How to Bullet-Proof Your Contracts for the Unknown

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What Could Possibly Go Wrong?

There’s the Usual Stuff…

- Payment issues
- Product quality
- Delivery
- Timing
- Bankruptcy
- Warranties

And then there's the Scary Stuff…

- Storms
- Earthquakes
- Terrorism
- Civil unrest
- Economic collapse
- Plagues, pandemics, and pestilence

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Big Disasters Can Mean a Wave of Litigation

- More than 1,100 commercial litigation cases have been filed in federal court related to the COVD-19 pandemic, including 11 in Oregon.
- There have been several requests for the convening of a multi-district litigation court to handle insurance litigation.

COVID-19 Contract Litigation

- 92 cases have been filed in federal courts regarding the performance of contracts in light of COVID-19
- 26 cases involve refund issues (but not including class action suits)
- 21 cases seek to suspend or cancel a contract on the basis of force majeure or other related doctrine
- 11 cases are for failure to close a deal (including cases invoking force majeure and a “material change in conditions”)
- 9 are for termination of a supply contract

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Protect Your Company by Making Strong Contracts

- Address defenses to contracts:
  - Force Majeure
  - Impossibility and impracticability
  - Frustration of purpose
- Limit liability
- Indemnify yourself
- Beware of attorney fee provisions
- Choose your forum

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This is not a CLE about Force Majeure

You've probably gotten some emails about that already…

Common Law and UCC Defenses

Impossibility

"Where, after the formation of a contract, facts that a promisor had no reason to anticipate, and for the occurrence of which he is not in contributing fault, render performance of the promise impossible, the duty of the promisor is discharged, unless a contrary intention has been manifested[.]". *Restatement (First) of Contracts* § 457 (1932)

What is Impossible?

- **Performance during a pandemic**?
- In *Lakeman v. Pollard*, 43 Me. 463 (1857), a laborer failed to fulfill his employment contract when he left the area because of an outbreak of cholera.
- The Court held that “the plaintiff was under no obligation to imperil his life by remaining at work in the vicinity of a prevailing epidemic so dangerous in its character that a man of ordinary care and prudence, in the exercise of those qualities, would have been justified in leaving by reason of it[.]”

What is Impossible?

- **Performance during a shelter-in-place order**?
- In *Eastern Air Lines, Inc. v. McDonnell Douglas Corp*., 532 F.2d 957, 994 (5th Cir. 1976) the Fifth Circuit held that "fundamentally coercive acts of Government, whatever their form, constitute an excuse for breach."
- To succeed in an impossibility defense, the defendant must show that its performance is actually or nearly impossible.

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Impracticability

- The UCC cousin of impossibility
- Model UCC § 2-615. Excuse by Failure of Presupposed Conditions
- ORS 72.6150. Excuse by Failure of Presupposed Conditions
- The provisions are substantially similar

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When does the UCC apply?

- The UCC Article 2 applies to transactions in goods that involve a merchant.
- A “merchant” is a person who deals in goods.
- The sale of goods must be the “dominant factor” in the contract.
- Services are not goods.
- Customization and modification of software may be a good.
- Still applies if contract includes ancillary installation and technical support.

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Is it impracticable?

Three conditions must be met under § 2-615 before performance can be excused:

(1) A contingency must occur,

(2) the performance must be made "impracticable" (not just "impractical" but the higher standard of "impracticable"),

(3) the non-occurrence of the contingency must have been a basic assumption on which the contract was made.

Ronald A. Anderson, 4 *Anderson on the Uniform Commercial Code* § 2-615:40 at 632-33.

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“Impracticable” vs. “Impractical”

“Impracticability” means more than “impracticality.” A mere change in the degree of difficulty or expense due to such causes as increased wages, prices of raw materials, or costs of construction, **unless well beyond the normal range**, does not amount to impracticability since it is this sort of risk that a fixed-price contract is intended to cover. Furthermore, **a party is expected to use reasonable efforts to surmount obstacles to performance** . . . , and a performance is impracticable only if it is so in spite of such efforts.”

Restatement (Second) of Contracts § 261 cmt. d (1981)

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"Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance."

4 *Anderson on the Uniform Commercial Code*, § 2-615:1 at 615 (1997 ed.)

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Impracticable. What's next?

- The contract is not void.
- The parties are discharged from performing their remaining obligations to the extent those obligations have become impracticable.
- If some performance is still possible, parties may still have duty to perform.

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It might just be temporary…

Impracticability of performance or frustration of purpose that is only temporary suspends the party's duty to perform while the impracticability or frustration exists but does not discharge the party's duty or prevent it from arising…

Unless the party's performance after the cessation of the impracticability or frustration would be materially more burdensome than had there been no impracticability or frustration.

Restatement (Second) of Contracts § 269 (1981)

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Frustration of Purpose

The difference between impossibility and frustration of purposes is that under the latter doctrine, performance is still possible, but it is now pointless in terms of the original purpose of the contract.

How to establish frustration of purpose

To prove a frustration of purpose defense, the defendant must establish:

(1) substantial frustration of the principal purpose of the contract;

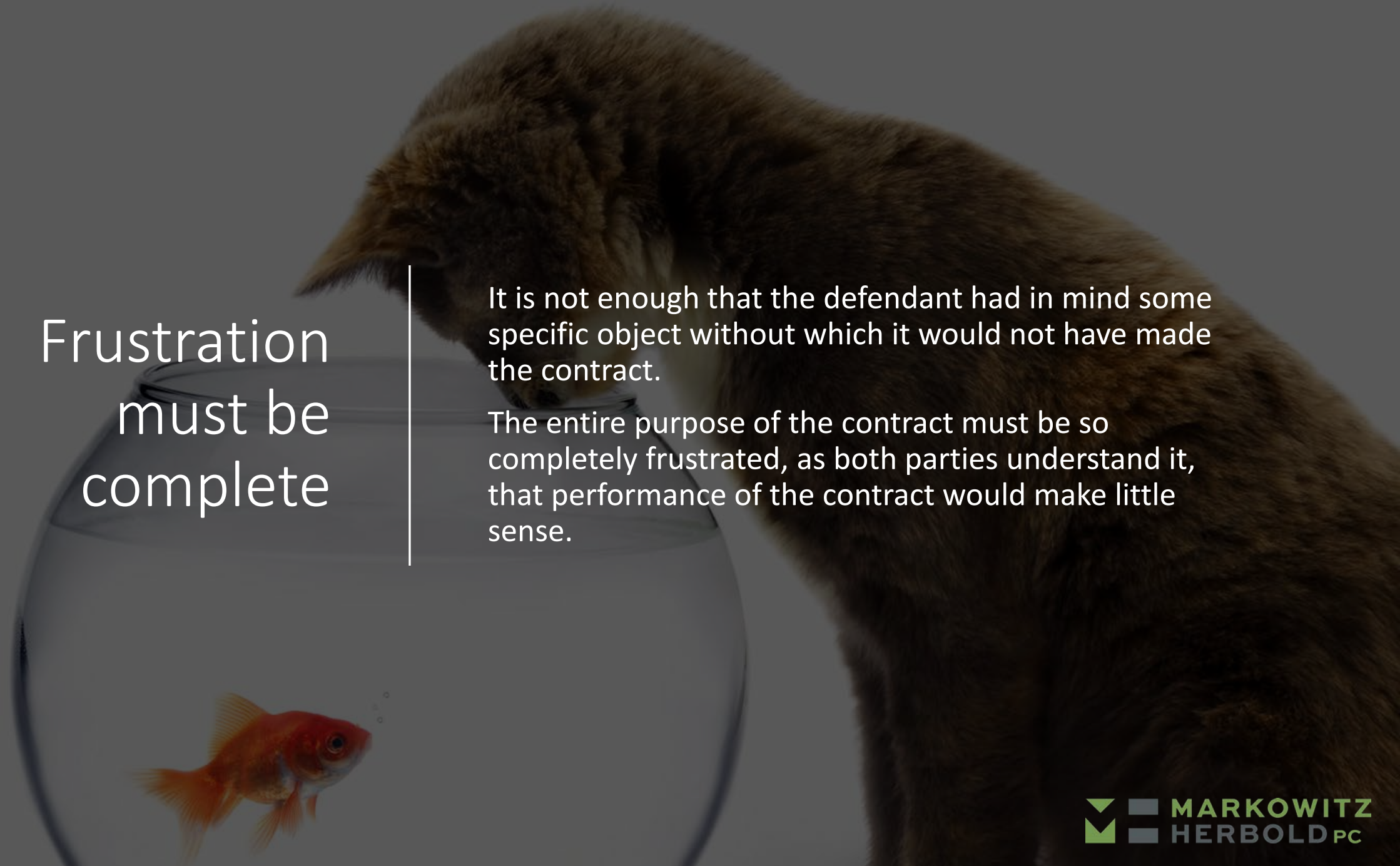
(2) that the nonoccurrence or occurrence of the frustrating event was a basic assumption upon which the contract was made; and

(3) no fault on the part of the defendant.

Frustration must be complete

It is not enough that the defendant had in mind some specific object without which it would not have made the contract.

The entire purpose of the contract must be so completely frustrated, as both parties understand it, that performance of the contract would make little sense.



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How do you protect your organization from these defenses?

Waive them!

How to waive?

- Contracts are designed to allocate risk. Courts will likely allow a provision that waives the defenses of impossibility, impracticability, and frustration of purpose.
- Use language like the party's duty to perform is "absolute and unconditional."
- Include specific waivers of each defense.
- Merge the waivers with a force majeure clause, which allocates the duties of the parties on the occurrence of specific events.

Limit liability

- Must be specific! A general limitation on liability might not cover torts. For example:

  "The liability of [Company] is limited to the Contract Sum."

- That limitation held not to cover a negligence claim between the parties. *Estey v. MacKenzie Eng'g Inc.*, 324 Or 372 (1996).
- Limitations on liability for gross negligence, fraud, or intentional misconduct likely violate public policy.

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Indemnify yourself (Carefully)

- Overbroad indemnity provisions can cause problems.
- If a contractual indemnity provision "is broad but indefinite—*e.g.*, referring to 'any and all claims' or 'any and all liability' without reference to particular risks or to the putative indemnitee's own conduct—the court determines the scope and enforceability of that language after assessing certain broader contextual considerations[.]" *Blanchfill v. Better Builds, Inc.*, 160 Or. App. 527, 534 (1999).
- Those "broader contextual considerations" can offer courts a lot of room for interpretation.

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Beware of attorney fee provisions

- The common assumption is that attorney fee provisions discourage meritless litigation because parties fear they could be responsible for paying the other party's attorney fees.
- This has not been my experience:
  - Parties—and their lawyers—often do a poor job of assessing the strengths and weaknesses of their cases.
  - Attorney fee provisions can *encourage* litigation when parties think that they will win and avoid the expense of the litigation.
  - This might even be more likely when limitations on liability prevent other recoveries.
  - The absence of attorney fee provisions may decrease the likelihood of litigation because both sides know that the upside of winning is limited.

Choose your forum

- Court or arbitration?
- Judge or jury?
- State or federal?

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Arbitration

- You can choose your judge (or judges)
- You can make it confidential
- You can make it faster
- You can choose your rules
- Appeals are limited

Thank You ACC!

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