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Presents Webinar

Excuses, Excuses! What To Do When Your Deals Fall Apart During COVID-19

Tuesday, May 5, 2020

Program - 12:00 p.m. - 1:00 p.m.

Los Angeles County Bar Association

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Alice M. Graham is the founder and principal of Graham Law Corporation in Marina Del Rey, California. Ms. Graham has practiced law in the area of real estate for over 30 years. Ms. Graham’s law practice focuses on all aspects of real estate law including real estate transactions; leases; insurance matters; and litigating disputes involving title and rights to real property, purchase and sale disputes, escrow, neighbor disputes, easements, investment fraud, landlord tenant matters, homeowners’ associations, construction law, insurance bad faith, contracts and business law. Ms. Graham has litigated real property and insurance matters in the trial courts, Court of Appeal and California Supreme Court.

Ms. Graham is an author of a chapter of CEB treatise, Neighbor Disputes: Law and Litigation, in which she continues to update two chapters annually.

For several years, Ms. Graham was a course instructor of The Law of Easements, a Lorman Education Services seminar for real estate professionals. Ms. Graham was a panelist at the 2011 California State Bar Real Property Retreat, on a panel entitled, “Why Can’t We All Just Get Along: Adjoining Property Disputes”.

Ms. Graham has been a panelist at various California State Bar events on the topics of easements, neighbor disputes, and advanced negotiation skills. Ms. Graham has also served as volunteer judge in Loyola Law School and National Moot Court competitions. She is currently in the process of preparing a webinar on force majeure clauses, in which she will participate as moderator.

Ms. Graham was a mediator member of the Los Angeles Superior Court Alternative Dispute Resolution Panel, serving on both its pro bono and pay
panels, while the panel existed. Ms. Graham has served as a member of the Executive Committee of the California State Bar Real Property Section. Ms. Graham has been an active member of the Los Angeles County Bar Real Property Section and State Bar Real Property Section. Ms. Graham served on the board of Santa Monica Bar Association and continues to be involved as a member. Ms. Graham has also served on the national editorial board of Commercial Real Estate Women (CREW), and the Board of Trustees of the Santa Monica Bar Association.

Ms. Graham has authored various published articles on real estate and mediation topics.

Currently, Ms. Graham is a member of the executive committee of the Small Firms and Solo Section of Los Angeles County Bar Association and its co-chair of programming.

Ms. Graham trained as a mediator with the Strauss Institute for Dispute Resolution of Pepperdine University School of Law. Ms. Graham holds a B.A. in English from UCLA and a J.D. from Loyola Law School.
Morvareed Z. Salehpour specializes in handling a diverse range of complex legal matters both in and outside the courtroom. She is experienced in negotiating a variety of contracts and tech transactions and handling cases from inception to trial and appeal. She has successfully represented entrepreneurs and small businesses to Fortune 500 companies in a variety of industries, including technology, media and entertainment, transportation, logistics, healthcare, real estate, fashion, cannabis, and food and beverage, among others. Ms. Salehpour enthusiastically applies unique solutions to client needs, working hard to devote herself to efficient resolutions.

Ms. Salehpour, a double Bruin, received her JD from the UCLA School of Law, where she also served as a Managing Editor for the UCLA Law Review. Ms. Salehpour previously practiced at BakerHostetler, a national firm where her work included being a member of the legal team seeking to recover the principal lost in the Madoff Ponzi scheme, and then at Strange & Butler, a complex litigation boutique. She is admitted to the State Bar of California, is a member of the bars of the United States District Court for the Central, Northern, Southern, and Eastern Districts of California, and a member of the bar of the United States Court of Appeals for the Ninth Circuit.

Ms. Salehpour is also President-Elect of the Santa Monica Bar Association, Career Chair for the UCLA Alumni Westside Network, a member of the UCLA Law Women LEAD Local Events Committee, and a member of the Advisory Board for The Rabbit Hole (Woman Blockchain Community). She is also active in the tech community and passionate about analyzing and discussing developing legal issues in that field for her clients and for her own pleasure, particularly with respect to artificial intelligence, blockchain, virtual/augmented reality, and esports.

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Interpreting and Drafting Force Majeure Clauses During the Pandemic

Force majeure clauses excuse a party’s inability to perform its obligations if an unforeseeable event prevents performance.

Analysis of such clauses is based upon the facts of the specific situation and the language of the force majeure clause at issue. Courts generally look at:

1. Specific language in the contractual force majeure provision;
2. Evidence that the force majeure event was in fact unforeseeable;
3. Evidence of causation between the force majeure event and the failure of performance; and
4. Evidence that the force majeure event was so severe that the contract could not be performed.

Typical force majeure clauses contain the following:

1. List of possible events that are unforeseeable and thus, can act to excuse performance – i.e. acts of God, government actions, pandemics. Specific listing of an event is a factor weighing in favor of a finding of force majeure. If an occurrence is foreseeable then it is not generally a force majeure event;
2. Standard to excuse performance – i.e. illegal, impossible, impracticable. Generalized economic hardship without more is not enough;
3. Any additional obligations re notice and/or mitigation; and
4. Effects of force majeure – i.e. additional time to perform, contract suspension, contract termination.

Precise drafting of these clauses is important moving forward with careful consideration of a party’s position in the contract (i.e. performing party or non-performing party) as that affects the position to be taken on each different element of the force majeure clause. For example, performing parties should consider incorporating specific references to applicable events such as the pandemic and/or government action, consider including a catch-all provision, and making sure standards for excusing performance are appropriate for their purposes (i.e. not too strict). Additionally, consider if the pandemic and its effects are truly “unforeseeable” at the time of drafting and, if not, consider incorporating language addressing foreseeability of force majeure events or separate provisions to address the pandemic and its effects explicitly.

Finally, note that contract enforcement will not only depend on the force majeure clause at issue, but also on defenses such as impossibility and frustration of purpose.

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Force Majeure and Other Excuses for Contractual Nonperformance in the Coronavirus Age: A Primer

Emil Petrossian, Partner
Force Majeure and Other Excuses for Contractual Nonperformance in the Coronavirus Age: A Primer

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Emil Petrossian is a litigation partner and trial attorney at Manatt’s headquarters in Los Angeles. His practice covers all facets of complex commercial litigation in federal and state courts and arbitral forums. In 2019, the Daily Journal named Emil one of the top 40 attorneys in California under the age of 40.

Emil has extensive experience litigating high-stakes commercial disputes for major corporate clients throughout the country, primarily in the entertainment, energy and financial services industries. In the entertainment sphere, Emil has represented motion picture studios, production companies, record labels, music publishers and artists in lawsuits involving a variety of subject matters, including copyright infringement, idea theft, contract disputes and investment fraud. In the energy arena, Emil has represented large energy companies in multimillion-dollar commercial disputes involving fraud and breach of contract claims. And in the financial services industry, Emil has represented mortgage banks, community banks and investment funds in disputes involving breach of contract, breach of fiduciary duty, data theft and FDIC receiverships.

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1 “Common law” refers to laws created over time through the written opinions of appellate courts. Common law is distinct from statutory law, which comprises the specific statutes passed by state and federal legislatures. The related common law doctrines of impossibility, impracticability and frustration of purpose are discussed below in Section 3.

2 The rationale behind this outcome is the well-established contract interpretation principle in the related common law doctrines of impossibility, impracticability and frustration of purpose are discussed below in Section 3.

The statute provides that they must do so expressly.

2 As this statutory language makes clear, parties may not agree to exclude force majeure events arising “by operation of law”—every party to a contract governed by California law has the right to declare force majeure when the operation of law renders contract performance impossible. However, parties may expressly exclude force majeure on the basis of an “irresistible, superhuman cause”—though the statute provides that they must do so expressly.
Introduction

From boardrooms to stockrooms, companies of all shapes and sizes around the country are grappling with COVID-19 and the “new normal.” Federal, state and local restrictions on commerce, travel and our very freedom of movement have thrown the business world into disarray, threatening the ability of many companies to satisfy their contractual obligations. As a result, the doctrine of “force majeure,” and the related defenses of impossibility, impracticability and frustration of purpose, have emerged to the forefront of many discussions in the commercial sector. But many companies have never actually addressed or handled these concepts, which are complicated and often do not have clear-cut application, in any meaningful way. This needs to change, and quickly.

“A fundamental understanding of how force majeure functions in the legal world is critical to developing and implementing the correct business strategies in the real world.”

A fundamental understanding of how force majeure functions in the legal world is critical to developing and implementing the correct business strategies in the real world. Parties to contracts containing force majeure provisions must ensure that they are adequately availing themselves of the legal protections such provisions can provide. Conversely, parties that may be adversely affected by the invocation of force majeure by counterparties need to decide whether to assert legal challenges of their own or to negotiate alternative solutions. And parties to contracts lacking enforceable force majeure provisions must determine what other potentially viable bases may offer some measure of protection, whether from claims of breach, the business interruptions that can result from a counterparty’s nonperformance or both.

This article provides a brief but comprehensive overview of the concepts and challenges relating to force majeure in a COVID-19 world, along with additional considerations that all contracting parties should keep top of mind as current circumstances continue to evolve.

1. What is force majeure?
2. Is COVID-19 a “force majeure event”?
3. What if a contract doesn’t contain a force majeure provision?
4. What are some other factors to keep in mind?
1. What is force majeure?

Translated literally, “force majeure” means “superior force” in French. The legal doctrine of force majeure may be summed up as follows:

*If an event or circumstance beyond the reasonable control of the contracting parties renders performance of the contract impossible, nonperformance of the contract will be excused and will not constitute a breach, unless the contract provides otherwise.*

A force majeure provision in a contract is essentially the contractual equivalent of the common law defense of impossibility. While force majeure may, at first glance, seem like a simple concept, it’s anything but.

As an initial matter, it’s important to remember that the application of force majeure is typically a contractual inquiry—because many commercial and business contracts contain some form of a force majeure provision. As a result, the application of force majeure often boils down to the language of the specific contractual provision at issue. This is part of what makes force majeure a complicated topic to summarize: every force majeure provision is different, and (with some exceptions) contracting parties can negotiate force majeure provisions to say whatever the parties want them to say. Nevertheless, it is possible to gain a general understanding of how contractual force majeure provisions are supposed to work and are likely to be construed by a court or arbitrator.

At its most fundamental level, every contract between two parties is an allocation of a set of risks. Each party makes a promise to perform something in exchange for the other party’s promise to perform something else. By doing so, each party assumes the risk that it will be unable to perform its promise. If one party can’t perform its promise, the risk of nonperformance will have materialized and that party will be held in breach of the contract—*unless* a provision in the contract or some legal statute or doctrine excuses the nonperformance. That’s where force majeure comes into play.

A contractual force majeure provision augments the parties’ basic risk allocation by providing that if something unexpected occurs that neither party caused or could have prevented and that renders performance impossible, any resulting nonperformance is excused and doesn’t constitute a breach. In other words, the nonperforming party doesn’t bear the risk of nonperformance (and can’t be held liable for breach) if the reason the party can’t perform its promise is the occurrence of a force majeure event.
2. Is the COVID-19 pandemic a force majeure event?

The question on many people’s minds is whether the COVID-19 pandemic is a force majeure event. There is no clear-cut answer. Arguments exist on both sides of the equation, and there are a number of factors and considerations that could impact how a court might answer the question in a legal dispute.

A. How does the operative contract define force majeure events?

As explained above, the threshold question in every force majeure analysis is whether the particular contract at issue contains a force majeure provision, and if so, what it says. Many force majeure provisions enumerate the specific events or circumstances that might excuse a delay or failure of performance. Those events often include such things as acts of war, natural disasters, work stoppages and inclement weather.

But as we are beginning to learn, many force majeure provisions in commercial contracts don’t identify “pandemics” or “public health crises” as specific force majeure events. Nevertheless, some force majeure provisions contain “catch-all” language that covers and encompasses other unforeseen events or circumstances beyond the parties’ reasonable control that materially prevent one or both parties’ performance. Thus, just because “pandemic” is not listed in a contract as one of the specific events giving rise to force majeure doesn’t mean a contracting party is out of luck. If the force majeure provision contains a catch-all, there is hope—though some jurisdictions do construe catch-alls narrowly to cover only events and circumstances that are of the same nature as those specifically enumerated in the remainder of the force majeure provision.

By contrast, parties to contracts containing force majeure provisions that neither identify pandemics as force majeure events nor contain catch-alls may be foreclosed from asserting force majeure. The reason goes back to the allocation of risk: if two parties have specifically identified a limited list of events or circumstances that could give rise to force majeure, courts may treat that as reflecting the parties’ agreement to limit force majeure only to those events or circumstances. In other words, courts will presume that if the parties wanted to list other events or circumstances or to include a catch-all in the force majeure provision, they could have and would have done so. That they didn’t do so reflects their intent to limit the force majeure provision to the specifically identified events and circumstances in the contract. This is the law in jurisdictions such as California, New York and Texas, and it is why drafting force majeure provisions to include catch-all language is of paramount importance.

B. How does catch-all language in a force majeure provision work?

Even with a sufficiently broad force majeure provision containing a catch-all, the question whether COVID-19 falls within the scope of that provision has no clear answer. The focal point for answering this question is the element of foreseeability—that is, whether the coronavirus pandemic was unforeseeable when the contract was executed such that it falls within the scope of the catch-all.

Courts in some jurisdictions have held that a party invoking force majeure in reliance on a catch-all is required to prove the element of unforeseeability by demonstrating that the inability to perform
is the result of an event or circumstance that was not reasonably foreseeable at the time the contract was executed—even if the contract doesn’t specifically require that showing. The rationale behind this requirement once again boils down to risk: when a particular event or circumstance is reasonably foreseeable such that the parties could have contracted to specify it as a force majeure event, the absence of any express mention of that event indicates that the parties assumed the risk of the event occurring. So if a pandemic is deemed to have been reasonably foreseeable and the operative force majeure provision does not specifically mention pandemics, then the parties may be deemed to have assumed the risk that a pandemic might occur and prevent them from performing. Under such circumstances, failure to perform because of COVID-19 would constitute a breach of the contract, absent application of some other, non-force majeure defense. In the eyes of the law, it is incumbent on contracting parties to protect themselves by including specific contractual language setting forth their expectations. This holds true not only with respect to force majeure, but the related doctrine of frustration of purpose (discussed further in Section 3 below).

The foreseeability inquiry also turns on the type of contract at issue. Under Article 2 of the Uniform Commercial Code (UCC Article 2), which governs contracts for the sale of goods (as opposed to contracts for the provision of services, which are governed by the common law), the defense of commercial impracticability is available to a seller of goods (but not a buyer) “if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made.” See, e.g., Cal. Com. Code § 2615. Thus, a seller who does not negotiate the inclusion of contractual language excusing nonperformance resulting from a reasonably foreseeable event will be deemed to have assumed the risk of the event’s occurrence. Under these circumstances, the seller cannot rely on a defense of commercial impracticability and will be in breach of the contract if the seller doesn’t perform. In this regard, some courts and commentators have referred to UCC Article 2’s impracticability defense as a “gap filler”—it applies only if the parties have not expressly or implicitly addressed the issue of impracticability in the contract through a force majeure provision.

These permutations in the law, among both different jurisdictions and different types of contracts, underscore why it’s so important for a party contending with these issues to consult with counsel and obtain specific legal advice regarding the laws applicable to the operative contract. None of this is “one size fits all.”

C. Was the COVID-19 pandemic reasonably foreseeable?

It’s important to understand that how a party frames a force majeure event, and how a court might interpret that event, are significant factors. For instance, was the force majeure event the pandemic caused by COVID-19? Or was it the subsequent mandatory lockdowns imposed by governments that precluded so many aspects of our daily lives? Or was it perhaps the market crash that occurred shortly after the federal government declared a national state of emergency? The answers to these questions, and how a party addresses them, may affect whether a party can successfully invoke force majeure.

At a fundamental level, it’s safe to assume that COVID-19 will be treated as the root cause of any invocation of force majeure. We would not be where we are today but for COVID-19. And indeed, parties seeking to assert force majeure are likely to argue (and are likely to do so successfully) that the novel coronavirus was not within their
reasonable control. But framing the force majeure event as the COVID-19 pandemic is a dangerous game if a party seeking relief from performance is relying on catch-all language or otherwise has to prove unforeseeability. On the one hand, COVID-19 seemingly came out of nowhere and disrupted every aspect of business and society in ways that, for many of us, were unimaginable or unexpected. Even our government agencies were grossly unprepared. On the other hand, scientists and experts have been predicting a major pandemic for years. And recent epidemics such as SARS, MERS and the Ebola virus have only bolstered the possibility of a major contagion spreading throughout the world and wreaking havoc. Under these circumstances, was the COVID-19 pandemic really unforeseeable such that contracting parties could not have contracted to expressly enumerate such an event in their force majeure provisions? This question, which has no easy answer and will almost certainly be litigated extensively in the coming years, reflects that the issue of foreseeability will be at the center of the forthcoming wave of COVID-19-related force majeure disputes.

The foreseeability inquiry is further complicated by the fact that market fluctuations are typically considered to be reasonably foreseeable and part of the allocation of risk between two contracting parties. Thus, a market crash that substantially affects a party’s ability to perform ordinarily won’t give rise to force majeure. Again, this is why framing matters. A party seeking to hold a nonperforming party liable for breach may contend that market fluctuations are always reasonably foreseeable, whether caused by a pandemic, a war, or some other event or circumstance, and thus can’t be used to excuse nonperformance.

Additionally, in some industries, phenomena not tied to COVID-19 have caused market fluctuations that have exacerbated the problems flowing from the pandemic. For example, in the oil-and-gas industry, the price of crude oil has dropped drastically in recent weeks in part because of a price war initiated by Saudi Arabia in early March. So will a party in the oil-and-gas industry be able to connect the decrease in the price of oil to COVID-19 for purposes of invoking force majeure? How should that party go about framing the issue so that the party is in the best legal position in the event of future litigation? These are difficult questions to answer. Getting top-notch legal counsel to help wade through them is essential.

All is not lost if a contract doesn’t contain a force majeure provision (or if that provision is not applicable or enforceable for some reason). At least one jurisdiction—California—has enacted a force majeure statute codifying bases for seeking force majeure even absent a force majeure provision. Thus, parties to a contract governed by California law may be able to invoke statutory force majeure, even if their contract doesn’t contain a force majeure provision, if performance is prevented or delayed (1) “by operation of law, even though there may have been a stipulation that this shall not be an excuse” or (2) “by an irresistible, superhuman cause ... unless the parties have expressly agreed to the contrary.” Cal Civ. Code § 1511. For parties grappling with the fallout of COVID-19, this statute could serve as a lifeline in contracts governed by California law.

### 3. What if a contract doesn’t contain a force majeure provision?

All is not lost if a contract doesn’t contain a force majeure provision (or if that provision is not applicable or enforceable for some reason). At least one jurisdiction—California—has enacted a force majeure statute codifying bases for seeking force majeure even absent a force majeure provision. Thus, parties to a contract governed by California law may be able to invoke statutory force majeure, even if their contract doesn’t contain a force majeure provision, if performance is prevented or delayed (1) “by operation of law, even though there may have been a stipulation that this shall not be an excuse” or (2) “by an irresistible, superhuman cause ... unless the parties have expressly agreed to the contrary.” Cal Civ. Code § 1511. For parties grappling with the fallout of COVID-19, this statute could serve as a lifeline in contracts governed by California law.
The question whether COVID-19 falls within the parameters of California’s statutory force majeure provision is sure to be litigated in the near future. Certainly, one can expect businesses to argue that the many restrictions on commerce and large-group gatherings implemented at the federal, state and local levels in recent weeks have prevented or delayed performance “by operation of law.” However, laws or other governmental acts that merely make performance unprofitable or more difficult or expensive typically do not excuse the duty to perform a contractual obligation. Thus, a party making this argument will have to show that governmental action has made it impossible or impracticable—not just unprofitable or more difficult—for that party to perform.

Likewise, whether the mandated restrictions constitute an “irresistible, superhuman cause” under California’s force majeure statute is an open question. Unfortunately, the California Supreme Court’s explanation of what constitutes such a cause—“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”—gives little clarity. Arguments exist on both sides of the force majeure analysis.

In addition to contractual and statutory force majeure arguments, the related common law defenses of impossibility, impracticability and frustration of purpose may also come into play. The key thing to remember about these defenses is that each of them requires a showing of reasonable foreseeability. If an event or circumstance was reasonably foreseeable at the time of the contract, the parties will be deemed to have assumed the risk of those events or circumstances occurring and will not be able to rely on these defenses.

While impossibility (and, to some degree, impracticability) is essentially the common-law equivalent of contractual force majeure catchalls, the frustration-of-purpose doctrine extends further. Frustration of purpose does not require a showing of impossibility, but rather proof that an unforeseeable, supervening event has so completely and fundamentally destroyed the value of the performance of the contract for one of the parties that the party is legally excused from any further performance. If this sounds like a high bar, that’s because it is. Many cases that have addressed frustration of purpose have held that it did not apply, either because the event or circumstance allegedly giving rise to the defense was foreseeable or because the value of performing the contract was not sufficiently destroyed. Nevertheless, frustration of purpose may be a potentially viable defense for some contracting parties that are unable to rely on a contractual or statutory force majeure provision or the common law defenses of impossibility and impracticability.

As for sales contracts, UCC Article 2’s commercial impracticability defense (discussed above) essentially subsumes the three common-law defenses of impossibility, impracticability and frustration of purpose into a single statutory defense for sellers.

“The key thing to remember about these [common law] defenses is that each of them requires a showing of reasonable foreseeability.”
4. What are some other factors to keep in mind?

Many force majeure provisions contain procedural and timing requirements that, if not followed faithfully, may result in waiver of the right of force majeure. Thus, it’s imperative that a nonperforming party understands its specific contractual obligations with respect to invoking force majeure.

“Many force majeure provisions contain procedural and timing requirements that, if not followed faithfully, may result in waiver of the right of force majeure.”

Providing adequate and timely notice of a force majeure event doesn’t just help to ensure that the party invoking force majeure is complying with the procedures set forth in the contract—it also places the other party on notice of its duty to mitigate damages. Every jurisdiction recognizes some form of a duty to mitigate damages resulting from a breach of contract. Thus, a party alleging that a nonperforming party who invoked force majeure (or any related defense) has breached the operative contract by failing to perform must reasonably attempt to mitigate its damages. Failure to do so could result in a lowering of any claimed damages in subsequent litigation, or at least give the nonperforming party an avenue of attacking the damages claim in a subsequent legal dispute. And for sales contracts in particular, a seller’s timely notice to a buyer of its inability to perform triggers the buyer’s duty to find substitute goods, which is an important element of mitigation under UCC Article 2.

Additionally, the specific contract at issue may have other rights and obligations that are relevant to the inquiry. For example, some contracts allow for cancellation or early termination under specific circumstances. These provisions may coexist with force majeure provisions; therefore, it’s important to consider all rights and options set forth in the contract itself.

Similarly, some contracts contain liquidated damages provisions that are triggered in the event of a breach or default. In this period of difficult choices, it may very well be the case that an efficient breach—i.e., the decision to intentionally breach a contract and pay damages because it would be more expensive or burdensome to perform the contract—becomes a realistic option for some parties. It’s important to get counsel to weigh in on these issues early in the process so that the party can be aware of all of its options, and the advantages and disadvantages of each choice.

Equally important is being able to determine whether performance is actually impossible. If a big-box retailer is not considered an essential business and is forced to shutter its stores until the COVID-19 pandemic has subsided and government restrictions have been lifted, is it truly “impossible”—as opposed to merely burdensome or difficult—for that retailer to continue paying rent on its store leases? Probably not. But because the closely related doctrine of impracticability involves extreme and unreasonable difficulty, expense, injury or loss involved with performing contractual obligations, the retailer could try to argue commercial impracticability instead. If the retailer has no online presence and is not generating any income during the pandemic, the requirement to continue paying rent may very well be so unreasonably difficult as to be impracticable.
Lastly, in some jurisdictions (including California), courts read into every contract an implied covenant of good faith and fair dealing. This covenant is implied also in sales contracts under UCC Article 2. In the simplest terms, the implied covenant of good faith and fair dealing precludes a party to a contract from interfering with the other party’s benefit of its bargain, regardless of what the express terms of the contract provide. It’s important for parties to keep the element of good faith in mind as they traverse the winding road of excuses for nonperformance of contracts. A breach of the implied covenant can give rise to a claim in litigation separate and apart from any alleged breach of express contractual terms.

5. Conclusion

COVID-19 has turned the business world upside down. As this article demonstrates, the issues and considerations relating to excuses for contractual nonperformance are numerous and complex. For parties seeking to avail themselves, or to oppose the invocation, of doctrines such as force majeure and frustration of purpose, gaining a thorough and foundational understanding of how these concepts might apply to a particular set of circumstances is essential to ensuring adequate protection and enforcement of rights.

Manatt’s COVID-19 Client Service Response Team

To ensure that our clients’ rapidly evolving needs are met during this unprecedented time, Manatt has established a COVID-19 Client Service Response Team of cross-industry, legal and business advisors. Manatt’s integrated, multidisciplinary model reflects the convergences you are facing and allows our diverse team of professionals to partner with you through these challenges. Industries including healthcare, entertainment and media, real estate, digital and technology, retail and financial services are bearing the brunt of many of the current challenges. Our range of service offerings—including business advisory, management consulting, government advisory, employment counseling, complex litigation, bankruptcy, and distressed assets, as well as debt restructuring and privacy and cybersecurity—provide a comprehensive breadth of counsel in the core areas that may impact your business in this rapidly changing environment.

COVID-19 Updates and Resources
Click here
Force Majeure and Other Theories to Terminate Contracts
or Defend Against Non-performance Claims
Real Estate Contracts and Beyond

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Howard Gould’s practice includes a wide variety of residential, commercial and industrial real estate matters including neighbor disputes, HOA matters and construction law. He regularly counsels real estate agents and their clients.

His second major area of practice is complex commercial matters with an emphasis on internal disputes at corporations, partnerships and LLCs, as well as intra-family disputes involving real estate, trusts, estates and family businesses. **Howard also serves as a provisional director, an elected director, an arbitrator, and a mediator.**

For almost thirty years Howard has been a member in international legal networks and has had affiliates from over 100 law firms in over 50 countries that he knows personally from their meetings around the world.

Howard has been a licensed CA real estate broker since 1980 and is a registered patent attorney. He earned his law degree at Georgetown University and his bachelor’s degree in physics at Columbia University.

Howard currently practices in his own firm, Gould Law, located at 1299 Ocean Avenue, 9th Floor, in Santa Monica, CA. For 10 years he has was a principal at the 10 lawyer Finestone & Richter firm in Brentwood and Century City and for 25 years before that he was a partner at his firm Doland & Gould. He began his legal career at the Kutak Rock law firm in Omaha, Nebraska.

Howard is chair of the BHBA Real Estate Section, formerly on the Executive Committee of the International Law Section of the BHBA, and is a member of the LACBA Solo and Small Firms Section.
Market Considerations and COVID-19: Leases

Leases are enormously important assets for landlords and for tenants, but at times either party may want a reason to terminate. Of course, these reasons may arise from COVID-19 restrictions on operations or other considerations such as

• A tenant with a below market lease wants to stay to the end but the landlord may want them out.
• A location may make or break a store and may not be replaceable - they can’t lose that location even if in an old building needing renovation but the landlord may want the lease terminated so he can sell to a developer or redevelop.
• Extraordinary events like COVID-19 epidemic may create opportunities on either side of the landlord-tenant equation to terminate a lease. And this applies to a wide variety of contracts – not just real estate.
Tenants Affected by COVID-19 and Opportunists

Consider some specific examples of tenants with difficult circumstances:

• A store without revenue such as a sporting goods store with only golf equipment and golf courses closed, likely for months

• Gyms don’t know when they will reopen or who will return, especially if they had an older clientele

• Massage studios and nail and hair salons which only operate based upon close personal contact. Recently these personal services were preferred tenants with retail stores on the decline, but now?

• Strip mall owner with tenants who want out.

• Office leases with rent too high or too much space.

How many tenants with take this moment as an opportunity to renegotiate?
Market Considerations and COVID-19: Sales

Pending purchase and sale transactions face many uncertainties:

• Residential sales may depend upon the buyer selling their property which is now almost impossible to market and to close a sale
• The residential buyer may have job insecurity that may affect their financing
• The residential buyer may confront inspection problems if they intend to accompany their inspectors to learn about the property
• However recording and title seem to be functioning for now
• Commercial buyers who are owner users may suddenly question their need for the new location given COVID-19 market disruption
Legal Theories

Legal Theories That May Apply

1. Force majeure or an Act of God clause
2. Frustration of purpose
3. Impossibility or impracticability
4. Supervening event
5. Failure of a condition
FORCE MAJEURE

Force majeure is a contract provision that allocates the risk of supervening events outside the parties’ control (traditionally such as inclement weather, war, terrorism, government acts, and labor strikes), which render performance either impossible, impracticable, or not serving the agreement’s primary purpose.
ESTABLISHING FORCE MAJEURE

There are no established or uniform set of events that constitute force majeure. The main elements used to establish the occurrence of force majeure is that the event or condition itself must have been (1) irresistible; (2) unforeseeable; (3) external to the parties and (4) must have made performance an impossibility and not merely more difficult or impracticable.
IDENTIFYING A FORCE MAJEURE AND MIXED CAUSATION

One California case specifically states that force majeure is not limited to an act of God.

“The 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.” Pacific Vegetable Oil Corp. v. C. S. T., Ltd., 29 Cal. 2d 228, 238 (1946).

And where human agency also plays a role in proximately causing harm, liability may result. Dufour v. Henry J. Kaiser Co., 215 Cal. App. 2d 26, 29 Cal. Rptr. 871(1963)
APPLICABLE CALIFORNIA STATUTE

The legal doctrine can be found in the California statutes at Civil Code §1511 (also see Com. Code § 2613):

§1511. What excuses performance, etc.

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:

1. When such performance or offer is prevented or delayed by the act of the creditor, or by the operation of law, even though there may have been a stipulation that this shall not be an excuse; however, the parties may expressly require in a contract that the party relying on the provisions of this paragraph give written notice to the other party or parties, within a reasonable time after the occurrence of the event excusing performance, of an intention to claim an extension of time or of an intention to bring suit or of any other similar or related intent, provided the requirement of such notice is reasonable and just;

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; or, ...
CIVIL CODE SECTION 1511, SUBSECTION 1: OPERATION OF LAW – WITH CAVEATS!

Section 1 of CC §1511 specifically talks about “operation of law” which prevents or delays performance as constituting an excuse for non-performance, and we have been operating under various stay at home orders and closure orders.

Will your circumstances satisfy §1511 (1)?

Note this section applies even if the contract provides to the contrary. The statute overrides the negotiated contract provision. Subsection 2 is different on this issue.

But, the contract can require notice within a reasonable time of the event.
CIVIL CODE SECTION 1511, SUBSECTION 2
IRRESISTIBLE, SUBPERHUMAN FORCE – WITH CAVEATS!

Section 2 of CC §1511 addresses an irresistible, superhuman cause excusing performance, as opposed to Section 1 which applies to operation of law or acts of the creditor.

But here there is an exception if the contract addresses the event, or type of event. If the parties agreed as to how that event will be treated to (1) excuse performance, (2) not excuse performance, or (3) perhaps call for some alternative performance, the contract clause governs.

Note that “an irresistible, superhuman cause” may be broader than the usual notion of an Act of God.
DEGREE OF FORSEEABILITY

A force majeure or Act of God may include floods or extraordinary freshets, but not such high water as is reasonably to be anticipated at certain times of the year. *Ryan v. Rogers* (1892) 96 Cal. 349, 353, 31 P. 244.

In order to constitute an Act of God, a storm must be so unusual in its proportions that it could not be anticipated by a defendant. *Inyo Chemical Co. v. City of Los Angeles* (1936) 5 Cal.2d 525, 532–535, 55 P.2d 850; *Clarke v. Michals* (1970) 4 Cal. App. 3d 364.
LANDLORDS AND TENANTS

Landlords and tenants should review their leases to determine the following:

• Is there a force majeure provision? If not look for another theory discussed below or consider use of CC §1511 through interpretation of the language of the statute.

• Is the force majeure provision applicable to these COVID-19 events?

• Does the force majeure provision excuse performance by the landlord, or by the tenant, or both?

• Is the coronavirus the reason the party is unable to perform the agreement?

• Notice provision - Does the lease specify within how many days of the party’s knowledge of a potential delay or non-performance a landlord must provide notice to a tenant? If unspecified, notice of any delays or nonperformance should be provided to the other party as soon as possible.

• Does the force majeure clause permit a party to terminate the lease? Or does it just allocate the risk or define alternate performance or remedies?
ACTIONS TO TAKE TO COUNSEL LANDLORDS AND TENANTS (CONTINUED)

Landlords and tenants should review their leases to determine the following (continued):

• Or the opposite – does the language require performance irrespective of the Act of God
• Determine your client’s duty to mitigate the impact of the force majeure event
• Landlords should require substantiation if the tenant gives notice claiming force majeure based on the coronavirus.
• Weigh the risks of declaring force majeure. Are there unintended consequences.
  - Does your client want to terminate the entire agreement, or only try to avoid part of it.
  - Are there any related agreements to consider?
  - Is there an option to purchase that may have value?
  - Could they simply downsize and sublet or ask the landlord to take back part of the space?
  - Does the force majeure event only influence some of the contractual responsibilities leaving the lease as whole potentially still enforceable.
• Litigation risk of loss, including your client being found to have failed to take available and reasonable measures that would lessen the impact and/or duration of the force majeure event.
"Impossibility" is defined as not only strict impossibility but as impracticability because of extreme and unreasonable difficulty, expense, injury, or loss. Temporary impossibility of such character that, should it become permanent, would discharge a promisor's entire contractual duty, operates as a permanent discharge if performance after the impossibility ceases would impose a substantially greater burden on the promisor; otherwise the duty is only suspended while the impossibility exists.

*Oosten v. Hay Haulers Dairy Employees & Helpers Union, 45 Cal. 2d 784, 291 P.2d 17 (1955)*

Generally impossibility of performance results from (1) the death or incapacity of one performing party, or (2) destruction of the subject matter of the agreement (through no fault of either party). Will COVID-19 qualify?
UNANTICIPATED AND EXCESSIVE COSTS MAY CONSTITUTE IMPOSSIBILITY

The defense of legal impossibility in a contract action is satisfied when an obligation is impracticable, though not literally impossible, to perform, that is, when it can only be performed at an excessive and unreasonable cost, disproportionate to the cost contemplated when the contract was made. Such impracticability may be the result of purely human acts, such as a court judgment. See City of Vernon v. City of Los Angeles (1955) 45 Cal. 2d 710, 719–720, 290 P.2d 841 and Mineral Park Land Co. v. Howard (1916), 172 Cal. 289, 293, 156 P. 458.
Courts may also discharge contractual duties when performance is rendered impracticable from a commercial perspective as a result of the supervening event. Impracticability occurs when a party’s obligation to perform is made impracticable solely as a result of the occurrence of an event, the nonoccurrence of which was a basic assumption upon which the parties relied when entering into the agreement in the first place. See Restatement 2d of Contracts, § 261(2nd 1981).
In order to find impracticability, the following must be established:

1. The supervening event must render performance unduly burdensome (i.e., it can only be performed with unreasonable risk, expense, and/or difficulty).

2. The event’s nonoccurrence must have been assumed by the parties when entering into the agreement (i.e., if the event was reasonably likely to transpire, its nonoccurrence was not a basic assumption).

3. The affected party must not be responsible for the event’s occurrence (including, without limitation, by failing to take reasonable measures to overcome the event).

4. The added risk caused by the event must not have been allocated by the agreement or applicable law to the affected party.
FRUSTRATION OF PERFORMANCE

The doctrine of commercial frustration applies when the expected value of performance to the party seeking to be excused has been destroyed by a chance event that supervenes to cause an actual, but not literal, failure of consideration. *Lloyd v. Murphy (1944)* 25 Cal. 2d 48, 53, 153 P.2d 47.

Performance remains possible, but the fundamental reason of both parties for entering into the contract has been frustrated by an unanticipated supervening circumstance, destroying substantially the value of performance. *Cutter Laboratories, Inc. v. Twining (1963)* 221 Cal. App. 2d 302, 314–315, 34 Cal. Rptr. 317.
FRUSTRATION OF PURPOSE DISTINGUISHED FROM IMPOSSIBILITY OF PERFORMANCE

Unlike impossibility and impracticability, the affected party is fully capable of performing.

Instead, pursuant to a frustration-of-purpose claim, the affected party is making the statement that performance has been rendered no longer valuable by the event.

Courts will generally discharge a party for frustration of purpose when (1) the supervening event and the ensuing frustration were not reasonably foreseeable, and (2) the primary purpose of the agreement is substantially or totally destroyed by the event.
FRUSTRATION OF PURPOSE

The purpose supposedly frustrated must have been within the contemplation of both parties to the transaction. It is not sufficient that one of the parties hoped to use the premises in a specific way not mentioned in the lease. Brown v. Oshiro (1945) 68 Cal. App. 2d 393, 396–397, 156 P.2d 976.

A lessee may seek to apply this doctrine to avoid liability for rent, but it is applied only in extreme cases. Fey v. Rossi Improvement Co. (1914) 23 Cal. App. 766, 767–768, 139 P. 908.
FRUSTRATION OF PERFORMANCE
INAPPLICABLE

The lease does not terminate and the frustration of purpose doctrine is not applicable when:

• The event was within the reasonable anticipation of the parties at the time of the drafting of the lease *Mitchell v. Ceazan Tires, Ltd. (1944) 25 Cal. 2d 45, 47, 153 P.2d 53*;

• The lease does not specifically limit the use to which the premises may be put to a use prohibited by a supervening statute. *Grace v. Croninger (1936) 12 Cal. App. 2d 603, 605–607, 55 P.2d 940*;

• A governmental regulation does not entirely prohibit the business to be carried on in the leased premises but only limits or restricts it and thereby makes it less profitable and more difficult to continue. *Lloyd v. Murphy (1944) 25 Cal. 2d 48, 56, 153 P.2d 47*; or

• The tenant has voluntarily assumed the duty of compliance with governmental regulations and is later unable to comply with them. *Glenn R. Sewell Sheet Metal, Inc. v. Loverde (1969) 70 Cal. 2d 666, 675–678, 75 Cal. Rptr. 889, 451 P.2d 721*. 

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SUPERVENCING EVENT

A supervening event will excuse performance when: (1) the event occurred through no fault of either party; (2) nonoccurrence of the event was a basic assumption of the parties at the time of contracting; (3) the risk of nonoccurrence was not otherwise allocated to one of the parties either by the agreement’s or by operation of law; and (4) the event renders performance either impossible, impractical, or contrary to the purpose of the agreement.
FAILURE OF A CONDITION

A party may not be required to fulfill a contractual obligation because of an unmet condition. A condition may be expressed in a contract or implied by its circumstances and subject matter. Is there an implied condition not met due to COVID-19 and the related consequences of the reaction to the pandemic?

A condition is a fact or event upon which a party’s obligation to render performance is contingent. Pursuant to the Restatement (Second) of Contracts, § 224 (2nd 1981), a condition is defined as “an event, not certain to occur, which must occur, unless its nonoccurrence is excused, before performance under a contract becomes due.” Restatement 2d of Contracts, § 224 (2nd 1981).

A condition can sometimes be outside of a party’s control, such as the weather, or within its control, such as timely delivery. It must, however, be an event that may or may not occur. For example, the passage of time is not a condition, as it is certain to occur. An unmet condition relieves a party’s performance of a related obligation and may also give rise to suspension and/or termination rights. A condition, in this way, serves as an effective risk allocation tool.