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What COVID-19 has taught us about protecting against the next crisis

VIEWPOINT
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We all know more seven months into this pandemic than we did at the outset, including businesses seeking legal redress for business disruption, breach of contract, insurance protection and business loss. It has been more than five months since my first column considering the contract law doctrines of force majeure, or frustration of purpose, impossibility and commercial impracticality in the age of COVID-19 ("Do not expect relief of most contractual obligations due to COVID-19," RBJ, June 2, 2020). Enough time has passed to extrapolate some learnings to help businesses plan for the future.

As discussed in the last column, the initial avenues explored for legal relief for pandemic related business disruptions included:

- force majeure (or "superior force") is the principle in contract law that parties may add as clauses to their agreements that specify instances where a party is relieved of performance obligations in the event of unforeseeable circumstances;
- frustration of purpose is a separate legal doctrine allowing termination of a contract
- when an unforeseen event undermines the principal purpose of that contract;
- impossibility is a legal defense available when a change in circumstances, the non-occurrence of which was an underlying assumption of the contract, makes performance of the contract literally impossible; and
- commercial impracticality is another defense that excuses non-performance or delay if an unforeseeable event materially changes the contractual obligation

The recent activity in cases described in the last column — D'Amico Dry D.A.C. v. McInnis Cement Inc., Venus Over Manhattan Art LLC v. 980 Madison Owner LLC and In re Pier 1 Import Inc. — confirms that the predictions made regarding the limited utility of these doctrines in the age of COVID were accurate. The cement manufacturer in D'Amico and the lessee in Venus both appear to have abandoned their assertions of force majeure and frustration of purpose, respectively and quietly discontinued their actions. As for Pier 1, the debtor is paying its rent again, a tacit admission that contractual performance is not (and perhaps, never was) impossible.

Federal and state case activity since the last column confirms the prediction that force majeure, frustration of purpose, and impossibility would find limited utility, even in these extraordinary times. While practitioners have persisted in making boilerplate assertions of force majeure, frustration or impossibility in new case filings, few have pleaded facts sufficient to reconcile those invocations with the narrowness of those doctrines. We can all agree that COVID-19 has been a gut punch to most businesses, but simply saying so is not enough to sustain force majeure, frustration or impossibility arguments.

Commercial impracticability seems to have attracted a bit more of a following, which makes sense if a contracting party has suffered extreme or unreasonable hardship due to COVID-19-related supply chain issues. For example, in The Regents of the University of California v. Under Armour Inc. (Ca. Superior Court, September 2, 2020), Under Armour claimed that the impact of COVID-19 made it commercially impracticable to meet its supply obligations to UCLA's athletic department, given its weakening financial position. UCLA was quick to fire back, noting that Under Armour's filling of other universities' orders showed there was no impracticability at all. This row brings up an important aspect of commercial impracticability: except in the case of a complete inability to perform, a supplier must allocate its limited supply across its customer base in a "fair and reasonable" manner. What does that mean? The Uniform Commercial Code does not specify, although the safe bet is to favor customer interests over the seller's, and prorate supplies evenly among all customers rather than allocate to the buyer that has agreed to a higher price.

Rather than use the effects of COVID-19 as a shield for contractual nonperformance, we may well find that those effects make a more effective sword to support a breach of contract case. For example, I represented an individual who reserved (and prepaid) an April 2020 rental of a beachfront unit in Florida. The onset of COVID-19 in March made travel to Florida in April inadvisable (to say the least), and my client did not take possession of the rental unit. Unfortunately, her request for a refund was denied by the rental company. But, it turns out she had an unwitting ally: Florida Gov. Ron DeSantis had issued two executive orders suspending vacation rental operations for the entire month of April. With that helpful fact in hand, one could argue that the rental company did not (and could not lawfully have) performed its side of the contract, and that this resulted in a breach of the rental contract.

Other litigants are trying similar arguments: one involves a Mediterranean cruise (Tupperware Brands Corp. v. Seabourn Cruise Line Limited in the Washington State Superior Court), and another deals with accommodations for a Hawaiian convention (Mechanical Contractors Ass'n of America, Inc. v. 3900 WA Associates LLC in the Delaware Superior Court). The abandoned passengers are likely to have a stronger position than the tropical conventioneers: in the former case, the cruise line was unable to operate its ship during the entirety of the scheduled voyage due to governmental port closures (much like the Florida rental company). By contrast, in the other case, Hawaii's governor only strongly discouraged (but did not prohibit) visitors from coming to his state during the dates of the convention. The conventioneers undoubtedly acted prudently in electing not to go, but they do not appear able to point to a government order prohibiting the convention venue from rendering services.

Force majeure clauses constitute, at bottom, an agreement as to what circumstances a party will be relieved of performance obligations in the event of a superior force. These clauses are typically found toward the end of a contract, which is indicative of how little thought is given to them. They are usually boilerplate; copied from one contract to another with little-to-no variation; include grandiose language regarding Acts of God, war, riots and what not; but are rarely expected to be enforced. COVID-19 has shown us that we can no longer treat force majeure clauses with such disregard.

An important distinction between force majeure, on the one hand, and frustration of purpose, impossibility and commercial impracticality, on the other should (by now) be evident. Force majeure clauses, while narrowly construed, can still be tailored for broader applicability by contracting parties, whereas the applicability of the remaining three doctrines cannot. Therefore, parties who are drafting contracts should be encouraged to give deeper consideration to force majeure clauses than has historically been the case.

Business law attorneys have generated countless news alerts, client updates and tweets in the last seven months regarding force majeure clauses and how to upgrade them. Many have observed that in New York and elsewhere, only those events specifically listed in a force majeure clause will relieve performance obligations. Accordingly, the common suggestion is to expressly include pandemics and epidemics among the list of events. This is a fine approach, assuming the next debilitating event is another pandemic. But, what if the next event is not a pandemic, but something else? This vulnerability shows that a reactive approach will work no better the next time than it did during COVID-19.

Some legal advisors may recommend adding catch-all language to the end of the force majeure list, such as "or other similar events beyond the control of a party." This will not work either. New York courts are constrained from giving such general language an expansive meaning, because general contractual words must be confined to things of the same kind or nature as the particular matters mentioned.

Even though courts will interpret force majeure clauses narrowly, this requirement must yield to the governing tenet of contract interpretation: the effectuation of the intent of the parties. Parties are always free to allocate risk as they see fit. The solution is to reimagine the standard, boilerplate force majeure clauses to focus not on the occurrence of a particular event, but the effect that an event outside the parties' control would have on the essential purposes of the agreement. This is, in a sense, contractually codifying the frustration of purpose doctrine, but with greater flexibility than the common law would otherwise permit.

Such a reimagining will not be easy, or without its detractors. Elevating force majeure to more than mere boilerplate will require more careful negotiation of these provisions, and may require concessions elsewhere in the contract. But, business law attorneys need to be proactive thought leaders and be ready to think around future corners, given the stakes often in play. This approach may offer an important way to better protect your business from the next crisis.

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