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COVID-19 VIRUS, FORBEARANCE AND CONTRACT DEFENSES.

We have been writing about the Covid-19 virus and its effect on contracts.[1]

Forbearance

Many banks, vehicle finance companies and vendors are offering forbearance of payments due. "Forbearance" is the intentional delay of payment or performance, usually for some specific period of time. Usually this would apply on an installment obligation like a loan or a lease. For example, BMW has a forbearance program of two months. Being realists, knowing that you cannot operate if you are closed or might as well be, and perhaps needing some forbearance on their own obligations as well, finance companies and other vendors are granting grace periods on payments. For loans, the payments in forbearance now are moved to the end of the loan period with the final due date extended. Some extra interest is paid.

From the tenant's side leases would be a natural obligation to forbear. However, landlords have their mortgage payment, property management fees, and maintenance expenses that really cannot be waived. For those reasons, it may be difficult to achieve forbearance with a lease or commercial lease.

Demand for Performance and Act of God Defenses in The Covid-19 Virus Economy.

Prima Facie Validity and Enforceability of a Properly Drawn Contract

Regardless of the catastrophic consequences of the virus pandemic on the world economy, a contract properly written is *prima facie* enforceable. *Prima facie* means that on its face or first impression something appears to be correct and valid. If the contract is *prima facie* valid and enforceable then (a) it would be up to the defendant to explain why it is not and (b) the defendant would have the burden of proof to show why it is not.

Force Majeure, The "Big Daddy" of Catastrophe Defenses

The virus pandemic gives rise to uncommon defenses, like *force majeure.* A *force majeure* is an unforeseeable event, typically substantial, that prevents performance. Collapse of the only bridge into town might be such an event; thus, excusing delivery of produce to the local store. A hurricane at sea which destroys ships carrying goods from China would be another. However, the huge increase in the price of oil during the energy crisis, although causing substantial harm to the cost of shipping and he economy, was held by the courts to not be a *force majeure* because the dramatic change in the price of oil was deemed foreseeable. And, even if an event is unforeseeable, the court

[1] See the article **Coronavirus and Contracts** at azbuslaw.com/Publications/Articles

will look to see if the defendant could have mitigated damages.[2] One can not just sit idly by allowing the harm to occur; one must try to prevent or reduce it.

With a case of alleged *force majeure*, the plaintiff, who is seeking performance or payment, will argue that the event was foreseeable, especially by someone with knowledge in the industry, like the defendant. With the virus the defendant might show that (a) even if foreseeable in general (people get the flu), a virus as pandemic that shuts down the world almost overnight was/is not foreseeable. Moreover, arguably, it was not foreseeable that the state and federal government would order businesses to close, quarantine and social distancing.

Force majeure provisions are fairly standard in contracts, but not all of them. A lease probably would not have such a clause, nor would an instalment payment contract typically have such a clause. *Force majeure* clauses are seen most often in supply contracts, whether goods, equipment or services. Like most of the terms labeled as "Definitions," "Miscellaneous," or in legal vernacular as "boilerplate," *force majeure* can be defined to the drafter's advantage. For example, if it benefits our client, we here at the firm may add "labor shortage" or "lack of supply" as incidents of f*orce majeure.* This addition can help contractors and manufacturers.

The question for many of the firm clients is: "What if the *force majeure* clause is not in the contract, then what? In this case the contract defendant may have a "tough row to hoe." Normally, asking the court to imply or apply the clause to a contract without it, would probably fail. However, the current climate of worldwide cause and effect of the virus, state and federal orders to close, quarantine or social distance would seem to be an indubitable and extreme case of disrupting events. And, in this case there is almost no way to mitigate damages – if the government orders you to close, you are closed.

Impossibility or Impracticability? That is the Question

As with *force majeure* the doctrine of impossibility of performance is based on an unforeseeable and uncontemplated (in the contract) event which prevents performance. In this case, the nonoccurrence of the event that happened must be a basic assumption upon which the contract is based, not including changes in demand or the breach of agreement. In other words, there was no reason to think this event would happen. In the original case of "impossibility" *Taylor v Caldwell*, the defendant could not deliver the music hall because it had been destroyed by fire. Destruction of the subject matter is the paradigm case of impossibility. Limitations of the defendant itself are considered an assumed risk. "Impossibility" is commonly seen as the situation where because of some intervening event it is not physically possible to perform. With "impracticability" performance is physically possible but due to the intervening event would be unduly burdensome. Impracticability is a contract defense in the sale of goods in the Uniform Commercial Code. UCC 2-615.

Here, as with force majeure the argument would be that the unforeseeable virus as well as the state and federal governments' orders relating to it make performance on a lease, or a contract, e.g. a

[2] "Mitigation of damages" means that the plaintiff cannot just sit on the file and let damages accrue. If the plaintiff can reduce the damages by reasonable action then it is compelled to do so. For example, a landlord cannot delay re-leasing a space if a suitable tenant becomes available.

bachelor party at a closed restaurant, impossible. Where the contract is for the sale of goods, like respirators, but there is a severe shortage of respirators an impracticable defense should apply.

Frustration of Purpose

As suggested by its name "frustration of purpose" doctrine focuses on events which destroy the reason for the contract itself, rather than impeding performance under it. The contract no longer makes sense. Government action is a frequent trigger to this defense. An example of frustration of purpose would be a law that makes the sale of something illegal or that takes away the reason for the contract, e.g. renting land to grow marijuana and a new law passes making that illegal.

Here the reason for many contracts, from restaurant leases to gun sales would disappear were the government, in response to the virus, to order the business to cease operations or product sales to cease. The pandemic of the Covid-19 Virus appears to be a paradigm case of frustration of purpose.

Conclusion

The doctrines of force majeure, impossibility, impracticability and frustration of purpose all seem to apply as a result of the Covid-19 virus and its aftermath. That being so many businesses are forbearing strict performance on contracts and granting extension of time to perform. Businesses which choose not to forbear performance will face the above defenses and will need good facts and argument why they do not apply in that case.