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The Force of Force Majeure and Other Contract Performance Excuses in Supply Chain Transactions

BY JOHN M. RICCIONE AND ELIZABETH WINKOWSKI

How best do suppliers navigate through the allocation of risk and damage associated with the forces placed on the supply chain by the COVID-19 pandemic? In order to answer this question, we will need to understand the legal concepts which allow suppliers some degree of forgiveness, under certain circumstances, from the strictures of their supply agreements when unforeseen events prevent their timely supply of goods. Here is a brief overview of the current supply-chain climate and some legal concepts that may be invoked to relieve pressure of supplying needed goods that are in short supply.

Foreseeability and causation are key elements to an analysis. Was the pandemic foreseeable and did the pandemic *cause* certain supply-chain shortages and bottlenecks? Clearly, these effects followed the pandemic, but that is not enough to relieve a party from supplying goods it contracted to supply. There is much being written on the supply-chain bottleneck; though it is becoming clearer that the causes are complex and numerous. Logistical challenges have exposed the drawbacks of "just-in-time" or "lean" manufacturing, where companies hold very little inventory and parts are delivered to factories just when they are needed. These manufacturing shifts over the years, coupled with increased demand from customers, the sudden absence of workers due to illness, a shortage of labor, and port

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closures have combined to produce the shortage of supply and increase in cost in almost every industry. The cost of sending a container from China to Los Angeles is now six times greater than it was in 2020.[1]

Suppliers are turning to several legal theories to avoid or transfer the risk of late or failed deliveries. Some suppliers are filing insurance claims alleging that government restrictions imposed as a result of the pandemic have caused them business losses. However, courts are almost unanimously finding that business interruptions due to supply-chain issues are not covered by commercial property and general liability insurance policies.[2]

Suppliers are relying on the following legal theories to try to avoid injury: (1) Force Majeure Clauses; (2) Impracticability; (3) Impossibility; and (4) Frustration of Purpose. Here is a brief explanation of each so you may recognize these defenses when raised.

1. Force Majeure

A force majeure clause is a "contractual provision allocating the risk of loss if performance becomes *impossible or impracticable*, especially as a result of an event or effect that the parties *could not have anticipated or controlled*."[3] For a force majeure event

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to excuse non-performance, the event must have "directly and proximately caused" the non-performance.[4] "Non-performance dictated by economic hardship is not enough to fall within a *force majeure* provision."[5] If an event, such as a pandemic, was reasonably foreseeable when the parties contracted, and it is not mentioned in the force majeure clause, it generally will not excuse performance. For reference purposes, there have been many pandemics in history:

- 11th Century: Leprosy
- 1350: The Black Death
- 1665: The Great Plague of London
- 1817: The Cholera Pandemic
- 1889: Russian Flu (H2N2 virus)
- 1918: Spanish Flu (H1N1 virus)
- 1957: Asian Flu (H2N2 virus)
- 2003: SARS (CoV-1)
- 2009: Swine Flu
- 2012: MERS (MERS-CoV)
- 2014: Ebola
- 2015: Zika
- 2020: COVID-19

2. Impracticability

Under some states' versions of the Uniform Commercial Code ("UCC"), which governs all sales of goods, § 2-615 excuses a seller's performance where performance "has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid." The applicable section of the UCC allows a seller to allocate production and deliveries among customers where only partial performance is available due to a contingency. It further requires the seller to "notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required, of the estimated quota thus made available for the buyer. It is important to note that increased cost alone is insufficient to escape the seller's contractual obligations. However, a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance may provide relief."[6]

Whether COVID-19 rendered performance impracticable seems likely, BUT. The pandemic itself or attendant governmental restrictions may arguably constitute a contingency that made performance impracticable within the meaning of UCC §2-615, but there do not yet appear to be any published decisions addressing this issue.

3. Impossibility

This concept, if proven, excuses contractual obligations where a party's performance becomes *objectively impossible* due to destruction of the subject matter or operation of law. Again, the high threshold burden is that such circumstances were not anticipated at the time of contracting. As with impracticability, economic hardship or decreased demand do

not rise to the level of impossibility. For example, 9/11 did not render a defaulting defendant's payment obligations "impossible," where the defendant had invested in aircraft prior to 9/11.[7]

4. Commercial Frustration of Purpose

This excuses contractual performance where a party's performance under the contract is rendered meaningless due to an unforeseen change in circumstances. In other words, the purpose of the contract was frustrated by an event that was not reasonably foreseeable; and the frustrating event totally or almost totally destroys the value of the party's performance. Can COVID-19 frustrate a contract's purpose? Probably not.

What is common to all of these "excuses" for performance of a contractual obligation is the fact that the causal event was "reasonably unforeseeable." As expressed above, the COVID-19 pandemic was not the first national or international pandemic in history. Parties are free to contract and courts are loath to relieve them of their agreed-upon obligations.

MANA welcomes your comments on this article. Write to us at mana@manaonline.org.

1 See Producer Price Index, Moody's Analytics, www.economy.com/united-states/producer-price-index-ppi.

2 *MGA Ent., Inc. v. Affiliated FM Ins. Co.*, No. CV2010499MWFJPRX, 2021 WL 2840456 (C.D. Cal. July 2, 2021).

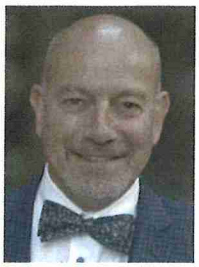
3 Force-Majeure Clause, Black's Law Dictionary (11th ed. 2019).

4 See *Rudolph v. United Airlines Holdings, Inc.*, 519 F. Supp. 3d 438, 449 (N.D. Ill. 2021).

5 Force Majeure clauses, 30 Williston on Contracts § 77:31 (4th ed.).

6 U.C.C. § 2-615, cmt. 4.

7 See *U.S. Bancorp Equip. Fin., Inc. v. Ameriquest Holdings, LLC*, No. 03-5447 ADM/AJB, 2004 WL 2801601, at *5 (D. Minn. Dec. 7, 2004).



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