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Expert Analysis

COVID-19 and Contracts Under Pressure

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Contracts are the underlying framework for every aspect of business activity. You have contracts with everyone—the HVAC people for your house; the warranty for your car; the service contract for the photocopy machine in your office; the collective bargaining agreement that either governs your relationship with your employees or governs the relationships between those employees and your critical suppliers. COVID-19 has wrought a tremendous disruption in the business world and civil society as restaurants are ordered closed, as hotel occupancy drops into the single digits and hotels close all over the country. All of your contractual relationships are now either at risk for a short period or at risk for fundamental change as we experience potential permanent economic dislocation and the total disruption of the service economy.

The law of contracts has evolved to include concepts to address unforeseen changes in business conditions like this. Let's consider some of them.

Please note that this is not intended to be a complete exploration but rather a starting point for a rational discussion of what options you might have. As always, you have to review your contract and its language for specific strategies as each contract may be different. It should go without saying that you should, as you consider one of the below, consult with your attorney and don't just go it alone.

Adequate Assurances. First, let's consider the right to demand adequate assurance of performance (UCC §2-609). This is a concept having to do with contracts for the sale of goods (Article 2 in general is restricted to that) but might, conceptually, be extended to other situations: it permits you to ask for reasonable assurances, if you have grounds to feel insecure, that the contractual counter-party will be able to perform its duties under its part of the contract. If you don't get those reasonable assurances, the Uniform Commercial Code relieves you of an obligation to continue to perform your part of the contract and entitles you to stop your performance or even exercise rights under §2-610 for Anticipatory Repudiation.

I would argue that this is a concept that should be expanded, under the current situation, to other contracts that require future performance, such as guaranties or indemnification agreements. The New York Court of Appeals has permitted this, not in all cases, but where the contract is "long-term" and "complex and not reasonably susceptible of all security features being anticipated, bargained for and incorporated in the original contract." *Norcon Power Partners, L.P. v. Niagara Mohawk Power*, 92 N.Y.2d 458, 468 (1998).

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Here's what you might think about doing: Write a letter to your

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contractual counter-party, put in writing why you think that you have grounds to demand adequate assurance, give the other side a reasonable deadline within which to respond, and ask the other side to give you reasonable assurances that it can meet its obligations under the contract, including reassurance as to financial condition (be careful not to overreach—this is highly fact specific). If you do not receive a response you deem acceptable, you may be able to use that as grounds to suspend your own performance.

Force Majeure. This contract doctrine is seeing a lot of airtime right now. Basically, it states that contractual performance may be excused for certain things that are so far beyond the control of one party as to act as an excuse for non-performance. These typically are written into a contract and may include "acts of God," strikes, wars, natural disasters, and government actions or decrees. If you think that the virus constitutes one of these force majeure provisions, or if the government has shut down your arena or restaurant, or has shut down those who supply your critical needs, you may have a force majeure. Bear in mind that your suppliers may have recourse to this doctrine, and you may see contracts being renegotiated as some suppliers seek simple business relief and others attempt to obtain commercial advantage.

How would you use this? First, it may be used against you and you should be prepared to have a contingency plan in place if you think that an important contractual counter-party might want to do so. Second, assuming your contracts contain this boilerplate, consider under what circumstances you might wish to examine your own contractual obligations if you are trying to control your economic exposure. Expenses are important and cash is king. This doctrine may help you control costs.

Frustration of Purpose/Impracticability or Impossibility of Performance. Here, the law allows a party to state, as a defense to a breach of contract claim, that the purpose of the contract has been frustrated—for instance, that delivery of produce under a fixed supply contract to a restaurant chain should be excused because that chain has been shut down. Or impossibility of performance—that the supplier of produce cannot actually obtain the produce to deliver, even if the restaurant chain were open. These related doctrines suggest an out for a contractual counter-party—that the purpose of the contract has been destroyed or that the performance of the contract, through no fault of either party, has become impossible. Nothing in these doctrines, if they fail, relieves the non-performing party of an obligation to show that it at least tried to mitigate damages—something to keep in mind if you are the non-breaching party.

This doctrine will be used not as an anticipatory course of action but as a defense to a breach of contract claim. It is important to keep in mind and to contemporaneously and carefully document your actions and reasons as to provide help to you later if you need to assert one of these defenses.

Efficient Breach—A Last Resort. What if you can't get out of your agreement under any of the above? The law recognizes the idea of an efficient breach. This doctrine states that where you think it would be less expensive to breach and pay damages rather than perform, you may make that choice. But be very careful here—the doctrine assumes that you will pay something. This should be a choice of last resort and it does require an exacting and careful analysis of which course of action will be the least bad one.

Whichever doctrine you choose to explore (and you should really do so with the advice of your attorney), please do so with consideration of what might happen to or with your insurance coverage. There may be consequences that follow from each doctrine you select—be careful not to select something that constrains your freedom of movement later with respect to your coverage. And whatever you do—keep good records. Good luck.