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DEFENSES TO NON-PERFORMANCE OF CONTRACTS DUE TO COVID-19

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In Arizona, four main defenses could excuse a party's nonperformance of a contractual obligation due to a supervening act of God or other extraordinary event like the current COVID-19 pandemic: (1) Force Majeure; (2) Impracticability; (3) Frustration of Purpose; and (4) Impossibility.

Force Majeure

Force Majeure (a "superior force") is a contractual provision that excuses a party's nonperformance when "acts of God" or other extraordinary events prevent that party from fulfilling its contractual obligations. It is an equitable legal principle that relieves a party from performing a contract when circumstances beyond their control make performance physically and/or economically impossible (or at least impracticable). A force majeure clause insulates the non-performing party from damages based upon an act of God. *Tech. Const., Inc. v. City of Kingman*, 229 Ariz. 564, 567, 278 P.3d 906, 909 (App. 2012).

The language of the contract governs the interpretation of a "force majeure" clause. Thus, whether the clause would apply to a particular circumstance such as COVID-19 will depend on the language of the contract. The primary question will be whether the clause covers the type of event (a pandemic) that a party claims is causing its nonperformance. Because such clauses are generally interpreted narrowly, the force majeure clause must specifically articulate the qualifying event. However, even when the clause covers a potential force majeure event, the non-performing party must mitigate any foreseeable risk of nonperformance. In other words, the non-performing party cannot invoke force majeure if the potential nonperformance was foreseeable and could have been prevented or otherwise mitigated.

Impracticability

Arizona courts recognize the doctrine of impracticability as a viable defense to nonperformance. Specifically, Arizona follows the Restatement of Contracts regarding this doctrine:

> Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981). Impracticability will apply when performance was objectively unreasonable—in other words, when the industry as a whole found the specifications impossible. Completion of the job must require so much beyond the parties' contemplation that it becomes an exercise in commercial futility *Willamette Crushing Co. v. State By & Through Dep't of Transp.*, 188 Ariz. 79, 83, 932 P.2d 1350, 1354 (Ariz. App. 1997). In addition, impracticability excuses the non-occurrence of a condition only if the occurrence of the condition is not a material part of the agreed exchange and forfeiture would otherwise result. *Thoracic Cardiovascular Associates, Ltd. v. St. Paul Fire & Marine Ins. Co.,* 181 Ariz. 449, 456, 891 P.2d 916, 923 (App. 1994) (condition requiring the insured to provide notice of a claim during the policy period is a material part of the agreed exchange. No coverage exists unless notice is given during the policy term; there can be no excuse for the nonperformance of a material provision). The doctrine does not apply where the non-performing party assumed the risk of non-performance. *Id.* ("Where, as here, an insured elects to purchase a claims made policy and does not elect to purchase occurrence coverage, the insured assumes the risk that claims will not be covered unless they are both discovered and reported during the policy period.").

Frustration of Purpose

Frustration of purpose is an equitable doctrine that excuses nonperformance when a "supervening frustrating event" prevents the contract from fulfilling its essential purpose. This doctrine focuses on intent of the parties and whether

some unforeseeable event has impeded the purpose of the agreement. This doctrine "deals with the problem that arises when a change in circumstances makes one party's performance virtually worthless to the other, frustrating his purpose in making the contract." *7200 Scottsdale Rd. Gen'l Partners v. Kuhn Farm Mach. Inc*., 184 Ariz. 341, 345, 909 P.2d 408, 412 (App. 1995). "Performance remains possible but the expected value of performance to the party seeking to be excused has been destroyed by a fortuitous event, which supervenes to cause an actual but not literal failure of consideration." *Id.*

This defense "has been severely limited to cases of extreme hardship so as not to diminish the power of parties to contract, and . . . require[s] proof from the party seeking to excuse himself that the supervening frustrating event was not reasonably foreseeable." *Next Gen Capital, L.L.C. v. Consumer Lending Assocs., L.L.C.,* 234 Ariz. 9, 11, 316 P.3d 598, 600 (App. 2013) (doctrine inapplicable to excuse tenant payday loan business from rent obligations after expiration of payday loan authorizing statute; expiration of statute was reasonably foreseeable and parties could have contracted around it).

The RESTATEMENT (SECOND) OF CONTRACTS § 265 enumerates the following four requirements before relief may be granted:

> First, the frustrated purpose must have been a principal purpose of that party and must have been so within the understanding of both parties. Second, the frustration must be so severe that it is not to be regarded as within the risks assumed [] under the contract. Third, the non-occurrence of the frustrating event must have been a basic assumption on which the contract was made. And, finally, relief will not be granted if it may be inferred from either the language of the contract or the circumstances that the risk of the frustrating occurrence, or the loss caused thereby, should properly be placed on the party seeking relief.

Next Gen Capital, L.L.C. 234 Ariz. at 11, 316 P.3d at 600Proper application of the doctrine requires proof from the party seeking to excuse themselves from performance that the supervening frustrating event was not reasonably foreseeable." *B.F. Goodrich Co. v. Vinyltech Corp.*, 711 F. Supp. 1513, 1519 (D. Ariz. 1989) (change in price or market conditions does not support frustration of contract defense).

Impossibility

This defense to nonperformance excuses a party from performance if it "becomes impossible due to circumstances beyond the parties' control." *Garner v. Ellingson*, 18 Ariz.App. 181, 182, 501 P.2d 22, 23 (1972). "The doctrine of impossibility of performance dates back to the celebrated case of Taylor v. Caldwell, 3 Best & S. 826 (1863) wherein Caldwell was relieved of liability in damages for non-delivery of a music hall to Taylor because the hall had been destroyed by fire. Since that case the courts have grown increasingly liberal in their construing of what constitutes 'impossibility.'" *Minderman v. Perry*, 103 Ariz. 91, 93–94, 437 P.2d 407, 409–10 (1968) Quoting the RESTATEMENT (SECOND) OF CONTRACTS, the *Minderman* court noted:

> [W]here performance of a promise becomes impossible because of facts which the promisor had no reason to anticipate and for the occurrence of which the promisor is not at fault his duty is discharged unless a contrary intention has been manifested; and, more specifically, where the existence of a specific person is essential to the performance of a promise the duty to perform that promise is discharged if the person is not in existence at the time for seasonal performance, unless a contrary intention is manifested or the contributing fault of the promisor causes the nonexistence.

Id. (quoting Restatement (Second) of Contracts §§ 457, 46). This defense also requires "proof . . . that the supervening frustrating event was not reasonably foreseeable." *Id*. Consequently, this doctrine is often pled as a defense in conjunction with impracticability and frustration of purpose.

Conclusion

Undoubtedly those who have been unable to perform contracts due to stay-at-home orders, business closures, and travel restrictions will be raising these defenses to contract claims. Whether such defenses will be successful will depend on the relevant facts, contract language, and the type of business at issue.

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This article is adapted from USLAW NETWORK'S Force Majeure Compendium of Law (during COVID-19 pandemic). Erik Stone authored the Arizona chapter. Read and download the Arizona chapter, and USLAW'S full compendium here.

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