Employer Resources from April 15, 2020 webinar *Leading Through COVID-19*

Laura Salerno Owens, President and Shareholder
laurasalerno@markowitzherbold.com

Everyone is cancelling their contracts (or I have to cancel mine), how should I respond?

- Do you have a force majeure clause?
- Do you have common law defenses of impossibility or frustration of purpose?
- See attached memo for all you could ever want to know about these concepts.

What clauses should I have in my contracts to protect me going forward?

Here is a list of clauses you might consider including in your contracts in the future:

- **Cancellation Clause**
  - A cancellation clause ensures there is a set time period to allow your clients to cancel without having to pay the remainder due on their account, and if they cancel after that period they are obligated to pay all remaining balances.
- **Rescheduling Clause**
  - A rescheduling clause should either (1) allow rescheduling to occur under your business practices in the event you can rebook the event date, or (2) not allow rescheduling to occur under any circumstances.
- **Safe Working Environment Clause**
  - A Safe Working Environment Clause tells your clients that your company reserves the right to discontinue service in the event some unsafe condition arose. You should modify this clause to your business practices and include all unsafe working environments that you do not agree to provide services under.
- **Clients' Responsibility to Secure Insurance Clause**
  - An insurance clause ensures that your clients agree to purchase all insurance that they deem necessary to protect themselves from unforeseen events.
    - Non-appearance and cancellation insurance

- **Indemnification Clause**
  - Indemnification clauses address the duty to compensate and defend for losses incurred. For service professionals, you want to ensure this clause involves losses incurred by you as the Company for any unforeseen third-party claims.
- **Limitation of Liability**
  - A limitation of liability clause limits liability under certain circumstances. This clause excludes indirect damages that may occur under a breach of contract, and also limits the maximum damages to the amount paid under the agreement.
- **Force Majeure Clause**
  - A force majeure clause should apply to each party to the agreement. These clauses specify the events which enable either party to declare a force majeure event, how a party should notify its counter-party about the occurrence, and the consequences after a force majeure event has occurred.
- **Failure of Company to Perform Services Clause**
  - A failure to perform services clause ensures that your clients understand the procedure should you not be able to perform your services. It is important to allow your clients to agree to substitution of another professional and not require such substitution.
- **Inclement Weather Clause**
  - An inclement weather clause relates to how your company will perform under certain weather conditions. This clause ensures to your clients that you will continue your service obligations unless the location or area is deemed unsafe weather-wise to perform your obligations.

Is it true independent contractors can apply for unemployment?

Yes. As long as a person's unemployment is connected to the COVID-19 pandemic, temporary benefits can be made available to self-employed individuals, independent contractors, and "gig" economy employees. State of Oregon Employment Department. This is new for many independent contractors. The Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 was signed into law on March 27. The CARES Act allows payment of Federal Pandemic Unemployment Compensation (FPUC).[1]

They also will be eligible to receive the additional $600 weekly Pandemic Unemployment Compensation. "The Employment Department is currently reviewing all the new April 10, 2020 federal legislation and will provide more information once [it] receives the required U.S. Department of Labor guidance so that [it] can carry out these changes as quickly as possible." Individuals should apply for

[1] FPUC is a program that provides unemployment assistance to an employee in addition to other unemployment benefits he or she is eligible to receive. FPUC will be automatically paid if the employee receives normal unemployment insurance benefits and will be paid as a separate payment at the same time as the employee's other unemployment benefits. FPUC is payable for weeks claimed beginning Sunday, March 29, 2020 through the week ending July 25, 2020. The Oregon Employment Department has started issuing these payments to eligible individuals as of April 10, 2020.

Oregonians who are already eligible for regular Unemployment Insurance benefits and eligible for FPUC will receive two weekly payments; one for regular UI benefits, and an additional $600 payment. Individuals will be receiving FPUC benefits using the same payment method as their regular UI benefits for the week. FPUC payments will be paid for each week someone is eligible from March 29, 2020 through the week ending July 25, 2020. The $600 payments will be retroactive for those eligible for payments.

these temporary new federal benefits through the Oregon Employment Department's Online Claim System.

Other potentially helpful resources for solopreneurs

- The Oregon Small Business Development Center Network has developed a set of guidelines for small businesses to consider in not only this unprecedented situation created by COVID-19, but in any situation that may create significant impacts to your business operation. Topics: Assumptions and Considerations, Sales, Cash Flow, Staffing, Operations, SBA Economic Injury Disaster Recovery Program Tax Relief.
- Facebook is offering $100M in cash grants and ad credits to help during this challenging time.
- Freelancers Relief Fund will offer financial assistance of up to $1,000 per freelance household to cover lost income and essential expenses not covered by government relief programs, including food/food supplies, utility payments, and cash assistance to cover income loss.
- Google made an $800+ million commitment to support small- and medium-sized businesses, health organizations and governments, and health workers on the frontline of this global pandemic.
- The Small Business Administration is offering Economic Injury Disaster Loans for up to $2 million.

MARKOWITZ HERBOLD PC

MEMORANDUM

TO: Interested Parties

FROM: Markowitz Herbold PC

DATE: March 22, 2020

RE: Addressing challenges to contracts from the COVID-19 pandemic

SUMMARY

Businesses nationwide are facing severe financial stress from the COVID-19 pandemic. As a result, many may be unable or unwilling to perform their contracts. In some cases, unusual and unexpected circumstances—potentially but not necessarily including the COVID-19 pandemic—can excuse performance of contracts. Many contracts have a "force majeure" clause. Force majeure clauses are designed to excuse performance of contracts in the event of unforeseen circumstances. Even when contracts do not have force majeure clauses, the common law may excuse performance of contracts when circumstances make performance impossible or the purpose of the contract has become nullified by intervening events.

This memorandum provides an overview of law concerning force majeure clauses and the common law affirmative defenses of impossibility, impracticability, and frustration of purpose.

DISCUSSION

I. Force majeure clauses

A. Force majeure clauses are designed to excuse performance of a contract in the event of extreme, unforeseen circumstances.

Force majeure clauses specify unusual conditions which excuse performance. A force majeure clause usually lists a number of events that could excuse performance. The following is an example of a force majeure clause:

> A party shall not be held liable for failure to perform its obligations under this Agreement if such failure is the result of an act of God, such as earthquake, hurricane, flood, or other natural disaster, or in the case of war, action of foreign enemies, terrorist activities, labor dispute or strike, government sanction or regulation, or embargo. The non-performing party must make every reasonable attempt to minimize delay of performance.

The goal of force majeure clauses is to re-allocate the risk of loss if performance becomes impossible or impracticable, especially as a result of an event that the parties could not have anticipated or controlled. "The purpose of a force majeure clause is to only

discharge a party from liability under the contract because of an event that is extreme, unforeseeable, beyond the control of the party, and without the party's fault or negligence." 102 *Am. Jur. Proof of Facts* 3d 401 (2008) (footnote omitted). If the conditions exist, then the party being excused cannot be held to have breached the contract. *See City of Reedsport v. Hubbard*, 202 Or 370, 387 (1954) (stating suit should have been dismissed because clause excused defendant's performance for circumstances beyond control of defendant, and War Production Board denial that prevented performance expressly fell under that clause).

Force majeure can be used either as a defense to a claim for breach of contract or offensively to terminate a contract.

B. The non-performing party bears the burden of proof and force majeure clauses are narrowly construed.

The "party who relies on a force majeure clause to excuse performance bears the burden of proving that the event was beyond the party's control and without its fault or negligence." *OWBR LLC v. Clear Channel Commc'ns, Inc.*, 266 F. Supp. 2d 1214, 1222 (D. Haw. 2003).

And, force majeure clauses "are construed narrowly." 30 WILLISTON ON CONTRACTS § 77:31 (4th ed.). "Force majeure clauses are to be interpreted in accord with their purpose, which is 'to limit damages in a case where the reasonable expectation of the parties and the performance of the contract have been frustrated by circumstances beyond the control of the parties.'" *Constellation Energy Servs. of New York, Inc. v. New Water St. Corp.*, 146 A.D.3d 557, 558, 46 N.Y.S.3d 25, 27 (N.Y. App. Div. 2017). "Interpretation of force majeure clauses is to be narrowly construed and 'only if the force majeure clause specifically includes the event that actually prevents a party's performance will that party be excused.'" *Reade v. Stoneybrook Realty, LLC*, 63 A.D.3d 433, 434, 882 N.Y.S.2d 8, 9 (2009) (quoting *Kel Kim Corp.*, 519 N.E. 2d at 296). In that case, the court interpreted "governmental prohibitions" in the clause to include a temporary restraining order that prevented performance.

C. Courts evaluate three factors when applying force majeure clauses.

In considering whether a force majeure clause applies, courts analyze the following three factors: First, the court will determine whether the event is listed as an event of force majeure under the contract. 30 WILLISTON ON CONTRACTS § 77:31 (4th ed.) ("What types of events constitute force majeure depend on the specific language included in the clause itself."). If the event is not specifically referenced but there is a catch-all "and other events beyond the parties' control" in the clause, then courts will use common law doctrines to decide whether the event falls within the clause. Second, a court will look to whether the non-performing party should have been able to mitigate non-performance. And third, a court will examine whether the event made performance impossible. (The second and third factors are often merged together.)

First factor. If pandemic, epidemic, plague, or public health crisis is mentioned in a list of events that excuse performance, the court will move to the second factor. If it is not, but there is a catch-all phrase such as "and other events beyond the parties' control," the key question will be how to interpret that phrase. Most courts require the non-performing party to demonstrate that the force majeure event was unforeseeable. *Watson Labs., Inc. v. Rhone-Poulenc Rorer, Inc.*, 178 F. Supp. 2d 1099, 1113 (C.D. Cal. 2001) (so holding). If the event was foreseeable, then the force majeure clause will *not* excuse performance. *TEC Olmos, LLC v. ConocoPhillips Co.*, 555 S.W.3d 176, 184 (Tex. App. 2018) ("Because fluctuations in the oil and gas market are foreseeable as a matter of law, it

cannot be considered a force majeure event unless specifically listed as such in the contract."); *Gulf Oil Corp. v. F.E.R.C.*, 706 F.2d 444, 453 (3d Cir. 1983) ("To support a definition of force majeure in a warranty contract, we must stress the element of uncertainty or lack of anticipation which surrounds the event's occurrence[.]"). Although the majority of courts require the event be unforeseeable, that is not universal. *Sabine Corp. v. ONG W., Inc.*, 725 F. Supp. 1157, 1170 (W.D. Okla. 1989) ("Plaintiff's argument that an event of force majeure must be unforeseeable must be rejected.").

Some courts will apply the doctrine of *ejusdem generis* to interpret a catch-all phrase. Under that doctrine, the court will seek to determine whether the unlisted event is of the same kind as the listed events. *Kel Kim Corp. v. Cent. Markets, Inc.*, 519 NE2d 295, 296–97 (N.Y. 1987) (applying *ejusdem generis* to determine whether force majeure clause applied).

Second factor. Some courts will require the non-performing party to attempt performance or mitigate the damages of non-performance to the other party. "To invoke force majeure and excuse performance, the nonperforming party's duty extends to showing what action it took to perform the contract regardless of the occurrence of the excuse." *Gulf Oil Corp. v. F.E.R.C.*, 706 F.2d 444, 452 (3d Cir. 1983).

Third factor. Even if a non-performing party can meet the requirement that the event listed in the contract actually occurred, it cannot invoke the force majeure clause if performance is merely impracticable or economically difficult rather than truly impossible. *See Watson Laboratories, Inc. v. Rhone-Poulenc Rorer, Inc.*, 178 F. Supp. 2d 1099, 1110 (C.D. Cal. 2001) (applying California law to deny defense based on force majeure clause because performance was merely difficult, not impossible); *Sause Bros. Ocean Towing Co., Inc. v. Gunderson, Inc.*, 265 Or. 568, 581 (1973) (regardless of whether the force majeure event happened, the non-performance was caused by a different event and clause did not apply); *Constellation Energy Servs. of New York, Inc. v. New Water St. Corp.*, 146 A.D.3d 557, 559 (N.Y. App. Div. 2017) (although event occurred, defendant still must prove "that its failure to [perform] was an unavoidable result of [Hurricane Sandy.]"). "California law requires a promisor invoking a force majeure clause to show 'that, in spite of skill, diligence and good faith on his part, performance became impossible or unreasonably expensive.'" *Jin Rui Grp., Inc. v. Societe Kamel Bekdache & Fils S.A.L.*, 621 F. App'x 511, 511 (9th Cir. 2015) (unpublished) (citing California law that quoted *Corbin on Contracts* § 1342).

II. Common law affirmative defenses

If the force majeure clause does not apply, the courts may still allow the non-performing party to contend that the common law affirmative defenses apply. *See Kel Kim Corp.*, 519 N.E.2d at 296 (addressing common law impossibility defense while also addressing force majeure clause).

A. Impossibility of performance

Under the doctrine of impossibility of performance, a defaulting party's performance under the contract is excused when, without any fault of that party, performance becomes impossible due to an unforeseen event that was beyond the control of the parties. The general rule is "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).

A clearer formulation of the impossibility doctrine comes from the Southern District of New York, citing both New York and federal precedent.

> [A] breach can be excused—and liability extinguished—if the breaching party can show that performance was impossible on account of a "supervening event" whose "non-occurrence of that event [was] a 'basic assumption' on which both parties made the contract."
>
> To sustain an impossibility defense, the "supervening event" must have been "unanticipated" by the parties. As the [U.S.] Supreme Court has explained, if an event "was foreseeable," it "should have been [provided] for it in the contract, and the absence of such a provision gives rise to the inference that the risk was assumed" by the party whose performance was frustrated. In other words, an impossibility defense only excuses non-performance if the "unanticipated event [ ] could not have been foreseen or guarded against in the contract."

World of Boxing LLC v. King, 56 F. Supp. 3d 507, 512 (S.D.N.Y. 2014) (Scheindlin, J.) (citations and footnotes omitted; rejecting boxing promoter's impossibility defense where his boxer failed to perform due to failed drug test). The court also clarified that "improbable" does not meet the standard of "unanticipated." "What the case law has in mind, however, are not improbable events, but events that fall outside the sphere of what a reasonable person would plan for." *Id.* at 514.

1. Impossibility due to disease.

There are a few cases that address impossibility of performance due to disease. In *Lakeman v. Pollard*, 43 Me. 463 (1857), a worker left his employment at roughly the mid-point of the timber sawing season. He sued for *quantum meruit* for the labor he supplied before he quit due to fear of a nearby cholera outbreak. The defendant contended it did not have to pay because the plaintiff breached the contract by quitting four months early. The jury returned a verdict for the laborer, and the court affirmed. The court discussed that impossibility would excuse performance, "[i]f the fulfillment of the plaintiff's contract became impossible by the act of God, the obligation to perform it was discharged." The court then stated that "[w]hen the laborer has adequate cause to justify an omission to fulfill his contract, such omission cannot be regarded as his fault. Whether or not the plaintiff had such cause was a question of fact, to be determined by the jury, upon the evidence." *Id.* at 467.

In 1874, a New York federal court allowed a defense of impossibility of performance due to an epidemic among horses. *Coombs v. Nolan*, 6 F.Cas. 468 (S.D.N.Y. 1874). Plaintiffs sued for damages because defendants were unable to timely unload a cargo ship. Defendants asserted the defense of impossibility because an epidemic made it impossible for several days to procure the necessary draft horses to pull the winch to lift and unload the granite from the boat and to cart it away. *Id.* at 468. The defendants eventually were able to hire horses at three-times the usual price. The court dismissed the claim and concluded that it was "a delay caused by an act of God," and, thus, "each party must bear the loss he has suffered[.]" *Id.* at 468-69.

2. Impossibility due to government acts.

Government decrees, such as a "shelter in place" order, create another type of impossibility defense. An act (taken after contract execution) of government that makes performance illegal or impossible is generally a valid defense, assuming that the government act is the actual cause of non-performance. "Whether predicated on a contractual provision or simply on the common law defense of impossibility these decisions indicate in the clearest terms that fundamentally coercive acts of Government, whatever their form, constitute an excuse for breach." *E. Air Lines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957, 994 (5th Cir. 1976) (citing cases).

Like other impossibility cases, affirmative defenses based on acts of government require that the defendant's performance must be actually or nearly impossible. *Elmira Lumber Co. v. Owen*, 96 Or. 127, 133 (1920) (negating impossibility defense where the defendants were unable to obtain a right of way by negotiation when they could have used eminent domain and stating "'it must appear obviously impossible of performance in the nature of things by any one'"; citation omitted).

B. Impracticability

For contracts for the sale of goods, the UCC applies, and the affirmative defense under the UCC is "impracticability." UCC § 2-615 provides for an impracticability defense based on "occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract." The provision states:

> Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:
>
> (a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed 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 by compliance in good faithwith any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.
>
> (b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.
>
> (c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

Thus, 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"), and (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 (footnote omitted).

This UCC section parallels the common law defense of impracticability. The Restatement of Contract provides that something "well beyond the normal range" is required to trigger the defense:

> "[I]mpracticability" 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). In addition to extreme hardship that could not be mitigated, the non-performing party must also prove that an epidemic like COVID-19 and the response to it were not foreseeable. *See Smith Tug & Barge Co. v. Columbia-Pacific Towing Corp.*, 250 Or. 612, 643 (1968) ("The contingency in the instant case is so obvious and material that the absence of any contractual provision concerning such contingency most probably indicates a willingness to assume the risk of the nonoccurrence of the contingency and an adjustment of the consideration to reflect the assumption of the risk").

Under both the UCC and common law, "[i]ncreased cost alone does not excuse performance [under U.C.C. § 2-615] 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*, *supra*, § 2-615:1 at 615 (1997 ed.) (quoting official commentary to U.C.C. § 2-615). In other words, "[t]he mere fact that performance becomes more expensive does not in itself excuse performance under UCC § 2-615." *Id.* § 2-625:58 at 640 (footnote omitted). Also, "the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances." *Id.*, § 2-615:1 at 616 (quoting official commentary to UCC § 2-615). Under the UCC, "[t]he defense of impracticability requires a wholly unexpected contingency." *Id.* § 2-615:47 at 636 (footnote omitted). "Unexpected difficulties and expenses do not excuse performance of a contract unless so extreme that a practical impossibility exists resulting in a hardship so extreme as to be outside any reasonable contemplation of the parties." *Id.* § 2-615:56 at 639 (footnote omitted). Similarly, the Ninth Circuit holds that "Section 2-615 applies only when the events that made the performance of the contract impracticable were unforeseen at the time the contract was executed." *Interpetrol Bermuda Ltd. v. Kaiser Aluminum Int'l Corp.*, 719 F.2d 992, 999 (9th Cir. 1984) (applying Texas law).

C. 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. For example, if person A agrees to lease her apartment in New York City on Fifth Avenue to person B so that B can watch the St. Patrick's Day Parade,

performance under the contract is pointless if the government subsequently cancels the parade—the purpose has been frustrated.

Discharge of duty due to frustration occurs "[w]here, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made * * *." *Restatement (Second) of Contracts*, § 265.

Frustration of purpose, under California law, is "where performance remains possible, but the reason the parties entered the agreement has been frustrated by a supervening circumstance that was not anticipated, such that the value of performance by the party standing on the contract is substantially destroyed, the doctrine of commercial frustration applies to excuse performance." *Habitat Tr. for Wildlife, Inc. v. City of Rancho Cucamonga*, 175 Cal. App. 4th 1306, 1336 (2009) (citation omitted). In *Habitat Trail*, the developer had promised to convey mitigation land to a trust as part of a development agreement with the city, but, unexpectedly, the local government disqualified the trust from receiving and holding any mitigation land. The purpose of the contract with the trust was frustrated because the transfer of the mitigation land would no longer qualify as a mitigation effort, which was the essential goal of the contract. *Id.* at 1336.

Frustration of purpose does not apply where the contract is simply made less profitable or more expensive:

> California courts "have required a promisor seeking to excuse himself from performance of his obligations to prove that the risk of the frustrating event was not reasonably foreseeable and that *the value of counterperformance is totally or nearly totally destroyed*[.]" . . . Application of the doctrine "has been limited to cases of extreme hardship so that businessmen, who must make their arrangements in advance, can rely with certainty on their contracts."
>
> . . . . .
>
> The doctrine of frustration is inapplicable when an unforeseeable event merely makes performance more expensive or less profitable than anticipated. Invocation of the excuse of frustration requires that the difference be so excessive as to make performance extremely impracticable.

Waegemann v. Montgomery Ward & Co., Inc., 713 F.2d 452, 454 (9th Cir. 1983) (citations omitted; emphasis added).