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The Hurdles In Defending COVID-19 Contract Nonperformance

By **John McIntyre** (September 15, 2020, 2:46 PM EDT)

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The COVID-19 crisis has significantly affected contract relationships the world over. Government-mandated lockdowns, travel restrictions and various commercial shutdown orders have all challenged the ability of businesses to comply with contract obligations created prior to the outbreak of the virus.

With various predictions of a second wave of cases on the horizon, businesses confronting these obstacles can consider a host of potential contract defenses, including force majeure, impossibility or impracticability, and discharge by supervening frustration of purpose. Three recent decisions, however, have highlighted some of the challenges to raising these defenses based on the ripple effects of COVID-19.

Force Majeure

Force majeure clauses are often included in commercial contracts to fully or partially excuse a party's performance that is hampered by various mutually agreed events, such as fires, hurricanes and terrorist attacks. Typically, the clauses will only provide relief if the event: fits squarely within the terms of the provision; has caused significant difficulties in performance; and was beyond the nonperforming party's control.

Many courts will also require the nonperforming party to show that it took all reasonable steps within its control to overcome the obstacles presented by the force majeure event.

In one of the first cases to consider the defense based on COVID-19, Future Street Limited v. Big Belly Solar, the U.S. District Court for the District of Massachusetts held that a force majeure provision did not excuse a licensee of its contractual obligations where it had not clearly shown that its failure to perform was caused by the effects of the pandemic.[1]

Future Street had moved for a preliminary injunction seeking to compel the performance of the licensor, Big Belly, under their licensing agreement for solar-powered waste and recycling bins, arguing that its own failures to comply with its minimum purchase requirements were excused under the contract's force majeure provision.

In its analysis, the court assumed, arguendo, that the pandemic fit within a catchall clause of the force majeure provision, which stated that neither party would be deemed in default for nonperformance solely due to "fire, labor disturbance, acts of civil or military authorities, acts of God, or any similar cause beyond such party's control."

Even so, the court found that Future Street's inconsistent performance under the contract before and after the outbreak of the pandemic called into question whether its relevant breaches were actually caused by the effects of COVID-19. Consequently, the court rejected Future Street's argument that its nonperformance was excused under the contract's force majeure clause and denied its declaratory judgment claim.

Impossibility or Impracticability

The doctrine of impossibility or impracticability has evolved to excuse contract performance in certain circumstances due to what are deemed unexpected and radically changed circumstances. Although the defense is often referred to in terms of impossibility, courts will also sometimes relieve parties of contract obligations that can only be accomplished at an excessive and unreasonable cost.

Section 261 of the Restatement (Second) of Contracts sets forth the standard as:

> Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

In order to make out the defense of impracticability, businesses will generally need to show: (1) there was a contingency, the nonoccurrence of which was a basic assumption underlying the contract; (2) the risks associated with the contingency were not assigned to either party; and (3) the promisor was not responsible for the difficulties in performance.

A number of courts also hold that the standard of impracticability is objective rather than subjective, meaning that the question is whether the thing can be done, not whether the promisor can do it.

The Massachusetts Land Court in Martorella v. Rapp recently rejected a contractual defense of impossibility — raised to excuse a buyer's delay in payment under a real estate contract due to the "effect of the coronavirus pandemic on the economic markets" — because it held that the agreement had assigned the risk of financing to the buyer.[2]

The buyer in Martorella, who signed an agreement to purchase the subject property for approximately $1.8 million in February this year, argued that his inability to make the specified payment on the agreed closing date should be excused because the parties could not have contemplated the effects of COVID-19.

Among other things, the buyer contended that the parties could not have predicted that the buyer's wife, an essential party to the financing, would be hospitalized for COVID-19. The court, however, rejected the buyer's impossibility defense, concluding that because the agreement did not contain a contingency clause, the buyer had assumed the risk of obtaining sufficient financing to make the requisite payment at closing.

Frustration of Purpose

The defense of frustration of purpose may also be available to excuse performance when an unanticipated change in circumstances has defeated the primary purpose of the contract for one of the parties.

Unlike impracticability, there is no need to show any impediment to performance, however, a party seeking to excuse its performance due to frustration of purpose must show: (1) a total or near total destruction of the primary object of the agreement; (2) that both parties understood that the transaction would make little sense without the object; (3) the frustration cannot fairly be regarded as a risk that the party assumed under the contract; and (4) the nonoccurrence of the frustrating event must have been a basic assumption on which the contract was made.

Section 265 of the Restatement (Second) of Contracts articulates the standard as:

> Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.

In Federal Trade Commission v. A.S. Research LLC, the U.S. District Court for the District of Colorado recently rejected a frustration-of-purpose defense raised by several parties to a settlement agreement reached with the FTC prior to the pandemic, holding that there was no evidence that

COVID-19 had defeated the parties' mutually understood purpose of the contract.[3]

The defendants in the case argued that because one of them (A.S. Research) would likely no longer be able to continue its business operations, "COVID-19 has resulted in the parties' objectives being impossible to meet." The court, however, found that the defendants had not shown that keeping A.S. Research in business was the sole or predominate purpose of the agreement, as understood by all of the parties, and that the "changed economic circumstances" caused by the pandemic were insufficient to establish a frustration-of-purpose defense.

These decisions illustrate some of the challenges associated with establishing contract defenses based on force majeure, impossibility and frustration of purpose, even for a development as momentous and unexpected as the current pandemic. Nonetheless, businesses should continue to evaluate the possible applicability of these and other contract defenses to their existing agreements based on the still-evolving effects of COVID-19.

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[1] Future Street Limited v. Big Belly Solar, LLC , 2020 WL 4431764 (D. Mass. July 31, 2020).

[2] Martorella v. Rapp , 2020 WL 2844693 (Mass. Land Ct., June 1, 2020).

[3] Federal Trade Commission v. A.S. Research, LLC, et al. , 2020 WL 4193507 (D. Col. July 21, 2020).
