Your Contract and Coronavirus: Now What?

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The COVID-19 pandemic has now caused most to experience significant disruptions with their normal course of business. In particular, access to goods and services has been impaired by governmental advisories and orders made in response to the spread of the virus. Many people are now subject to lockdowns, quarantines and travel bans. These disruptions have caused much actual and anticipated interference with contractual obligations and rights. Parties are assessing the economic and practical effects of the pandemic on their contractual rights and obligations, and those of their counterparties, to determine next steps. We anticipate that, in the current environment, parties seeking to excuse performance under a contract will argue that the significant changes resulting from the spread of COVID-19, including the various governmental restrictions put in place to stop the spread of the virus, constitute a force majeure event or make their performance impossible or impracticable. Contract language, the specific obligation that a party is seeking to excuse, and factual circumstances will all be factors in any contractual dispute. Seeking legal guidance sooner than later can help you determine the best path forward.

Force Majeure – How Does it Work?

Force majeure clauses are a way for contracting parties to describe the facts that create contractual impossibility due to an unforeseeable event. See *Perlman v. Pioneer Ltd. P'ship*, 918 F.2d 1244, 1248 n. 5 (5th Cir. 1990) (citing 6A Arthur L. Corbin, Corbin on Contracts § 1324 (1962)). Essentially, force majeure's historical significance has fallen to the wayside and, in modern use, "is not little more than a descriptive phrase without much inherent substance." *Sun Operating Ltd. P'Ship v. Holt*, 984 S.W.2d 277, 283 (Tex. App.—Amarillo 1998, pet. denied). Thus, the parties to a contract themselves define the contours of force majeure in their contract and those contours dictate the application, effect and scope of force majeure. *Id.* (citing *Texas City Ref., Inc. v. Conoco, Inc.*, 767 S.W.2d 183, 186 (Tex. App.—Houston [1st Dist. 1989, writ denied)). Stated another way, analysis and application of a force majeure clause is based upon the terms of the contract in which it is used and a court will look primarily at the specific language of the clause to determine its applicability. *See id.*

As one might expect, the specific language of force majeure clauses varies greatly from contract to contract. Some clauses are expansive, while others narrowly define the types of unforeseen events that may excuse a party's performance. Some exclude a party's payment obligations from the applicability of the clause while others are silent on this obligation. For these reasons, a party considering the effect of the conditions created by the COVID-19 virus and how those conditions implicate a contractual force majeure provision should seek prompt legal review of the subject contract.

Can Major Economic Changes Qualify as a Force Majeure Event?

This depends on the specific language of your contract's force majeure clause. Certainly, the COVID-19 pandemic is a new problem but its effects on the economy are not unique. We have faced significant economic downturns in the past and such downturns have resulted in litigation related to contractual performance. Not surprisingly, an economic downturn has been cited as the reason for a party's reliance on a force majeure contract clause. In *TEC Olmos, LLC v. Conocophillips Co.*, for example, TEC entered into a farmout agreement with Conoco to test-drill land leased by Conoco in search of oil and gas. 555 S.W.3d 176, 179 (Tex. App.—Houston [1st Dist.] 2018, pet. denied). The contract contained the following force majeure clause that would change the contractual drilling deadline:

Should either Party be prevented or hindered from complying with any obligation created under this Agreement, other than the obligation to pay money, by reason of fire, flood, storm, act of God, governmental authority, labor disputes, war or any other cause not enumerated herein but which is beyond the reasonable control of the Party whose performance is affected, then the performance of any such obligation is suspended during the period of, and only to the extent of, such prevention or hindrance, provided the affected Party exercises all reasonable diligence to remove the cause of force majeure…

Id. After execution of the contract, the global oil market dramatically changed, eliminating the financing TEC expected, which caused it to invoke the foregoing force majeure clause. *Id.* at 180. Conoco disputed the applicability of the clause and filed suit seeking a declaration that the force majeure clause did not apply. *Id.*

TEC did not contend that the market downturn qualified as one of the specific force majeure terms listed in the clause but instead claimed it was included in the catchall provision that covered "any other cause not enumerated herein but which is beyond the reasonable control of the Party whose performance is affected." *Id.* at 182. The court found that because fluctuations in the oil and gas market were foreseeable, such changes could not be considered a force majeure event unless specifically listed as such in the contract. *Id.* at 184. Because economic conditions were not specified in the force majeure clause, TEC was not able to rely on the clause. *Id.*; see also *Valero Transmission Co. v. Mitchell Energy Corp*., 743 S.W.2d 658, 663 (Tex. App.—Houston [1st Dist.] 1987, no writ)("An economic downturn in the market for a product is not such an unforeseeable occurrence that would justify application of the force majeure provision, and a contractual obligation cannot be avoided simply because performance has become more economically burdensome than a party anticipated.")

Notably, the *TEC* court acknowledged that its force majeure analysis was principally guided by the language of the contract. *Id*. at 181. In that regard, the court held that when parties to a contract specify certain force majeure events in their contract, there is no need to show that the occurrence of such an event was unforeseeable. *Id*. at 183. When the force majeure event, however, is not specified but is claimed as part a "catch-all" provision, a showing of unforeseeability is required because in that instance the contract does not provide a clear answer so common law notions of force majeure apply to "fill the gaps" including the concept of unforeseeability." *Id* at 184. Thus, the lesson of *TEC* is that, while force majeure's historical basis has mostly eroded in favor on contract interpretation, it is still relevant in situations where the clause is not clear.

When reviewing your contract's force majeure clause it is important to also consider the doctrine of ejusdem generis. The doctrine provides that when specific items in a list are followed by a general or catch-all statement, the latter is limited to things like the former. *Id*. at 185. As the *TEC* court noted, the parties' contract identified specific force majeure events like a fire, flood, storm, etc., none of which were akin to an economic downturn. Id. As a result, and for that additional reason, the court concluded that TEC was unable to take refuge in the force majeure clause. Id.

Can a Global Health Crisis Constitute a Force Majeure Event?

Again, it depends on the language in your force majeure clause. One example exists in a case where a force majeure clause was raised as a defense in the context of the Avian Flu outbreak in the spring of 2015. In *Rembrandt Enters. v. Dahmes Stainless, Inc*., Rembrandt, a producer of eggs, entered into a contract with Dahmes for an egg dryer. No. C15-4248-LTS, 2017 U.S. Dist. LEXIS 144636, at *3-4 (N.D. Iowa Sept. 7, 2017). The parties' contract called for Dahmes to install the dryer by December 1, 2015 with it being fully operational by January 1, 2016. *Id*. at *4. When the Avian Flu hit, Rembrandt had to cut is bird production by over 50% and declared a force majeure to its buyers. It also cancelled construction of the facility in which the Dahmes' dryer was to be installed. *Id*. at *5-6. Dahmes claimed breach of contract and Rembrandt filed suit, in part, to obtain declaratory relief regarding its contract with Dahmes. *Id*. at *6. The parties agreed they entered into a valid contract and that Rembrandt breached the contract but Rembrandt said its breach was excused based on theories of frustration of purpose, impracticability and force majeure.

As to the force majeure clause, the court held that it did not apply to the facts of the case. In particular, the clause provided as follows:

Force Majeure. Neither party shall be liable to the other for failure or delay in performance of the Work caused by war, riots, insurrections, proclamations, floods, fires, explosions, acts of any governmental body, terrorism, or other similar events beyond the reasonable control and without the fault of such party…

Id. at *32. "Work" was defined to mean Dahmes' efforts in building, delivering and installing the dryer. *Id*. at 35. In other words, the court found that the force majeure clause applied only to the failure or delay in the performance of Dahmes' obligations under the contract. *Id*. at *36. Because it was Rembrandt that unilaterally cancelled the contract, not Dahmes, no force majeure event occurred per the express terms of the contract. *Id*. Thus, because of the specific language of the force majeure clause, the Avian Flu outbreak was irrelevant. The *Dahmes* case stands as a prime example of why the

specific language employed in the force majeure clause can be outcome determinative and why it is so important a careful analysis of that language be conducted before deciding whether to rely on that clause.

Countless examples of force majeure clauses exist along with many cases interpreting such clauses. In addition to the language used in the clause, it is important to carefully consider the facts and circumstances surrounding when the clause is invoked. For example, courts have held it improper for a party to rely on a force majeure clause when the party's time for performance occurred before the force majeure event occurred. Similarly, where notice is required by the contract, other courts have strictly construed such provisions preventing a party from relying on a force majeure clause where the party failed to follow it by giving timely notice. These cases demonstrate it is important to review your contract with counsel, even before performance has been interrupted, to properly analyze your rights and obligations.

The Doctrines of Impossibility/Impracticability – Do They Help if My Contract Does Not Have a Force Majeure Clause?

In the event that a force majeure provision is not applicable to specific circumstances, or a contract does not include a force majeure provision at all, the common law doctrines of impossibility and impracticability may be implicated to excuse a party's contractual performance. We expect that parties will argue the adverse economic and practical effects of social distancing, shelter-in-place orders and quarantines have been so significant that satisfaction of their contractual obligations is impossible or impracticable. The success of these arguments will largely be dependent on the specific facts and circumstances surrounding your contract.

In Texas, courts have recognized no functional distinction between the doctrines of impossibility, impracticability and frustration of purpose. *Tractebel Energy Mktg. v. E.I. du Pont de Nemours & Co.*, 118 S.W.3d 60, 64. n.6 (Tex. App.—Houston [14th Dist.] 2003, pet. denied). That being said, there are remnants of Texas law that treat them differently. For example, with respect to the defense of impossibility there remains an important distinction between objective and subjective impossibility, with courts recognizing only objective impossibility as excusing a party from its obligations. Objective impossibility relates solely to the nature of the promise such that something is objectively impossible "if the thing cannot be done," such as the inability of a promisor to settle a claim in a lawsuit which had been dismissed prior to completion of the agreement. *Grayson v. Grayson Armature Large Motor Div., Inc.*, No. 14-09-748-CV, 2010 Tex. App. LEXIS 4465, at *14 (Tex. App.—Houston [1st Dist.] June 15, 2010, pet. denied). Subjective impossibility, on the other hand, is impossibility due wholly to the inability of the individual promisor. *Id*. A promisor's financial inability to pay has been considered subjective impossibility because, even though the specific party making the promise cannot pay, payment could be made by another party. *See id*. Only objective impossibility can serve as a defense in a breach of contract suit. *Id.* Because the objective impossibility standard is so high, impossibility will not be a viable affirmative defense except in specific factual circumstances in which no party could possibly have performed the obligation. *Id*. Thus, in most instances it will be extremely challenging for a party to successfully assert an impossibility defense for payment obligations. *See id.*

Contrasted with impossibility, the defense of impracticability, which appears to be the term preferred by modern courts in Texas, occurs where a party's contractual performance is made impracticable, without its fault, by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made. *Tractebel*, 118 S.W.3d at 64. It arises in situations where both parties to a contract held a basic (but unstated) assumption about the contract that proves untrue. *Id*. at 66. In that situation, the party's performance is discharged unless contractual language or other circumstances require the contrary. *Id*. at 64. Importantly, a party claiming the defense must use reasonable efforts to surmount the obstacle to performance and performance remains impracticable in spite of such efforts. *Id*. at 69.

Can Major Economic Changes Make Contract Performance Impracticable?

This is a question that has been raised frequently following the COVID-19 outbreak. Generally, Texas courts agree that contractual obligations cannot be avoided simply because one party's performance has become more economically burdensome than anticipated. *See, e.g., Grayson*, 2010 Tex. App. LEXIS 4465, at *14 (inability to pay not objectively impossible); *Huffines v. Swor Sand & Gravel Co., Inc.*, 750 S.W.2d 38, 40 (Tex. App.—Fort Worth 1988, no writ) (fact that cost to perform contract became more expensive due to county ordinance did not make performance impracticable). Foreseeability still somewhat plays a role in this analysis, although that factor has gradually decreased in importance over time. *Centex Corp. v. Dalton*, 840 S.W.2d 952, 953 (Tex. 1992). In that regard, in deciding whether the

non-occurrence of an event was a basic assumption of both parties to the contract, courts consider the language or circumstances of the contract to see if they indicate that the event was considered by the parties. Tractebel, 118 S.W.3d at 64; *Chevron Phillips Chem. Co. LP v. Kingwood Crossroads, L.P.*, 346 S.W.3d 37, 52 (Tex. App.—Houston [14th Dist.] May 26, 2011, pet. denied). If the contract, properly construed, shows that a party assumed the risk of an unanticipated event, then impracticability will not be a viable defense for that party. *See Chevron,* 346 S.W.3d at 52.

Additionally, remember that a party asserting impracticability arising out of the COVID-19 epidemic will need to demonstrate reasonable efforts to overcome the barriers to performance created by the epidemic. *Tractebel*, 118 S.W.3d at 69 (citing the Restatement (Second) of Contracts Section 261, cmt. d). What constitutes a reasonable effort to overcome an epidemic-related obstacle will necessarily depend on the obstacle and the circumstances. This is another reason to seek legal advice early. Particularly with extensive federal and state assistance anticipated as a result of the economic impact of the epidemic, to the extent economic difficulty is cited as a basis for nonperformance, it will likely be expected that the nonperforming party have exercised all options to obtain available government assistance before that party can claim impracticability.

Can a Government Order Arising out of a Global Health Crisis Make Contract Performance Impracticable?

Texas courts have specifically allowed parties to escape contractual obligations where performance was prevented by government regulation. This is true even where the government regulation turned out to be invalid. *Tractebel*, 118 S.W.3d at 64. An example of government interference that created an impracticable defense occurred in *Centex Corp v. Dalton*, where Centex promised to pay Dalton a fee for his assistance helping Centex acquire a package of thrift institutions in the late 1980s. 840 S.W.2d 952, 953 (Tex. 1992). Before entering into that agreement, Centex and Dalton met with the federal agency that had created the plan to close, merge and liquidate thrift institutions, which advised that the payment to Dalton was acceptable. *Id*. The night before the closing of the sale, the federal agency changed its mind and indicated it would probably not permit the payment of the fee to Dalton. *Id*. The deal closed with government's approval, conditioned upon a prohibition of payment of the finder's fee to Dalton. Id. As a result, Centex refused to pay Dalton, who sued. Centex argued its performance was made impracticable by reason of the government's order prohibiting payment of a fee to Dalton. *Id*. The Texas Supreme Court agreed with Centex and held that a government regulation or order making performance impracticable was "an event the non-occurrence of which was made a basic assumption on which the contract was made" and, therefore, Centex was excused from performance of its contract with Dalton. *Id*. at 954.

Outside of Texas, government orders arising from an epidemic have also been cited as reasons for a party's refusal to perform its contract obligations. In *Gregg School Township v. Hinshaw*, a school district in Indiana closed due to the influenza epidemic. 132 N.E. 586 (Ind. App. 1921). This prevented Hinshaw, a teacher, from being paid for the full term of her contract so she sued. *Id*. The school defended on the ground of impossibility due to an order from health authorities that required the school to close temporarily. *Id*. On appeal, the court confirmed that it was impossible for the school to stay open in the face of the health board's closure order and, therefore, it was not liable to pay the teacher for lost wages during the time of that closure. *Id*. at 587. Just the opposite result was reached in neighboring Illinois when the State Board of Health closed a school also due to the influenza epidemic. *Phelps v. School Dist*., 134 N.E. 312, 312 (Ill. 1922). A teacher sued for two months' of lost wages due to the school closure, which the school refused to pay based on the argument that its performance of the contract was made impossible due to the government closure order. *Id*. The court there held that the school closure was not an act of God and that such closure was a contingency which could have been addressed in the parties' contract. *Id*. Essentially, because the law allowing the government to close schools due to an epidemic existed at the time the parties entered into a contract, the court took the position that the school district could have placed a provision in its teacher contracts relieving it from the obligation to pay teacher salaries during times of closure. *Id*. at 313. Because the school did not do so, it was responsible for paying the teacher's wages during the two months of closure.

Conclusion

The present circumstances of the COVID-19 epidemic are unprecedented and will result in parties seeking to assert defenses to their performance obligations affected by the spread of the virus and the resulting economic and social effects. Parties will seek relief from those obligations in a contract's force majeure clause and plead affirmative defenses

of impossibility and impracticality. However, just because COVID-19 prevents a party from performing its contractual obligations does not necessarily mean that party has no obligation to perform or will have no liability. The specific language concerning the scope and applicability of a force majeure provision, together with the factual circumstances in play, will determine whether a party's performance is excused. Assertions of impossibility or impracticability of performance will also require careful analysis and understanding of a party's obligations under a contract and thoughtful consideration of reasonable alternatives before deciding not to perform.

Visit Winstead's COVID-19 Resource Center

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