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## Contracts, Quarantines, and COVID-19: The Coronavirus Outbreak's Impact on Contractual Obligations

In the span of a few short months, the coronavirus (COVID-19) outbreak has had a global impact. Earlier this year, the World Health Organization declared the COVID-19 outbreak a Public Health Emergency of International Concern.<sup>1</sup> In late January, the China Council for the Promotion of International Trade (CCPIT) began issuing thousands of force majeure certificates to shield companies from damages arising from the COVID-19 outbreak.<sup>2</sup>

In response to the outbreak, the U.S. federal government limited travel and declared a state of national emergency.<sup>3</sup> To combat the spread of the virus, an increasing number of states, including California and New York, and municipalities have enacted “Safer at Home” orders requiring the public remain in their homes except to engage in essential activities and forcing closure of a wide range of businesses nationwide.<sup>4</sup>

With the coronavirus pandemic impacting companies of every size, force majeure clauses are more important than ever. This article discusses force majeure clauses and whether parties to a contract may invoke COVID-19, the government responses to stop the spread of the virus, or the slowdown or stoppage of the supply chain as force majeure events that excuse contractual performance.

### What is a Force Majeure?

A force majeure, or “superior force,” is an event that prevents a party from fulfilling its contractual obligations.<sup>5</sup> A force majeure does not have to be an act of God; it can be a natural occurrence (e.g., Hurricane Sandy, the Ebola virus) or the result of human intervention (e.g., labor disputes or terrorist attacks) so long as the event itself could not have been anticipated or

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<sup>1</sup> Coronavirus Disease (COVID-19) - events as they happen, WORLD HEALTH ORG. , <https://www.who.int/emergencies/diseases/novel-coronavirus-2019/events-as-they-happen> (last visited Mar. 24, 2020).

<sup>2</sup> Huileng Tan, *China Invokes 'Force Majeure' to Protect Businesses-but the Companies May Be in for a 'Rude Awakening,'* CNBC (last update Mar. 6, 2020, 5:53 AM), <https://www.chinadaily.com.cn/a/202002/17/WS5e4a38eaa31012821727818d.html>.

<sup>3</sup> Charlie Savage, *Trump Declared an Emergency Over Coronavirus. Here's What It Can Do.*, N.Y. TIMES (Mar. 13, 2020), <https://www.nytimes.com/2020/03/13/us/politics/coronavirus-national-emergency.html>.

<sup>4</sup> See Zack Burdyk, *States Urge Citizens to Stay at Home, Businesses to Suspend In-Person Operations*, THE HILL (Mar. 23, 2020, 11:25 AM), <https://thehill.com/homenews/state-watch/489003-states-urge-citizens-to-stay-at-home-businesses-to-suspend-in-person>.

<sup>5</sup> Force Majeure Definition, *Black's Law Dictionary* (11th ed. 2019), available at Westlaw.

controlled by the parties to a contract.<sup>6</sup> The event itself must also impact the parties' ability to perform under the contract.

To determine whether an event qualifies as a force majeure that excuses contractual performance, California courts look to "whether under the particular circumstances there is such an insuperable interference occurring without the party's intervention as could not have been prevented by prudence, diligence, and care."<sup>7</sup> A mere increase in expense or inconvenience does not qualify as a force majeure unless there is "extreme and unreasonable difficulty, expense, injury, or loss involved."<sup>8</sup>

## **Force Majeure Clauses of a Contract Are Controlling**

Some contracts include an explicit force majeure clause. Under those circumstances, the language of the clause controls the parties' obligations to one another. A force majeure clause in a contract allows the parties to mitigate the negative effects of a force majeure event. With force majeure clauses, parties can allocate risks by defining the circumstances in which performance may be excused, and their obligations in the event of a force majeure.<sup>9</sup>

Force Majeure clauses typically identify the events that may constitute events of force majeure. These events may include, but are not limited to, natural disasters, government action, strikes or slow-downs, or epidemics. If an event specified in the force majeure clause occurs, the impacted party is excused from performance.<sup>10</sup> The more extensive the list of qualifying events, the less likely that a court will enforce a non-listed event as a force majeure. Recent California decisions also suggest that if a contract does not explicitly identify an event as a force majeure, the event must be unforeseeable at the time of the contract to qualify as a force majeure.<sup>11</sup> Furthermore, California courts require that the party invoking a force majeure clause show "that, in spite of skill, diligence and good faith on his part, performance became impossible or unreasonably expensive."<sup>12</sup>

Parties might include catch-all language such as "acts beyond their reasonable control" or the phrases "including," "including, without limitation," and "including, but not limited to" in their force majeure clauses to capture events that are not explicitly listed in the force majeure clause. However, catch-all language, no matter how broad, might not be enough to cover known risks or excuse performance under the contract. California courts favor a narrow construction of force majeure language and are likely to find that boilerplate language does not extend to events not specified in the contract.<sup>13</sup> Moreover, interpretation of force majeure clauses is dependent on applicable state and federal law. Certain courts might read catch-all language as only capturing unlisted events similar to those enumerated in the force majeure

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<sup>6</sup> *Id.*; see also Aaron Nicodemus, *Can 'Force Majeure' Save Your Company from the Coronavirus?*, COMPLIANCE WEEK (Mar. 5, 2020, 6:52 AM), <https://www.complianceweek.com/risk-management/can-force-majeure-save-your-company-from-the-coronavirus/28562.article>.

<sup>7</sup> *Pac. Vegetable Oil Corp. v. C.S.T., Ltd.*, 29 Cal 2d. 228, 237 (1946).

<sup>8</sup> *Butler v. Nepple*, 54 Cal. 2d 589, 599 (1960).

<sup>9</sup> Force Majeure Clauses: Key Issues (CA), Practical Law Practice Note w-016-3797.

<sup>10</sup> See *San Mateo Comm. College Dist. v. Half Moon Bay Ltd. P'ship*, 65 Cal. App. 4th 401, 413 (1998).

<sup>11</sup> *Free Range Content, Inc. v. Google, Inc.*, 2016 WL 2902332, at \*6 (N.D. Cal., May 13, 2016) (citation omitted).

<sup>12</sup> See *Jin Rui Group, Inc. v. Societe Kamel Bekdache & Fils S.A.L.*, 621 Fed. Appx. 511 (9th Cir. 2015) (citation omitted).

<sup>13</sup> See *Watson Labs., Inc. v. Rhone-Poulenc Rorer, Inc.*, 178 f. Supp. 2d 1099, 1113 (C.D. Cal. 2001) (force majeure clause language related to "regulatory, governmental . . . action" could not be reasonably construed to excuse performance).

clause.<sup>14</sup> Others might interpret “acts beyond their reasonable control” or other broad language as only including events that are dissimilar to those already in the contract.

It is worth noting that parties may also contract to exclude certain events, such as an economic downturn or more expensive performance, will not excuse performance under the contract.<sup>15</sup>

## **What If My Contract Does Not Have a Force Majeure Clause?**

In the absence of a force majeure clause, parties to a contract might invoke the common law doctrines of impossibility, frustration of purpose, or impracticability to suspend performance of a contract or completely excuse performance impacted by what would otherwise be considered a force majeure event.

To successfully assert the impossibility defense, the impacted party’s performance must be objectively impossible, not merely inconvenient.<sup>16</sup> Despite this objective impossibility standard, California courts have held that temporary impossibility of indefinite duration may justify termination of the contract. Otherwise, the duty to perform is suspended only while the impossibility exists. For example, the California Supreme Court found that the plaintiff in *Autry v. Republic Prods.* was not under a duty to perform under an acting contract following his discharge from the military given the economic changes following World War II.<sup>17</sup>

Under the frustration of purpose doctrine, performance may be excused if performance is possible, but the basic assumption underlying the contract has been destroyed by a “supervening and unforeseen event.”<sup>18</sup> The source of the frustration must be unforeseeable. If the possibility of the frustrating event (e.g., governmental regulation) is reasonably foreseeable, then there is no frustration of the contract because of that event.<sup>19</sup>

The doctrine of impracticability discharges a party’s contractual obligations if “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.”<sup>20</sup> California courts look to the facts of a given case to determine whether impossibility or frustration excuses a party’s performance.<sup>21</sup>

California has codified the doctrines of frustration of purpose and impracticability. Under Cal. Civ. Code § 1511, contractual performance may be excused when it is delayed or prevented by the operation of law an irresistible superhuman cause.<sup>22</sup> In addition, California’s commercial code provides that delay or non-delivery of goods is not a breach of contract if performance is made impracticable by: (1) unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting; or (2) compliance in good faith with

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<sup>14</sup> See *Sears, Roebuck & Co. v. San Diego County Dist. Council of Carpenters*, 25 Cal. 3d 317, 331 n. 10 (1979) (“[W]here general words follow the enumeration of particular classes of persons or things, the general words will be construed as applicable only to persons or things of the same general nature of class as those enumerated.”).

<sup>15</sup> See Force Majeure Clauses: Key Issues (CA), Practical Law Practice Note w-016-3797.

<sup>16</sup> See CAL. CIV. CODE § 1597; *Peterson v. Hubbard*, 2 Cal. Unrep. 607, 608 (1885).

<sup>17</sup> See *Autry v. Republic Prods.*, 30 Cal. 2d 144, 149 (1947).

<sup>18</sup> *Dorn v. Goetz*, 85 Cal. App. 2d 407, 410 (1948).

<sup>19</sup> See *Glen Falls Indem. Co. v. Perscallo*, 96 Cal. App. 2d 799, 802 (1950).

<sup>20</sup> Restatement (Second) of Contracts § 261 (1981).

<sup>21</sup> *Glen Falls Indem. Co.* at 802 .

<sup>22</sup> CAL. CIV. CODE § 1511.

a governmental regulation or order, such as the “Stay at Home” order recently enacted by Gavin Newsom.<sup>23</sup>

## Does COVID-19 Excuse Performance?

**The short answer is “It depends.”** The COVID-19 outbreak, along with government orders enacted to stop the spread of the virus, may potentially qualify as force majeure events or otherwise suspend contractual obligations or excuse performance.

There is precedent for finding that the global outbreak of a highly contagious and deadly disease might constitute an event of force majeure. The federal case, *Rexing Quality Eggs v. Rembrandt Enterprises, Inc.*, held that the 2015 avian flu outbreak may qualify as a force majeure event that would potentially excuse performance of a cage-free egg supply contract.<sup>24</sup> However, California courts have yet to rule as to whether other pandemics, such as the coronavirus, qualify as force majeure events. Even if COVID-19 were to qualify as a force majeure event in some instances, it may not suspend or excuse performance of contractual obligations in every instance.

Under certain circumstances, parties may be able to argue that the outbreak, which has an estimated morbidity of 1% and is highly contagious, itself qualifies as an event of force majeure. The CDC defines an epidemic as “an increase, often sudden, in the number of cases of a disease above what is normally expected in that population in that area” while a pandemic is described as an “epidemic that has spread over several countries or continents, usually affecting a large number of people.”<sup>25</sup> Given their interrelated definitions, force majeure provisions allocating for the risks of an epidemic may serve to suspend or terminate contractual obligations impacted by the coronavirus pandemic. Parties attempting to suspend or terminate their contractual obligations may argue that the COVID-19 pandemic qualifies as a force majeure event under catch-all force majeure provisions covering “acts of God.” Under California law, “no man is responsible for that which no man can control” and acts of God that may suspend or terminate contractual obligations include natural phenomena, such as the outbreaks of disease, which operate independently of human intervention.<sup>26</sup>

Even though COVID-19 may qualify as a force majeure event, it may not excuse or delay performance under a contract unless the pandemic itself impacts performance. A party whose contract requires in-person performance may be able to suspend or terminate their contractual obligations if they are diagnosed with coronavirus. However, where the virus itself does not prevent performance of the contract, parties likely cannot invoke COVID-19 as a basis for excusing or suspending their contractual obligations.

Separately, parties seeking to avoid performance of contracts might argue that governmental orders in response to the COVID-19 pandemic, including “Safer at Home” orders and travel restrictions, qualify as force majeure events or otherwise excuse contractual

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<sup>23</sup> CAL. COM. CODE § 2615 (a).

<sup>24</sup> *Rexing Quality Eggs v. Rembrandt Enterprises, Inc.*, 360 F. Supp. 3d 817, 841 (S.D. Ind. 2018) (“Unlike the avian flu example, which may plausibly constitute an unforeseeable event precipitating a dramatic change in market conditions, a change in purchaser demand—even a substantial change— is a foreseeable part of doing business.”).

<sup>25</sup> *Lesson 1: Introduction to Epidemiology, Section 11: Epidemic Diseases*, CTRS. FOR DISEASE CONTROL AND PREVENTION, <https://www.cdc.gov/csels/dsepd/ss1978/lesson1/section11.html> (last visited Mar. 24, 2020).

<sup>26</sup> CAL. CIV. CODE § 3526; see also *Conlin v. Coyne*, 19 Cal. App. 2d 78, 87 (1937).

performance. There is case law to support such an argument. In *Autry v. Prods.*, the California Supreme Court found that extraordinary circumstances arising from the entry of the United States into World War II transformed temporary impossibility to perform into impracticability which excused contractual performance.<sup>27</sup> Based on this precedent, impacted parties might argue that federal, state, and local orders related to the COVID-19 outbreak, especially given the uncertainty as to when those protective measures will end, may excuse performance or justify suspension of existing contracts. However, *Autry* stands in contrast to the more recent case, *Watson Labs., Inc. v. Rhone-Poulenc Rorer, Inc.*, where a California District Court found that an FDA shutdown of a pharmaceutical manufacturing facility did not qualify as a force majeure event as it was foreseeable when the parties entered the contract and such regulatory action was not included in the contract's force majeure clause.<sup>28</sup>

The nature of the government orders impacting the delay also inform the courts' analysis in determining whether force majeure clauses apply. For example, the Court in *Indus. Dev. & Land Co. v. Goldschmidt* found that a lease for premises to be used specifically as a liquor store was inoperative as a result of Prohibition based on the restrictive clauses in the lease.<sup>29</sup> In light of current government action, courts are more likely to find that a mandatory order prohibiting certain business activity, which prevents performance of a contract, would qualify as a force majeure event or otherwise terminate performance obligations under the doctrines of impossibility and impracticability. In contrast, mere recommendations by federal, state, or local governments to socially distance or avoid public spaces may not be sufficient to excuse performance, even if those guidelines result in increased expense to the parties involved.<sup>30</sup>

Whether obligations to perform are suspended or excused will also depend on the nature of the business involved in the contract. State and municipal stay at home orders have mandated the closure of all "non-essential" businesses, including, but not limited to, movie theaters, gyms, and certain retail businesses. Other businesses, such as restaurants, continue to stay open, but have been burdened by government measures in response to the COVID-19 outbreak. Despite these restrictions, these essential businesses may face increased difficulty in justifying suspension or excusing performance of their contractual obligations, if they are still able to conduct some normal operations, even if the emergency government measures make performance of the contracts more expensive.<sup>31</sup>

Interruptions in the supply chain due to the COVID-19 outbreak may constitute another basis for delaying or excusing incomplete performance. To excuse performance based on COVID-19, the impacted party would likely need to establish that he or she has made a good faith effort, but performance was otherwise impossible or unreasonably expensive due to compliance with government orders limiting travel or "non-essential" business activities.<sup>32</sup> For instance, if a medical supply contract allowed the supplier to obtain materials from any source, the unavailability of one particular source likely would not qualify as a force majeure event that excuses the supplier's obligations.<sup>33</sup> However, the same supplier may be able to suspend or excuse performance if the supply chain were broken and the supplier could not obtain the necessary materials to perform its contract.

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<sup>27</sup> *Autry v. Republic Prods, Inc.*, 30 Cal. 2d 144, 149 (1947).

<sup>28</sup> *Watson Labs., Inc. v. Rhone-Poluenc Rorer, Inc.*, 178 F. Supp. 2d 1099, 1113 (C.D. Cal. 2001).

<sup>29</sup> *Indus. Dev. & Land Co. v. Goldschmidt*, 56 Cal. App. 507, 509–11, (1922).

<sup>30</sup> *Butler v. Nepple*, 54 Cal. 2d 589, 599 (1960).

<sup>31</sup> *See Lloyd v. Murphy*, 25 Cal. 2d 48, 58 (1944).

<sup>32</sup> *See Force Majeure Clauses: Key Issues (CA)*, Practical Law Practice Note w-016-3797.

<sup>33</sup> *Force majeure disputes*, 14 Bus. & Com. Litig. Fed. Cts. § 146:39 (4th ed.)

Parties might also argue the recent market downturn following the spread of the COVID-19 outbreak qualifies as a force majeure event. However, after the 2008 financial crisis, parties were largely unsuccessful in raising the changed economic circumstances to invoke force majeure clauses or the common law principles of impossibility, impracticality, or frustration of purpose to excuse performance of contracts. The majority of courts found that changes to economic conditions, even those resulting in a recession, were generally considered foreseeable circumstances outside the scope of force majeure clauses that did not otherwise allocate risks for changing economic conditions.<sup>34</sup>

The timing of contracts will also impact whether the parties can claim COVID-19 or any of the resulting government orders qualify as force majeure events. For parties who entered into a contract in 2019 or earlier, the COVID-19 outbreak and its global impact were unforeseeable and may serve to excuse or suspend contractual obligations. In contrast, parties who entered into those same contracts in late February or March 2020, and possibly even as early as January 2020, are far less likely to successfully wield a force majeure clause as a shield that excuses their contractual obligations.

## Next Steps

The coronavirus outbreak has left many feeling uncertain. Companies are concerned about the legal impact of the COVID-19 pandemic and recent laws and regulations enacted by the federal, state, and local governments will have on their business. Whether contracts can be suspended or terminated depends on many factors, but the following practical considerations may help in determining what contractual obligations, if any, are impacted by COVID-19:

- **Confirm what law governs the contract. The availability of statutory or common law doctrines excusing or suspending performance is dependent on which law applies.**
- **Determine whether there is a force majeure clause. If so, determine which events are specified as force majeure events.**
- **Evaluate whether any party's inability to perform under the contract is directly tied to a potential force majeure event (i.e., COVID-19, "Safer at Home" orders).**
- **If performance has been impacted, attempt to find alternative means of performing the contract or reach a mutual agreement regarding extensions or substitutions.**
- **Keep detailed records about how performance has been impacted and document any unanticipated costs.**

To learn more about whether you have the ability to suspend or terminate your contracts due to impacts from the COVID-19 pandemic, feel free to reach out to the attorneys in Raines Feldman's Trials and Litigation Department:

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<sup>34</sup> See, e.g., *Rexing Quality Eggs v. Rembrandt Enterprises, Inc.*, 360 F. Supp. 3d 817, 841 (S.D. Ind. 2018); *Langham-Hill Petrol., Inc. v. S. Fuels Co.*, 813 F. 2d 1327, 1329-30 (4th Cir. 1987) (market downturn was foreseeable); *Great Lakes Transmission Ltd. P'ship v. Essar Steel Minn., LLC*, 871 F. Supp. 2d 843, 852-53 (D. Minn. 2012) (2008 financial crisis only constituted force majeure in S.D.N.Y case under clause which specifically included 'changes to economic conditions' as an enumerated event).

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