown of their citizens. These actions have caused some businesses to close down, rendering them unable to honor contractual obligations.

The global pandemic is impacting performance under contracts in a variety of ways, including prohibiting the fulfillment of obligations, delaying fulfillment, or frustrating the purpose of agreements. Many companies are facing a double edged sword that has them, on one side, defaulting on an obligation under a contract while, on the other side, facing a customer or client that is defaulting on their obligations.

Performance or non-performance of contracting parties during the pandemic almost certainly will give rise to claims under force majeure clauses and frustration of purpose, impracticability and impossibility doctrines. Will the COVID-19 pandemic excuse a party from performance under this clause or these doctrines? There is no uniform bright line answer, and the outcome will depend on contractual language, the state law applicable to the agreements and industry practice.

## What Is a Force Majeure Provision?

Every business in the United States and around the world should be reviewing its contracts for the inclusion of a force majeure provision, as not every contract contains such a provision. "Force Majeure" mean a superior force, and the general purpose of a force majeure provision is to limit damages and delay or excuse performance where the reasonable expectation of the parties and the performance of the contracts have been frustrated by circumstances beyond the parties' control.

While the meaning of the clause is fairly standard in domestic and international contracts, the language used in force majeure clauses differs in almost every contract. For example, some include specific terms and events and may excuse performance for things like Acts of God, terrorism, pandemics, and other unforeseen circumstances:

As used in this Agreement, the term "Force Majeure" shall mean any act of God, strike, lock-out or other

industrial disturbance, war (declared or undeclared), riot, epidemic, fire or other catastrophe, act of any government and any other similar cause not within the control of the party affected thereby.

A force majeure clause may be general or be very specific and a party's ability to rely on the clause is language dependent. While "Act of God" language appears to be broad, it is unlikely to cover the COVID-19 pandemic. Most jurisdictions determine that an "Act of God" refers to natural disasters such as earthquakes and tsunamis, or weather related events such as tornadoes and hurricanes.

In some force majeure clauses, non-performance is not excused and may only be extended:

In the event that Area Developer is unable to comply with the Development Schedule due to strike, riot, civil disorder, war, failure to supply, fire, natural catastrophe or other similar events beyond its control, and upon notice to Franchisor, the Development Schedule and this Agreement shall be extended for a corresponding period, not to exceed ninety (90) days.

In the above clause, for example, the circumstances giving rise to the application of the force majeure provision is somewhat general, including "other similar events," and not as specific as the prior example.

In some clauses, the inclusion of not just a force majeure but a separate "Governmental Action" condition may excuse performance. The below example is from an agreement between international companies:

- (i) **Governmental Action:** compliance with any action, order, direction, request or control of any governmental authority or person purporting to act for any governmental authority.
- (ii) **Force Majeure:** interruption, unavailability or inadequacy of the supply of the Products or of any facility of production, manufacture, storage, transportation, distribution or delivery for any reason, including wars, hostilities, public

disorders, acts of enemies, sabotage, strikes, lockouts, labor or employment difficulties, fires, floods, acts of God, accidents or breakdowns, plant shutdowns for repairs, maintenance or inspection or weather conditions.

The most important takeaway is that there is no standard force majeure clause. Each provision will be written differently, and each jurisdiction has different precedent for enforcement of these contractual provisions. Most tribunals will examine the clause strictly, or narrowly, and the language used will be important. If the “force” is expressly listed in the clause, then delay or excuse is a valid defense. However, if the language included in the contract is general or vague, tribunals will look to preserve the sanctity of the contract.

An immediate contract review is important because it will also assist in determining the “notice” requirements for raising the force majeure clause or other impracticability of performance. The “notice” requirement, if not met, could eliminate non-performance as a defense for failure to meet a contractual condition.

But, what if the contract does not specify diseases? Many of our states, cities, and municipalities have enacted “stay at home” orders or have shut down all non-essential services. Long-standing contract law may excuse performance due to government action, including

orders that were unforeseen and beyond the reasonable control of the parties. For example, New Jersey’s governor ordered a “shut down” of the State’s non-essential businesses and ordered people to stay home.<sup>1</sup> Presumably, businesses affected by the New Jersey order operate through contracts with other businesses to provide products or services and are experiencing issues with their supply chains. It is important during this “shut down” period for businesses to review all contracts, including supply contracts, purchase contracts, leases, and performance contracts (especially if dependent upon downstream suppliers). A party involved in back-to-back contracts or interrelated contracts will need to take into account the overall impact of the claim for force majeure on its obligations under the related contracts and whether to issue a protective “notice.”

If a business finds that its contracts lack a “force majeure” provision, the performance may still be excused under common law contract principles such as impossibility, impracticability, and frustration of purpose.<sup>2</sup> In recent times, most courts use the standard of impracticability in place of the “impossibility” analysis. Under this doctrine performance is excused when it is not practical and could be done only at excessive and unreasonable cost. Meeting this standard typically requires: (1) an unexpected event; (2) the assumption that the event would not take place; and (3) that the event rendered performance of the event either impossible or impractical depending



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on the jurisdiction. Both United States common law contract principles and state commercial codes include an impracticability standard.

A party that has contractual obligations affected by COVID-19 should record and document its prevention or mitigation of the impact on its affected contracts. Nevertheless, great concern and consideration should be employed in invoking a force majeure claim, as a ruling that the force majeure clause did not provide for an excuse or delay of a contractual obligation could have serious consequences, including damages for breach of contract or termination of the contract.

### What Should Be Done Now?

- Review all contracts for force majeure or other lack of performance or delay provisions and seek legal advice early if needed;
- Determine the economic effect of invoking a force majeure or similar provision if it applies;
- Identify contractual obligations that are affected and separate those that are impossible or may not be possible and which may be excused or extended due to delay with focusing on performance specifically related to COVID-19;
- Identify contractual “notice” requirements and immediately prepare notice for those obligations affected by COVID-19 keeping in mind that documentation may be required;
- Review insurance policies for business interruption or force majeure coverage;
- Determine whether relief may be available under COVID-19 programs such as the Paycheck Protection Program (PPP), Small Business Debt Relief Program, Economic Injury Disaster Loans (“EIDL”), and potential tax credits and deferment of certain federal payroll taxes; and
- If notice under a force majeure provision is received, examine the claimed reason for nonperformance, whether such reasons satisfies the contractual language under which non-performance is claimed, and whether “notice” requirements have been met.

In sum, COVID-19 has and will continue to affect the ability of companies to perform pursuant to their contractual agreements. As a result, businesses need to expeditiously review their agreements, and, in

particular, the precise language relating to performance of obligations thereunder in light of the current environment. Companies should be particularly mindful of the interaction between affected and non-affected contracts and the requirements of notice if non-performance of an obligation is a consequence of the COVID-19 pandemic. ■

### References

1. As of April 8, 2020, forty-three states, and the District of Columbia, have issued stay at home orders. The order in New Jersey requires all retail business not considered “essential” to close their physical locations, but permits delivery and online operations of retail businesses. The order also closes recreational and entertainment businesses until further notice, which includes, among others, casinos, fitness centers, racetracks, golf courses and personal care service facilities such as beauty salons and barber shops.
2. The relevant clause may not be specifically labeled “Force Majeure” but may expressly provide remedies for excuse or delay. *See, e.g.*, the uniform contracts used by the American Institute of Architects, AIA Document A201-2017 §8.3. In other instances a standard definition of “force majeure” may apply even though the definition is not included in the contract. International rules, for example, may impose specific definitions in contracts that mention, but do not define “Force Majeure.” *See, e.g.*, International Chamber of Commerce Force Majeure Clause 2003, available at <https://iccwbo.org/resources-for-business/model-contracts-clauses/force-majeure>.

*Ron Campione is a principal in Bressler’s Business Litigation practice representing businesses of all sizes in litigation, complex negotiation, transactions, and counseling. Ron has represented business clients with legal issues, and assisted them with preventing legal issues, for more than 20 years. He has extensive experience in the courtroom, before regulatory boards, pre-trial litigation practice, transactional work and negotiations. He has been, and continues to be, lead counsel for clients in state and federal courts at trial and appellate levels. In addition to his career in the civilian legal profession, Ron serves in the United States Marine Corps as a Judge Advocate.*



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