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Business Litigation Alert

Force Majeure and Other Potential Defenses for Parties in Breach Due to The COVID-19 Pandemic

The historic COVID-19 pandemic and related governmental orders have created adverse economic consequences for many businesses. Across the country (and the globe for that matter), many businesses are now unable to meet their contractual obligations. Under certain circumstances, the law may excuse a party from performing its contractual obligations. This Alert provides a brief overview of potential legal defenses to breach of contract claims.

Force Majeure Provision in Contract

Does the contract contain a *force majeure* clause? A *force majeure* clause is a provision in a contract that excuses the parties thereto for nonperformance of their contractual obligations caused by a series of enumerated unforeseeable events beyond the parties' control. If there is a *force majeure* clause in the contract, the next question is: does the *force majeure* clause cover the particular circumstance causing nonperformance? Parties may (and often do) use boilerplate provisions that enumerate a litany of events that excuse nonperformance. One such example is:

> *Each party shall be excused from liability for the failure or delay in performance of any obligation under this Agreement by reason of any event beyond such party's reasonable control including but not limited to Acts of God, pandemic, epidemic, fire, flood, explosion,*

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earthquake, or other natural forces, war, civil unrest, accident, any strike or labor disturbance, or any other event similar to those enumerated above.

However, parties may also limit excusable *force majeure* events to very specific instances. In such a case, the courts have held that because the parties specifically tailored their *force majeure* clause to apply only in very specific circumstances, the nonperforming party could not be excused from nonperformance even for reasons excusable at common law.

It is important to understand that *force majeure* clauses, as with any contractual provision, must always be interpreted in accordance with their language and context. Thus, where a variety of events are listed within a *force majeure* clause, a court may reject a *force majeure* defense where an unenumerated event was the cause of non-performance and a court determines that the parties implicitly intended that the nonperforming party take on the risk of the unenumerated event occurring. Conversely, where the parties clearly intended to excuse nonperformance for a specified event and that event occurs, courts will accept the *force majeure* defense.

A key determination when considering this issue vis-à-vis COVID-19 is what event specifically caused nonperformance. The virus itself may not have been the cause of the nonperformance unless the individuals charged with performance contracted the virus and suffered symptoms severe enough to render performance impossible. Rather, the economic and/or governmental response to the virus' outbreak was most likely the cause. While perhaps pedantic, this distinction is potentially very important where *force majeure* clauses are silent on the circumstance giving rise to nonperformance—in this case, a pandemic (or 'disease' or 'epidemic'). Accordingly, if a *force majeure* clause excuses nonperformance when governmental regulations render performance impossible, but not serious illness or disease, a party may not be excused if the government regulation did not cover the contract at issue and nonperformance was caused by employees essential to performance taking ill.

Even if a *force majeure* provision is applicable, the nonperforming party must still adhere to its other implicit contractual duties, including its obligation to mitigate damages, to act in good faith, and use best efforts, and it must comply with any notice provisions contained in the agreement. Thus, even where a party can establish that its *force majeure* clause covers a particular event, a court may still reject a *force majeure* defense if it would be inequitable to do so or if the party failed to meet other contractual duties within its control.

No *Force Majeure* Provision

If there is no *force majeure* provision in a contract, and the contract is not for the sale of goods, there may be still be a defense to a breach of contract claim under the common law doctrine of impossibility. The defense of impossibility excuses performance under an agreement when it would be impossible, or in some cases unreasonably costly, for a party to carry out its contractual obligations. In evaluating an impossibility defense, courts determine to whom the parties would have assigned the risk of

nonperformance if the parties had foreseen the possibility the excusing event could occur at the time of contracting. If the court determines that the parties would have assigned that risk to the non-breaching party, then the impossibility defense succeeds and the nonperforming party is not liable for breach of contract.

To raise a defense for impossibility in Illinois, a nonperforming party must show: (1) the circumstances creating the impossibility were not and could not have been anticipated by the parties; (2) the party asserting the doctrine did not contribute to the circumstances; and (3) that it has tried all practical alternatives available to permit performance. The doctrine of impossibility of performance will be applied if there is an unanticipated circumstance that has made the performance of the promise vitally different from what should reasonably have been within the contemplation of the parties when the contract was entered.

This doctrine is narrowly applied due in part to judicial recognition that the purpose of contract law is to allocate the risks that might affect performance and that performance should be excused only in extreme circumstances. Two examples will illustrate how the courts have applied the impossibility defense.

In *YPI 180 N. LaSalle Owner, LLC v. 180 N. LaSalle II, LLC*, 403 Ill. App. 3d 1, 6 (1st Dist. 2010), the court held that the 2008 financial crisis did not render performance impossible even though performance depended on securing financing because it was foreseeable at the time of contracting that the nonperforming party might fail to secure financing notwithstanding the 2008 crisis. Similarly, courts generally hold that the impossibility doctrine never justifies failure to make a payment, because financial distress differs from impossibility.

However, in *Parker v. Arthur Murray, Inc.*, 10 Ill. App. 3d 1000 (1st Dist. 1974), the court held that an individual who had prepaid for dance lessons was entitled to a refund after suffering an injury rendering him permanently incapable of dancing. Illness rendering performance impossible has also been held excusable under the impossibility doctrine.

As it concerns pandemics, there is very little case law. Almost a century ago, the Illinois Supreme Court, in *Phelps v. School Dist. No. 109, Wayne County*, 302 Ill. 193 (1922), held that a school district could not raise an impossibility defense in a contract to pay a teacher:

> *Where performance of the contract is rendered impossible by act of God or the public enemy, the district is relieved from liability, but where the school is closed on account of a contagious disease, or destruction of the school building by fire, and the teacher is ready and willing to continue his duties under the contract, no deduction can be made from his salary for the time the school is closed.*

Interestingly, the Illinois Supreme Court in *Phelps* held that a pandemic is not an act of God. It is certain that courts throughout the country will be dealing with this question in the months and years of post-COVID-19 litigation.

The impossibility defense may also be applicable when performance of a contract would be illegal because of a statute, regulation or other official action that has occurred since the contract was signed. Parties need to be mindful of whether performance could be achieved notwithstanding the current hardships. For example, if an Illinois business is deemed "essential" under the Governor's executive order, it may be obligated to perform.

Whether the impossibility doctrine will apply will depend heavily on the facts. It will be important to pinpoint exactly what caused nonperformance—e.g., illness, government regulation -- as the cause of nonperformance will be critical to the court's analysis of which party should bear the risk that a virus outbreak would occur.

Contract for the Sale of Goods

If a contract concerns the sale of goods, then the Uniform Commercial Code governs. In Illinois, Section 5/2-615 of the UCC provides that, in the absence of contradictory contractual language, a seller who fails to deliver goods (timely or at all) in whole or in part is not in breach 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."

Under the UCC, three conditions must exist for a nonperforming party to be excused under the contract: (1) a contingency must occur, (2) performance must thereby be made 'impracticable' and (3) the nonoccurrence of the contingency must have been a basic assumption on which the contract was made. The third condition turns upon whether the contingency was foreseeable, i.e., if the risk of the occurrence of the contingency was unforeseeable, the seller cannot be said to have assumed the risk. If the risk of the occurrence of the contingency was foreseeable, that risk is tacitly assigned to the seller. However, even if the cause of increased cost was caused by events unforeseeable by the parties at the time of contracting, increased cost does not usually constitute impracticability under section 2–615. Whether the COVID-19 pandemic, and the government's response to the health crisis, was foreseeable will ultimately need to be decided by the courts.

Other Considerations

Where *force majeure* or impossibility may not apply, other defenses may be available. These include the legal doctrines impracticability or frustration of purpose. Whether these will apply depends on an analysis of the applicable law and facts.

Another aspect of the consequences from a *force majeure* event, such as a pandemic, is consideration of a company's business interruption insurance. These insurance policies should be reviewed to determine any available coverage or exclusions. Several lawsuits have already been filed by business policyholders seeking coverage from their insurers due to COVID-19.

Given the rather unique confluence of circumstances surrounding the coronavirus pandemic, and the significant time and expense involved in litigation, it is almost always advisable to explore opportunities to resolve a dispute before filing a lawsuit or arbitration demand. Any such attempt must be considered in light of the overall terms of the contract, the facts and applicable law. This is good practice in any case (and may be required by applicable court rules or the terms of the contract). It is likely the other party may be dealing with its own challenges to the pandemic *force majeure* event, and may be open to resolving the matter instead of incurring the costs and uncertainties of engaging in a legal dispute.

For current executed business contracts, perhaps now is a good time to re-read and consider the fine print in those contracts, take a look at the *force majeure* provision, if any, and add it to the list of things to discuss with your attorney.

If you have any questions about this Alert, or if you would like assistance in managing and enforcing your contract rights and obligations, please contact the authors listed below or the Aronberg Goldgehn attorney with whom you work.

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