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CALIFORNIA CLIENT ALERT

THE PANDEMIC – LEGAL DEFENSES TO CONTRACTUAL NONPERFORMANCE UNDER CALIFORNIA LAW

This Alert reviews potential legal defenses under California law to contractual nonperformance that might occur due to the novel coronavirus. The doctrines of *force majeure*, impossibility/impracticability, and frustration of purpose might afford a defense to the nonperforming party, and California law tends to support a relatively broader application of those doctrines than the law of some other jurisdictions. In any event, companies should carefully evaluate their contracts to determine whether they include *force majeure* provisions and the scope of those provisions, as well as options to mitigate the impact of nonperformance.

WHEN A CONTRACT HAS A *FORCE MAJEURE* PROVISION

Force majeure, Latin for "superior force," is a legal doctrine that excuses nonperformance due to extraordinary circumstances beyond the control and contemplation of the parties. The California Supreme Court has held that "[t]he test is whether under the particular circumstances there was such an insuperable interference occurring without the party's intervention as could not have been prevented by the exercise of prudence[,] diligence and care."[1]

In California, the doctrine is codified in several statutes, although the term "*force majeure*" is not used. For example, California Civil Code, § 1511, entitled "Causes excusing performance," provides:

> The want of performance of an obligation, or of an offer of performance, in whole or in part, or any delay therein, is excused by the following causes, to the extent to which they operate: … 2. When it is prevented or delayed by an irresistible, superhuman cause, or by the act of public enemies of this state or of the United States, unless the parties have expressly agreed to the contrary… .[2]

Many contracts contain express *force majeure* provisions. Commonly enumerated circumstances include (i) acts of God (weather disasters, fires); (ii) war; (iii) terrorism and civil disorder; (iv) acts of governmental authorities such as expropriation, condemnation, and changes in laws and regulations; (v) strikes and labor disputes; and (vi) curtailment of transportation

[1] *Pac. Veg. Oil Corp. v. C. S. T., Ltd.*, 174 P.2d 441, 447 (Cal. 1947).

[2] *See also* the following two maxims of jurisprudence: "The law never requires impossibilities," and "No man is responsible for that which no man can control." Cal. C. Code §§ 3531 ("Impossibilities"), 3526 ("Responsibility for unavoidable occurrences").

facilities.[3] Some *force majeure* provisions include epidemics and pandemics.[4] Some include a "catch-all" provision excusing performance due to "any other emergency beyond the parties' control, making it inadvisable, illegal, or impossible to perform their obligations under this Agreement," or similar language.[5]

Because a "*force majeure* clause is not intended to buffer a party against the normal risks of a contract,"[6] and applying the doctrine might deprive the promisee of the benefit of its bargain, courts tend to read *force majeure* provisions narrowly.[7] Consistent with that, the party asserting *force majeure* must demonstrate not only that one of the listed events has occurred, but also that (i) the risk of nonperformance was unforeseeable by the parties[8] and could not have been mitigated against,[9] and (ii) the triggering event has rendered performance "impossible."

Applying these requirements against the current backdrop, the first step is to determine whether a contractual *force majeure* provision covers a pandemic. A provision might directly reference epidemics or pandemics, or it might do so indirectly by referencing acts of governmental authorities in response to a pandemic, including changes in laws and regulations. Whether recent governmental orders closing non-essential businesses and mandating social distancing are "acts of governmental authorities" sufficient to support *force majeure* remains to be decided. In light of the narrow reading courts give these provisions, the "catchall language" may not be sufficient to support the doctrine's application. But given the pandemic's pervasiveness, a court

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[3] 30 Williston on Contracts § 77:31 (4th ed.) ("Williston").

[4] As concerns about the novel coronavirus began to increase earlier this year, lawyers began inserting into merger and acquisition agreements express language excepting pandemics from *force majeure* provisions. *See* James B. Stewart, "The Victoria's Secret Contract that Anticipated a Pandemic," *N.Y. Times* (Apr. 29, 2020) (noting that the language was at issue in *L Brands v. SP VS Buyer*, No. 2020-0304 (Del. Ch.)).

[5] Williston § 77:31.

[6] *Horsemen's Benev. & Protective Ass'n v. Valley Racing Ass'n*, 6 Cal. Rptr. 2d 698, 713 (Ct. App., 4th Dist., 1992).

[7] *See, e.g.*, *Watson Labs., Inc. v. Rhone-Poulenc Rorer, Inc.*, 178 F. Supp. 2d 1099, 1113 (C.D. Cal. 2001) (provision excusing non-performance due to "regulatory, governmental … action" was too "vague and boilerplate" to excuse drug supplier's failure to supply drugs after the FDA closed its plant).

[8] *See, e.g.*, *Aristocrat Highway Displays v. Stricklen*, 157 P.2d 880, 881 (Ct. App., 4th Dist., 1945) (performance not excused despite cost-increase due to war; the parties entered into the contract less than two months before war broke out and "we must conclude that the parties … contracted with the danger of war a foreseeable event and should have provided for it in their contract or be subject to the inference that the risk of war was assumed"); *Watson Labs.*, 178 F. Supp. 2d at 1111 (holding that "contractual *force majeure* provisions which are silent on the issue of whether the excusing event must be unforeseeable should be construed to require unforeseeability").

[9] *See, e.g.*, *Oosten v. Hay Haulers Dairy Emp. & Helpers Union*, 291 P.2d 17, 21 (Cal. 1955) (party seeking to invoke *force majeure* provision must show that "in spite of skill, diligence and good faith on his part, performance became impossible"); *Watson Labs.*, 178 F. Supp. 2d at 1111 ("California law requires (not 'permits') that each event claimed to be a '*force majeure*' be beyond the control of the breaching party."); *Mobil Oil Corp. v. S. Cal. Edison Co.*, No. B145834, 2003 WL 147770, at *10 (App. Ct., 2d Dist., Jan. 21, 2003) (declining to excuse nonperformance resulting from a massive power outage because the defendant power company could have taken a number of actions to prevent or minimize the effects on the plaintiff: "a contracting party must exercise reasonable diligence in taking steps to ensure performance and to prevent an event from occurring").

conceivably could view the crisis as an "emergency beyond the parties' control," and deem the language applicable.

If the *force majeure* provision addresses the current circumstances, the next step is to determine whether, at the time of contracting, the parties could have foreseen the risk that a virus would impair one party's ability to fulfill its obligations. If the risk was unforeseeable at that time, then the party seeking to invoke the doctrine must demonstrate that it took steps to mitigate that risk. That is largely a fact-intensive inquiry. Depending on the nature of the business, relevant questions could include whether the business had and made use of alternative supply lines or created and/or implemented a plan to continue operations in the event of an emergency.

As a practical matter, parties to contracts with an applicable *force majeure* provision should be mindful of the duty to mitigate, and should proactively consider, and take reasonable steps to assure, continued operations and their continued ability to fulfill their contractual obligations. To assist in proving that they met the mitigation requirement, those parties also should maintain a record of the steps they considered taking and why they did or did not take those steps.

The final element of *force majeure*, impossibility, overlaps with other common law defenses to nonperformance. The requirements for successfully asserting impossibility, whether as part of a *force majeure* defense or as a stand-alone defense, are addressed in the next section.

WHEN A CONTRACT HAS NO *FORCE MAJEURE*, OR NO APPLICABLE *FORCE MAJEURE*, PROVISION

Parties seeking to excuse nonperformance under a contract that does not contain a *force majeure* provision (or an applicable *force majeure* provision) might try to assert the common law doctrines of impossibility and frustration of purpose. The requirements for invoking those doctrines are similar, and similarly stringent, to the requirements for invoking *force majeure*.[10]

Impossibility/Impracticability

To invoke impossibility or impracticability, a party must show that the situation was unforeseeable[11] and rendered performance impossible. While some states require that performance be "objectively impossible,"[12] California requires that performance be "impracticable," a somewhat lower standard:

> A thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost.

[10] One court has stated that "'[f]orce majeure' is the equivalent of the common law contract defense of impossibility." *Citizens of Humanity, LLC v. Caitac Int'l, Inc.*, No. B215232, 2010 WL 3007771, at *14 (Ct. App., 2d Dist., Aug. 3, 2010).

[11] *Caron v. Andrew*, 284 P.2d 544, 547 (Cal. 1955).

[12] *See, e.g., Kel Kim Corp. v. Cent. Markets, Inc.*, 519 N.E.2d 295, 296 (N.Y. 1987). ("Impossibility excuses a party's performance only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible.").

Mineral Park Land Co. v. Howard, 156 P. 458, 460 (Cal. 1916). What constitutes sufficient excessive and unreasonable cost depends on the facts of the case, but merely *some* increased cost or *some* added burden is insufficient. In *Mineral Park Land*, the California Supreme Court held that the defendants were excused from performing their contract to take gravel because the gravel was under water and the cost would be ten or twelve times more than if the gravel were on dry land:

> We do not mean to intimate that the defendants could excuse themselves by showing the existence of conditions which would make the performance of their obligation more expensive than they had anticipated, or which would entail a loss upon them. But, where the difference in cost is so great as here, and has the effect, as found, of making performance impracticable, the situation is not different from that of a total absence of earth and gravel.

Id. The court concluded that a ten- to twelve-fold cost increase meant "it was impossible for defendants to take [the gravel]." *Id*.[13]

Notwithstanding the general requirement of a substantial and excessive increase in cost or burden, courts have excused contractual performance in circumstances that might seem less than burdensome. For example, when Gene Autry's motion picture contract was adversely affected by the diminution in the value of dollar due to World War II, the California Supreme Court held that it would be impracticable for him to continue to perform under the contract if his compensation would be at the same pre-war pay rate. *See Autry v. Republic Productions, Inc.*, 180 P.2d 888, 894 (Cal. 1947). Courts have found impossibility/impracticability even when the allegedly unforeseeable event would likely lead to a substantially less profitable outcome (or to a loss), as opposed to substantially increased costs.[14] By contrast, in New York, financial hardship resulting from unforeseeable events will not suffice to excuse contractual performance, regardless of the degree of the hardship.[15]

Frustration of Purpose

[13] California caselaw construing "impossibility" is consistent with the Restatement (Second) of Contracts, which provides that a party's duty to perform may be deemed "impracticable," and thus excused, when "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." Restatement (Second) of Contracts § 261 (2019). "Impracticable" is a slightly lower standard than "impossible." *Id.* § 261 cmt. d. ("Although the rule stated in this Section is sometimes phrased in terms of "impossibility," it has long been recognized that it may operate to discharge a party's duty even though the event has not made performance absolutely impossible.").

[14] *See, e.g.*, *Schmeltzer v. Gregory*, 72 Cal. Rptr. 194 (Ct. App., 5th Dist., 1968) (allowing for potential use of impossibility defense when questionable availability of capital meant likely inability to make a profit); *Praxis Dev. Grp., Inc. v. Richman, Lawrence, Greene & Chizever*, No. A104874, 2005 WL 1607784, at *8 (Ct. App., 1st Dist., July 8, 2005) (excusing performance under land development deal because the parties had assumed, incorrectly, that a freeway interchange would be constructed near the property: "[T]he agreement as contemplated by Specialty and Praxis became impossible to perform or impractical because success of the project depended upon this condition.").

[15] *See, e.g.*, *Urban Archaeology Ltd. v. 207 E. 57th St. LLC*, 891 N.Y.S.2d 63, 64 (App. Div., 1st Dep't, 2009); *Gen. Elec. Co. v. Metal Resources Grp., Ltd.*, 741 N.Y.S.2d 218 (App. Div., 1st Dep't, 2002)

June 11, 2020

The doctrine of frustration of purpose is concerned with the consideration for performance. The doctrine is invoked when an unforeseen event causes a failure of the consideration or a practically total destruction of the expected value of the performance, even though performance remains possible.[16] As with the other doctrines considered here, mere economic hardship is insufficient.[17]

Courts traditionally have applied the frustration of purpose doctrine in three circumstances: supervening death or incapacity of a person necessary for performance; supervening destruction of a specific thing necessary for performance; and supervening prohibition or prevention by law.[18] In *Habitat for Trust for Wildlife v. Rancho Cucamonga*, for example, the court permitted a developer to rescind its contract to convey land to a non-profit land trust. The purpose of that contract was to mitigate the environmental impact of a development planned by the developer. But the city failed to approve the trust as a qualified conservation entity to receive the land. That, the court held, resulted in a failure of material consideration to the developer. *See* 96 Cal. Rptr. 3d 813, 843 (Ct. App., 2d Dist., 2009).

CONCLUSION

California law arguably takes a broader approach than the law in other jurisdictions to *force majeure* and similar doctrines excusing nonperformance. This suggests that courts applying California law might be more receptive to pandemic-related claims of contractual nonperformance. Given the coronavirus's severity and pervasiveness, and the fact that the scale of economic upheaval is unlike anything most Americans, including judges, have ever seen, courts applying California law might consider the doctrines' restrictive precedents more skeptically, and more favorably for those seeking to invoke them.

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[16] *Lloyd v. Murphy*, 153 P.2d 47, 53-54 (Cal. 1944).

[17] *Lloyd*, 153 P.2d at 54; *Glen Falls Indem. Co. v. Perscallo*, 216 P.2d 567, 569 (Ct. App., 2d Dist., 1950) ("Mere difficulty, or unusual or unexpected expense does not establish frustration").

[18] Restatement (Second) of Contracts § 261 (2019).