

COVID-19 Fact Sheet #5

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This Fact Sheet is part of our continuing series addressing some of our clients' pandemic-related concerns.

Feel free to share this information. But be sure to contact a lawyer to receive legal advice.

COVID-19'S IMPACT ON CONTRACT DISPUTES

What happens when an extreme, unanticipated event occurs that undermines or frustrates the purpose of a contract? Are the parties still bound by the contract, or are they relieved of their obligations?

The COVID-19 pandemic has raised these and countless other questions. The answers are not clear, but there are three legal concepts that help shed light on the situation. Here's what you need to know about force majeure clauses, contractual impossibility, and the frustration of purpose doctrine.

FORCE MAJEURE OR "ACTS OF GOD" PROVISIONS

The first place to look is in the contract itself. Although not all contracts address what happens if an unanticipated event outside the parties' control occurs, many contracts do. These provisions are generally known as force majeure clauses and are usually found toward the end of a contract. Force majeure provisions vary in terms of detail. They typically contain a list of events, including unexpected and unplanned events such as riots, wars, and disasters, which will free either party from liability or excuse a delay in a party's performance.

There are three types of force majeure provisions that may provide guidance with respect to the COVID-19 pandemic.

1. Some provisions specifically mention pandemics, epidemics, or disease outbreaks, though this language is relatively rare. If a contract does contain pandemic language, that may resolve the liability issue.
2. Many force majeure provisions mention "Acts of God," which generally mean natural hazards outside of human control, such as earthquakes, hurricanes, or tornados. Tennessee courts have held that "Acts of God" include floods, falling trees caused by strong storms, and lightning strikes, but other more ordinary and predictable weather events such as heavy rains and icy roads are not covered. Given the nature of the pandemic and the accompanying shut down, it is unclear if a court would treat the COVID-19 pandemic as a natural force, or see the shutdown accompanying the pandemic as human action, which may fall outside of the definition of "Acts of God."
3. Some force majeure provisions reference "Acts of Government" or government regulations and orders, which might provide an avenue for relief. In such a case, even if the COVID-19 pandemic itself is not considered an "Act of God," a government order to shut down a business may nonetheless create a force majeure event impacting contractual liability.

It is important to note that the COVID-19 pandemic is, in many ways, a new event, and there is not yet guidance from Tennessee courts regarding whether standard force majeure clauses would be triggered by the current circumstances.

LEGAL DEFENSES –

Impossibility and Frustration of Purpose

If a contract does not contain a force majeure provision or if the provision does not address pandemics, two other legal doctrines may come into play to allocate liability under the contract. Courts may consider the



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doctrines of impossibility and frustration of purpose to determine what the parties would have done if they had taken the time to plan for the event at issue. Each doctrine evaluates whether the event was foreseeable and also examines the underlying purpose of the contract.

When a contractual obligation cannot be fulfilled because of unanticipated events, this can be referred to as a situation of "impossibility" or "commercial impracticability." For example, if a tornado destroys a building where an apartment is located, it is impossible to lease the space. If an apartment suffers heavy water damage, however, it may still be possible to lease the space, but it may be essentially worthless or impracticable to do so. Because the concepts are quite similar, they are often referred to together as an "impossibility defense." In Tennessee, courts generally will not allow a party to assert an impossibility defense if the situation causing the impossibility was foreseeable.

Like the impossibility defense, the frustration of purpose doctrine requires a party to show that an unanticipated circumstance has fundamentally changed the contract from what was reasonably to be expected by the party to the point that the value of the performance is virtually destroyed. One example might be if a government regulation has changed what the parties are legally able to do.

Given the shutdowns due to a combination of widespread illness and new regulations, many people and businesses in contractual relationships may claim that they should be released from liability, and their claims will likely involve impossibility or frustration of purpose defenses. Resolution of these issues will often involve having a court determine whether the contract remains legally binding.

What You Should Do Now

There are no clear answers to whether force majeure clauses will be interpreted to include COVID-19 shutdowns or whether impossibility and frustration of purpose defenses will apply to these circumstances. Courts will need to resolve these issues in future cases, and the rulings may be very specific to the individual circumstances of the contract being interpreted.

In the meantime, if you have a contract that has been breached or is facing a potential breach, you should review it carefully—especially any force majeure provision—to see if it might have language that could be interpreted to address the COVID-19 pandemic and shutdown. You also should consider whether your circumstances might support an impossibility or frustration of purpose defense. If any of these situations apply, you may need to provide notice to alert the other party to your contract. Additionally, going forward, we suggest that you work with your legal advisor to consider including appropriate force majeure definitions in your contracts to protect you in your future transactions.