NIESAR & VESTAL LLP

Law Alert

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Is coronavirus an excuse for non-performance of your contractual obligations?

One important coronavirus-related question we are getting often is whether there is a defense to a breach of contract claim where performance is rendered impracticable or even impossible by coronavirus. This question has been particularly relevant since the San Francisco Bay Area has issued "shelter-in-place" orders.

For instance, there are concerns over issues like what happens if a buyer has entered into an agreement to purchase a business which has now been closed due to the "shelter-in-place" order and, thus, has no operations. Is the purchaser obligated to purchase the nonoperational business?

The answer depends on the specific contract language, local law, and the causal connection between Covid-19 and the parties' ability to perform their obligations under the agreement.

Analysis of the application of contract defenses always starts with reading the specific language used in the contract, if such language exists.

Contracts containing a Force Majeure clause

A contract with a Force Majeure clause will typically contain a list of events which can constitute a Force Majeure Event (e.g., earthquake, flood, fire, quarantine, terrorism, war, workers' strike, etc.). The clause may also define specific events and then include broad "catch-all" language, such as "reasons which are beyond the parties' control and make performance of the contract impractical or impossible."

If the clause in your agreement contains a "global pandemic" event in the list of Force Majeure Events, the presence of this language will allow the claiming party to argue that the coronavirus qualifies in light of the fact that is has been officially declared a pandemic by World Health Organization.

When an agreement contains a Force Majeure clause, California courts have traditionally given the clause a strict interpretation "A force majeure clause is not intended to buffer a party against the normal risks of a contract.... A force majeure clause interpreted to excuse the buyer from the consequences of the risk he expressly assumed would nullify a central term of the contract." *Horsemen's Benevolent & Protective Assn. v. Valley Racing Assn.*, 4 Cal. App. 4th 1538, 1565 (1992), modified (Apr. 6, 1992).

However, even in the case of a Force Majeure provision in a contract, mere increase in expense does not excuse the performance unless there exists extreme and unreasonable difficulty, expense, injury, or loss involved. *Butler v. Nepple*, 54 Cal. 2d 589, 598, 354 P.2d 239 (1960). Thus, not fulfilling its contractual obligations by advancing only the concern of losing money will likely be insufficient to trigger a Force Majeure defense.

In addition, written notice regarding difficulties or delays in performance should be communicated to the other party with care, in particular without suggesting that the party giving notice is repudiating the contract.

Contracts without a Force Majeure clause

The principle underlying the doctrine of Force Majeure is simple: "No man is responsible for that which no man can control." Cal. Civ. Code Section 3526.

Section 1511 of the California Civil Code section seems to act as a default Force Majeure clause for a contract without one. This Section excuses performance of a party's contractual obligations "when it is prevented or delayed by operation of law" or by an "irresistible, superhuman cause."

The test for whether a Force Majeure situation is present is generally "whether…there was such an insuperable interference…as could not have been prevented by the exercise of due diligence." *Pac. Vegetable Oil Corp. v. C.S.T., Ltd. (1946) 29 Cal.2d 238.*

In addition, as discussed above, any burden resulting from the coronavirus or other reason asserted as the irresistible, superhuman cause must be more than an increase in expense or financial difficulty. A winery's contract to host 500 professionals for a dinner might be excused where the county is under lockdown due to wildfires.

Note that Section 1511 requires "written notice to the other party or parties, within a reasonable time after the occurrence of the event" in case performance is prevented or delayed by the operation of law.

Impossibility/Impracticability and Frustration of Purpose

In addition to Force Majeure, the doctrine of frustration of purpose is available as a defense where the main purpose of a contract has become frustrated. *Dorn v. Goetz*, 85 C.A.2d 407 (1948). In other words, the contractual performance has become valueless. The total or near-total destruction of the purpose for which, in the contemplation of both parties, the transaction was entered into must be shown.

Other options may potentially be available to excuse performance, such as the defenses of impossibility and impracticability.

Conclusion

Many businesses are now seeking to determine whether they are obligated to perform under their contracts, or whether they can invoke a contract defense to excuse performance temporarily or even permanently.

A contract for sale of goods with a specific deadline for delivery is an example of a contract where frustration of purpose, or even Force Majeure, may or may not be applicable. If the contract is for the delivery of 500,000 "Super Bowl Champion" T-shirts for a team that hopes to be the winner, the requirement to deliver two weeks before the scheduled game may or may not provide a complete excuse for either side's performance. If three weeks before the scheduled game the entire country is shut down as in our current coronavirus crisis, it would seem that either party could claim frustration of purpose. But if the game is only postponed for six months, maybe neither party has an out.

As you can see from the above summary, this is a very complex and fact specific area of law. The outcome of a particular situation, like the delivery of the "Super Bowl Champion" T-shirts, may well depend upon a close examination of the terms of the applicable contract.

In addition, notice should be communicated to the other party with care. For example, in some situations, it may be important to use language that will not say or imply that the party giving notice is repudiating the contract. In most cases, the notice should probably be crafted by legal counsel.

If you have any questions regarding contract defenses, please feel free to contact Gerald Niesar (gniesar@nvlawllp.com), Oscar Escobar (oescobar@nvlawllp.com), or Carolina Aricu (caricu@nvlawllp.com).