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CLIENT ALERT

Business Disruption and Commercial Contracts (Part 3): Does The Law Of Impossibility Or Frustration Excuse Performance?

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In responding to a business disruption caused by the COVID-19 pandemic, it is not enough to read and rely on the language of the contract. You will also need to consider the law governing contract interpretation and commercial relationships. The relevant law may excuse non-performance even without a force majeure clause, and will certainly affect the interpretation of the force majeure clause.

1. What excuses for non-performance are recognized by the law governing the contract?

All jurisdictions will interpret and decide on the application of a force majeure clause if one exists. In the absence of a force majeure clause, there are default rules in most jurisdictions that may excuse a party's non-performance. The doctrine of impossibility should be considered when an outside event makes performance impossible or impracticable. The doctrine of frustration of purpose should be considered when changed circumstances make performance radically different from what the parties contemplated when entering the contract.

Almost all jurisdictions recognize some version of the doctrine of impossibility. The doctrine typically applies to excuse nonperformance if the non-performing party can establish that: (1) an unexpected intervening event occurred; (2) the parties' agreement assumed such an event would not occur; and (3) the unexpected event made contractual performance impossible. For example, if the government orders that a company's factories be used to manufacture products needed for fighting the pandemic, such as respirators or ventilators, the company's non-performance of other production contracts may be excused due to impossibility. Notably, absent other factors, increased difficulty or expense in performing the contract will likely not make it impossible to perform. In addition, the doctrine of impossibility likely will not excuse monetary obligations under the contract.

Many jurisdictions also recognize the doctrine of frustration of purpose. Frustration of purpose may be invoked when the fundamental reason for the contract has been frustrated by an unanticipated event beyond the control of the parties. Both parties must have been aware of the purpose of the contract, and the purpose must be so essential to the contract that without it the transaction would make little sense. The frustration must be near total and must significantly change the nature of the outstanding contractual rights or obligations. Thus, for example, contracts which were premised on some event, like a concert, festival, or sporting event, which has since been cancelled, may be subject to frustration defenses for non-performance.

The doctrines of impossibility and frustration are reflected in the Uniform Commercial Code (U.C.C.). The U.C.C. applies in some form to commercial contracts in many U.S. jurisdictions. The U.C.C. provision on "Excuse by Failure of Presupposed Conditions" (Art. 2-615) provides that:

> Delay in delivery or non-delivery in whole or in part by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence

of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

As the use of the word "impracticable" indicates, the standard in the U.C.C. is less stringent than strict impossibility. Even under this less stringent standard, decisions excusing performance based only on changed costs or other economic circumstances are very rare.

2. Are these other excuses relevant if there is a force majeure clause?

The inclusion of an express force majeure clause in a contract may preclude separate reliance on the jurisdiction's default rule about impossibility or impracticality on the basis that the parties have contracted around that doctrine. A frustration defense may, however, still be available.

But even if the default rules about impossibility or frustration do not apply directly, they may inform the interpretation of a force majeure clause. Unless the force majeure clause specifically states otherwise, a court interpreting the clause may apply the same standards for foreseeability, causation, inability to perform, and other questions to the interpretation of the clause as it would to deciding a defense of impossibility in the relevant jurisdiction.

3. How do excuses for non-performance vary from jurisdiction to jurisdiction?

Most jurisdictions, including many foreign jurisdictions, recognize some version or force majeure and the related doctrines of impossibility or frustration, but every jurisdiction will have its own nuances. One-size-fits-all advice is therefore impossible, and jurisdictions can expand or construe more narrowly recognition of the doctrines of impossibility and frustration of purpose.

Any response to a business disruption should be informed by careful consideration of both the contract and the relevant governing law. In almost all instances, however, there will be certain concrete actions you should consider taking in order to protect your rights, as discussed here.

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