

Client Alert

COVID-19 and Contractual Obligations

The COVID-19 outbreak and efforts to contain it continue to have a major impact on commerce around the globe. In this alert, we examine some of the key legal doctrines that may affect the rights and obligations of parties under existing contracts, and which should be considered in negotiating future contracts, in the face of a volatile market and unanticipated changes in financial circumstances.

Force Majeure

Force majeure provisions are often inserted into commercial contracts to excuse a party's inability to timely perform its obligations due to certain events outside of the party's control. If applicable, the affected party will be relieved from its obligation for the duration of the force majeure event.

However, force majeure, as a defense to breach of contract, is only available if a force majeure provision is included in the contract, and the applicability of such a provision to a particular situation in connection with the COVID-19 outbreak will depend on the wording of the provision, the relationship between the pandemic and the contractual obligation involved, and, ultimately, court's interpretation of the precise contractual language as applied to the circumstances. Therefore, any party seeking to rely on a force majeure provision for excused performance, or a party seeking to dispute another party's invocation of a force majeure defense, must review the contract carefully to determine whether the pandemic is, in fact, a force majeure event and, if so, whether the failure to timely perform is sufficiently related to the pandemic to excuse performance. It is important to note that many force majeure contract provisions expressly state that force majeure will NOT excuse an obligation to pay money.

March 19
2020

This Client Alert has been prepared by Sills Cummis & Gross P.C. for informational purposes only and does not constitute advertising or solicitation and should not be used or taken as legal advice. Those seeking legal advice should contact a member of the Firm or legal counsel licensed in their state. Transmission of this information is not intended to create, and receipt does not constitute, an attorney-client relationship. Confidential information should not be sent to Sills Cummis & Gross without first communicating directly with a member of the Firm about establishing an attorney-client relationship.

Impossibility

Performance of contractual obligations may be excused if events not contemplated by the parties and outside of their control render such performance objectively impossible. Impossibility is a legal doctrine that is not dependent on there being a specific contract provision, but is reserved for extremely rare events such as the terrorist attacks of September 11, 2001. As is the case with a force majeure provision, performance is not excused merely because the event has occurred. The party seeking relief must also show that its performance was made impossible as a result of the event. For example, compliance with a contract with a hotel to hold a large conference would be rendered impossible in the face of a ban on such gatherings. While case law with respect to the doctrine of impossibility will likely evolve over the coming months and years in the context of COVID-19, it is plausible that courts will permit parties to rely on the doctrine in certain circumstances.

Frustration of Purpose

A party's performance may also be excused if the contract's principal purpose is frustrated by an unforeseen event to an extent rendering the contract effectively worthless. A court will typically only enforce this frustration of purpose doctrine if it is clear that the frustrated purpose is the basis of the contract. As the movement of people and goods continues to be restricted in response to the COVID-19 outbreak, this doctrine will likely to become applicable to more and more contracts.

Impracticability

The Uniform Commercial Code (UCC) governs contracts for the provision of goods in the majority of states. Under the UCC, a delay in the delivery of goods may not constitute a breach of contract if such delivery is made impracticable by circumstances outside the delivering party's control. Although applied sparingly, courts have excused the delivery of goods when intervening actions of a government render such delivery impracticable. As governments around the world continue to respond to the COVID-19 outbreak, situations are likely to arise that make an impracticability defense plausible for manufacturers, exporters and other suppliers of goods, such as failure to deliver in the face of factories being closed as a public health measure.

Material Adverse Effect/Material Adverse Change

Many contracts for the purchase and sale of a business, whether structured as an asset purchase, equity purchase, merger or other such transaction, contain language permitting termination or other modification of the terms of the contract as the result of a "material adverse effect" (MAE) or "material adverse change" (MAC) in the financial condition, results of operations, or other significant aspects of the target business or its assets. Such clauses may also appear in contracts for the sale of goods or other commercial arrangements. MAE and MAC clauses are typically favorable to the potential purchaser, and may permit the purchaser to terminate the transaction if certain events have a materially negative impact on the seller or its assets. Contracts often do not define the types of events that constitute a MAE or MAC, rather, they focus on the impact on the target business without regard to the cause. The burden will rest with the party seeking to terminate or modify the contract to prove that there was, in fact, a

material adverse change or material adverse effect. In any event, parties to applicable contracts should study their contractual language carefully and consult with their attorneys regarding the development of the case law as the current outbreak evolves.

Other Contractual Provisions

Many contracts provide remedies for purchasers or suppliers in the event of a disruption in the supply chain that prevents performance of a party's contractual obligations. Parties should review their contracts to determine whether the supplier is permitted to make partial shipments or whether the purchaser may reject any shipment that is incomplete or not on time. A party may also be permitted to terminate the contract entirely in the event of non-performance by the counterparty. In such cases both parties should take note of any notice and cure period requirements prior to termination.

Loan Agreements and Promissory Notes

Loan agreements and promissory notes rarely excuse a borrower from making payment on the basis of force majeure, and courts rarely enforce impossibility or impracticability doctrines in this context. Furthermore, a lender may even have the ability to demand immediate repayment of the balance of a loan in the event of a material deterioration in the financial condition of the borrower. Both borrowers and lenders should review the contractual language carefully to understand the rights of both parties.

Future Contract Negotiations

In the years following the September 11 attacks, language has commonly been added to commercial contracts to include (or exclude) acts of terrorism or sabotage in the definitions of force majeure and material adverse effect. Following the COVID-19 outbreak, similar language is likely to be added with respect to epidemics, pandemics and other health-related crises. Parties should consult with counsel to determine whether bargaining for such provisions is likely to be to their benefit in ongoing or future negotiations. In the near term, any contracts entered into during the current emergency should take into account the potential for rapid changes in circumstances.

If you would like additional information, please contact:

Ira A. Rosenberg, Esq.

Client Alert Co-Author; Co-Chair, Corporate Practice Group

irosenberg@sillscummis.com | (973) 643-5082

Charles H. Newman, Esq.

Client Alert Co-Author; Of Counsel, Corporate Practice Group

cnewman@sillscummis.com | (973) 643-4776