The Pandemic's Impacts on Developers and Contractors May Call for Seldom-Used Relief: An Overview of the Principles of Force Majeure, Impracticability, and Frustration of Purpose

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As society responds to the COVID-19 pandemic, states and local governments across the United States, including the State of California, issued shelter-in place ("SIP") orders[1] to prevent its spread. While intended to benefit Americans in the long run, these actions have resulted in massive and largely unprecedented disruptions in the economy, including record levels of unemployment and sharply limiting the ability of businesses to provide, and customers to purchase, goods and services.[2] The effects of the pandemic are wide spread and have created financial hardships for individuals and families in every state and locality, as well as inexplicable shortages of toilet paper.[3]

While the principal focus in the battle against COVID-19 remains on limiting the human impact and global efforts to slow its spread, it is impossible to ignore the scale of the economic impact of the virus. Like almost every other aspect of life, real estate interests and land development have not been spared from the wrath of COVID-19. Many local governments in California have implemented residential and commercial tenant protection and eviction moratoria during the pendency of the pandemic.[4] With varying criteria, these orders generally grant temporary respite from evictions for qualifying commercial and residential tenants due to nonpayment of rent arising out of substantial decrease in income or substantial out-of-pocket medical expenses resulting from COVID-19.[5] The orders do not exempt tenants from ultimately tendering past due rent, but, instead grant said tenants an extension to respond to unlawful detainer complaints and submit payment.[6]

From a land use perspective, COVID-19 has slowed local governments from processing and approving projects as staff shelter in place and it has disrupted the flow of equipment, materials, and labor along the supply chains necessary for development of entitled construction projects.[7] Additionally, certain SIP orders have expressly prohibited most construction activities, even those related to much-needed residential development, due to inherent violations in social distancing guidelines identified by the Center for Disease Control.[8] Construction prohibitions and disruptions to any link in the supply chain have the potential to delay development, increase construction costs, decrease availability of governmental personnel for project inspections, and threaten the ability for developers to utilize certain entitlements[9] within the statutorily proscribed time periods.[10] These problems may be particularly acute for developers who were awarded entitlements well in advance of the current pandemic or who entered into construction contracts prior to the emergence of the outbreak.[11]

This article addresses contractual provisions and legal doctrines—the principles of force majeure, impracticability, and frustration of purpose—that may be exercised by developers and contractors to protect their investments from project delays or increased labor costs related to certain unforeseen consequences beyond their control. It is critical to note that application of these principles is a fact- and contract-specific endeavor, particularly as it relates to the impacts of COVID-19. This article is intended to provide a broad, general overview of the principles.

I. FORCE MAJEURE

At the most macro level, force majeure (from the French, "superior force") can be defined as a contractual provision and or affirmative defense, allocating risk seen through the lens of impossibility, impracticability, or illegality, and is often the term used in contracts or entitlements that forgive performance of the obligations identified therein under very specific circumstances. Force majeure, which is a contractual—not common law—construct, is based on the premise: "No man is responsible for that which no man can control."[12] Generally, a force majeure contractual clause is triggered by the occurrence of an event, sometimes referred to as an "act of God," which ultimately renders performance impracticable.[13]

There are two aspects to the operation of force majeure clauses: (i) the definition of force majeure events; and (ii) the operative clause that sets out the effect on the parties' rights and obligations if a force majeure event occurs.[14] The burden of proving such an event and resultant outcome rests on the party invoking a force majeure provision as a defense.[15]

The specific circumstances identified in a force majeure clause are paramount, and may be construed narrowly. Generally, in defining qualifying events, many contracts require force majeure events to be: (i) unforeseeable; (ii) outside the reasonable control of the party seeking to have its obligations excused; and (iii) a result of circumstances other than that party's negligence or willful misconduct.[16] The wording of the exact provision at issue will be key.

California law requires proof that a party relying on a force majeure clause did not exercise reasonable control over the excusing event.[17] A party shows it did not exert "reasonable control" over the event by showing it had good faith in not causing the excusing event and was diligent in taking reasonable steps to ensure performance.[18] The test is whether, under the particular circumstances, there was an insurmountable interference to the performance of the contract that the parties could not have prevented by prudence, diligence, and care.[19] While often referred to as such, the circumstance does not need to be "the equivalent of an act of God." [20]

The force majeure defense requires more than mere economic hardship.[21] However, a party that explicitly assumed the risk for this type of event, even if it was unforeseeable, cannot successfully assert a force majeure defense.[22]

The remedies available to a developer or contractor experiencing a qualifying force majeure event will depend on the applicable contractual or approval obligations.[23] These remedies may include extension of time to perform those obligations or suspension of contractual performance for the duration of the force majeure event.

A developer or contractor's right to relief for force majeure is typically conditioned upon the provision of a notice and supporting evidence to the other party, usually within a specified period from when the affected party first became aware of the force majeure event.[24] Failure to comply will result in forfeiture of the right to this contractual defense.[25]

When it comes to COVID-19, the disruptions are twofold: the pandemic itself and the various governmental responses discussed above. To this end, "pandemic" or "quarantine" are not typically expressly included in the definition of force majeure. Therefore, when assessing applicability of a force majeure provision, a party hindered by COVID-19 impacts should ask the following questions:

- Does the force majeure clause have specific notice and response provisions, including timing, content, or delivery method?
- What are the specific factors that make performance impossible? Beyond simply a loss in demand or change in market conditions, are there specific non-economic factors making performance impossible such as government restrictions on gatherings?
- How can the client take reasonable steps to perform, even if not in the same manner initially contemplated? Is delay or rescheduling possible? Can the contract be performed by alternative means? Are there protective measures that can be taken to continue performance?
- Does the force majeure provision specifically include or exclude this type of event (e.g., disease, pandemic, quarantine)?

- Are any individuals who are sick as a result of the outbreak responsible for performing, without whom performance is impossible?
- Did the parties specifically negotiate the force majeure provision?

Consider how declaring force majeure under one contract affects other agreements and legal obligations, including risk and litigation disclosures.

II. TEMPORARY IMPRACTICALITY OR FRUSTRATION OF PURPOSE

In the instances where neither a construction contract nor an entitlement contain a force majeure provision, or include one that fails to sufficiently identify public health crises or pandemics, thereby rendering the clause inapplicable to the difficulties wrought by COVID-19, developers and contractors may rely on common law doctrines of impracticability or frustration of purpose.

Under these doctrines, intervening circumstances render the contract or approval worthless, due to an alteration of a basic assumption underlying the contract or entitlement, so that performance pursuant to contractual terms (including conditions of approval) is impracticable or negates the very purpose for the contract.[26] Assertion of impracticability or frustration of purpose is intended to stave off allegations of breach or default of contract by the other party or the public agency responsible for entitlement approval. While the typical remedy for these doctrines is either a full excuse from performance or a rescission of the contract entirely,[27] a developer or contractor may want simply to pause performance of its development obligations.

The ongoing COVID-19 pandemic may provide at least a temporary defense for California developers or contractors looking to pause contractual obligations if such performance would be impracticable at present because it would contravene either the state or local SIP order or would result in excessive and unreasonable difficulty or expense due to breaks in the supply chain.[28]

A. Impracticability

Under California jurisprudence, any condition in a contract "which is impossible or unlawful" to be fulfilled is void.[29] Additionally, the law permits excuse from contractual performance "[w]hen it is prevented or delayed by an irresistible, superhuman cause."[30] The doctrine of impracticability recognizes that it would be unfair and inequitable to hold a contracting party to their contractual duties when the circumstances interfering with their performance are extraordinary and beyond their control.[31]

This doctrine applies where performance is prevented or prohibited by a judicial, executive, or administrative order—such as the above-described SIP orders that prevent construction and non-essential business operations that result in supply chain delays.[32] To be an excuse for nonperformance of a contract, the impracticability of performance must attach to the nature of the thing to be done and not to the inability of the obligor to do it.[33] In instances in which impracticability is temporary, the obligation to perform is usually only suspended during the time the conditions exist.[34]

A developer asserting the defense of impracticality has the burden to prove the following elements: (i) a supervening event made performance impracticable; (ii) the nonoccurrence of the event was a basic assumption upon which the contract or entitlement was based; (iii) the occurrence of the event resulted without the fault of the developer; (iv) the developer did not assume the risk of occurrence; and (v) the developer has not agreed, either expressly or impliedly, to perform despite impossibility or impracticability that would otherwise justify nonperformance.[35]

B. Frustration of Purpose

Akin to impracticability, the doctrine of frustration of purpose (or commercial frustration) follows much of the same law.[36] Frustration of purpose occurs when: (i) performance remains possible; (ii) but the fundamental reason of both parties for entering into the contract has been frustrated by an unanticipated supervening circumstance; and (iii) this event substantially destroys the value of performance by the party under the contract.[37]

It should be noted that courts have generally hesitated to discharge parties from their contractual obligations based on the general policy that parties should be held to their contractual promises.[38] Therefore, this doctrine should be viewed as a narrow equitable defense reserved for situations of extreme hardship.[39] When assessing applicability of the doctrine of commercial frustration, a party hindered by COVID-19 impacts should ask the following questions:

- What was the underlying main purpose of the agreement?
- When did contracting parties meet/decide to enter into a contract? Was it before or after the COVID-19 outbreak was publicized in mainstream media?

- Can the frustration be explained by reasons other than simply the loss of revenue/profit?

III. CONCLUSION

Meanwhile, confusion and uncertainty abound in the real estate industry from both a transactional and land use perspective, with many parties unable to meet a variety of contractual obligations as a result of the COVID-19 pandemic and fallout, and related government shutdowns, employee limitations, and supply chain disruptions. To date there are no published California decisions that squarely confront an ubiquitous virus or global pandemic in relation to contract and equitable principles.[40] Therefore, it is not currently clear how transactional and land use disputes will ultimately be resolved.

Nonetheless, it seems likely that force majeure provisions and the doctrines of impracticability and frustration of purpose will play a significant role in the ultimate resolution of land use and transactional disputes. These doctrines are fact-dependent and subject to interpretation. This means that the unique factual circumstances of each industry, each party, and each agreement will dictate the result. However, based on the widespread pandemic and indisputable hardship resulting from COVID-19, arguments can be made in favor of the applicability and enforceability of these doctrines. We anticipate that these defenses will play a critical role as developers and contractors continue to navigate the performance of contractual obligations against the backdrop of COVID-19.

Endnotes

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1 See, e.g., State of Cal., Executive Dept., Executive Order N-33-20, (issued Mar. 19, 2020) <(https://covid19.ca.gov/img/Executive-Order-N-33-20.pdf>; City and County of S.F., Dept. of Public Health, Order of the Health Officer No. C19-07 (issued Mar. 16, 2020) <(https://www.sfdph.org/dph/alerts/files/HealthOrderC19-07-%20Shelter-in-Place.pdf>; L.A. County, Dept. of Public Health, Order of the Public Health Officer – Safer At Home Order for Control of COVID 19, (issued Mar. 16, 2020) <(http://publichealth.lacounty.gov/media/Coronavirus/docs/HOO/HOO_Safer_at_Home_Order_for_Control_of_COVID_20200513.pdf>.

2 Filippo Taddei, *COVID-19's Historic Economic Impact, in the U.S. and Abroad* (Apr. 16, 2020) John Hopkins Magazine <https://hub.jhu.edu/2020/04/16/coronavirus-impact-on-european-american-economies/>.

3 Maria Nicola, Zaid Alsafi, Catrin Sohrabi, Ahmed Kerwan Ahmed Al-Jabir, Christos Iosifidis, Maliha Agha & Riaz Agha, *The Socio-Economic Implications of the Coronavirus and COVID-19 Pandemic: A Review* (Apr. 17, 2020) <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7162753/>.

4 See, e.g., State of Cal., Executive Dept., Executive Order N-37-20 (issued Mar. 27, 2020) <https://www.gov.ca.gov/wp-content/uploads/2020/03/3.27.20-EO-N-37-20.pdf>; City and County of S.F., Office of the Mayor of S.F., Fifth Supplement to Mayoral Proclamation Declaring the Existence of a Local Emergency Dated February 25, 2020 (issued Mar. 23, 2020) <https://sfmayor.org/sites/default/files/032320_FifthSupplement.pdf>; City of San Diego, Ord. No. 21177 (issued Mar. 25, 2020) <accessed at https://docs.sandiego.gov/council_reso_ordinance/rao2020/O-21177.pdf>; City of L.A., Ord. No. 186585 (issued Mar. 27, 2020) <http://clkrep.lacity.org/onlinedocs/2020/20-0147-S19_ORD_186585_03-31-2020.pdf>.

5 Alex Merritt & Daniel Maroon, *COVID-19 Impacts: California Governor Newsom's Executive Order Explained* (Apr. 8, 2020) <https://www.realestatelanduseandenvironmentallaw.com/executive-order-rent-relief.html>.

6 Alfred Fraijo Jr., *Emergency Tenant Protections Take Effect in the City of Los Angeles* (Apr. 1, 2020) <https://www.realestatelanduseandenvironmentallaw.com/emergency-tenant-protections-la.html>.

7 David Robertson, Dr. Matthew Secomb, and Emily Elliott, *COVID-19: Managing Force Majeure Risk in a Construction Project Supply Chain* (Apr. 13, 2020) <https://www.whitecase.com/publications/alert/covid-19-managing-force-majeure-risk-construction-project-supply-chain>.

8 City and County of S.F., Dept. of Public Health, Order of the Health Officer No. C19-07b (issued Mar. 31, 2020) <https://www.sfdph.org/dph/alerts/files/HealthOfficerOrder-C19-07b-ShelterInPlace-03312020.pdf>; Elizabeth J. Dye, *Force Majeure, Construction Delays, Labor Shortages and*

COVID-19 (Mar. 30, 2020) <https://www.gravel2gavel.com/force-majeure-delays-shortages-covid-19/>.

9 For purposes of this article, entitlements shall mean discretionary approvals, permits, and issuances required for development plans.

10 Robertson et al., *COVID-19: Managing Force Majeure Risk in a Construction Project Supply Chain*, *supra*; Robert Epstein, Zackary D. Knaub, David C. Jensen & John Mascialino, *For Developers and Owners: How COVID-19 Is Affecting Construction Project and Actions You Should Consider* (Apr. 15, 2020) <https://www.natlawreview.com/article/developers-and-owners-how-covid-19-affecting-construction-projects-and-actions-you>.

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12 Civ. Code, § 3526.

13 *Watson Labs., Inc. v. Rhone-Poulenc Rorer, Inc.* (C.D. Cal. 2001) 178 F.Supp.2d 1099, 1110.

14 Damian McNair, *Force Majeure Clauses – Revisited* (June 2012) <www.dlapiper.com>2012/06>Files>FileAttachment>.

15 *San Mateo Cmty. College Dist. v. Half Moon Bay P'ship* (1998) 65 Cal.App.4th 401, 414.

16 Tara S. Kaushik & Kevin J. Ashe, *Force Majeure: COVID-19 Pandemic Issues that Could Impact Electricity Contract* (Mar. 23, 2020) <https://www.hklaw.com/en/insights/publications/2020/03/force-majeure-covid19-pandemic-issues-that-could-impact-electricity>.

17 *Nissho-Iwai Co. v. Occidental Crude Sales, Inc.* (5th Cir. 1984) 729 F.2d 1530, 1540 (interpreting California law).

18 *Id.*; see *Oosten v. Hay Haulers Dairy Employees & Helpers Union* (1955) 45 Cal.2d 784.

19 *Horsemen's Benevolent & Protective Assn. v. Valley Racing Assn.* (1992) 4 Cal.App.4th 1538, 1565.

20 *Id.*

21 *Butler v. Nepple* (1960) 54 Cal.2d 589, 599.

22 *Eastern Air Lines, Inc. v. McDonnell Douglas Corp.* (5th Cir. 1976) 532 F.2d 957, 992.

23 Iain Elder, *COVID-19: Force Majeure Event?* (Mar. 12, 2020) <https://www.shearman.com/perspectives/2020/03/covid-19--force-majeure-event>.

24 *Id.*

25 *Id.*

26 Johnson et al., *Temporary Impracticality or Frustration of Construction Contracts During the COVID-19 Pandemic*, *supra*; see generally, *FPI Development, Inc. v. Nakashima* (1991) 231 Cal.App.3d 367 (the frustration must be so severe that it is not fairly to be regarded as within the risks that were assumed under the contract); *Christin v. Super. Ct.* (1937) 172 Cal.2d 289, 293 (courts have recognized impracticability due to excessive and unreasonable difficulty or expense); Civ. Code, § 1511(1); *Nat'l Pavements Corp. of Cal. v. Hutchinson Co.* (1933) 132 Cal.App. 235, 238 (impracticability excuses performance when the difference in cost is so great as to make performance manifestly unreasonable).

27 *Lloyd v. Murphy* (1944) 25 Cal.2d 48; *Autry v. Republic Prods.* (1947) 30 Cal.2d 144, 148, 155.

28 *Mineral Park Land Co. v. Howard* (1916) 172 Cal. 289, 293.

29 Civ. Code, § 1441; 6 Williston on Contracts (rev.ed.) § 1931, pp. 5407-5411.

30 Civ. Code, § 1511(2).

31 Kent Schmidt, *Coronavirus and Contractual Performance Disputes – Does a Pandemic Excuse Performance of Contractual Obligations* (Mar. 10, 2020) <https://www.dorsey.com/newsresources/publications/client-alerts/2020/03/coronavirus-and-contractual-performance-disputes>.

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33 *Id.*; *El Rio Oils, Canada, Ltd. v. Pac. Coast Asphalt Co.* (1949) 95 Cal.App.2d 186, 188 (the inability to perform "must consist in the nature of the thing to be done and not in the inability of the obligor to do it").

34 Rest.2d, Contracts (1981) §§ 269-70.

35 *Oosten v. Hay Haulers Dairy Emps. & Helpers Union* (1955) 45 Cal.2d 784, 788; Moses et al., *California Contractual Enforceability Arising in the Wake of COVID-19: Force Majeure, Frustration and Impossibility*, *supra*.

36 Cal. U. Com. Code, § 2615; Civ. Code, § 1932.

37 *FPI Development, Inc*, *supra,* 231 Cal.App.3d at p. 399; *Fed. Leasing Consultants, Inc. v. Mitchell Lipsett Co.* (1978) 85 Cal.App.3d 44, 47; *Gold v. Salem Lutheran*

Home Assn. of Bay Cities (1959) 53 Cal.2d 289, 291 (the event must be one of a nature not reasonably to be foreseen).

38 *Wunderlich v. State ex rel. Dept. of Pub. Works* (1967) 65 Cal.2d 777, 782 (if one agrees to do a thing possible of performance, he or she will not be excused or become entitled to additional compensation because unforeseen difficulties are encountered).

39 Michael M.K. Sebree & David M. Jolley, *Does COVID-19 Excuse Performance Under Your Contract?* (Mar. 31, 2020) <https://donahue.com/resources/publications/does-covid-19-excuse-performance-under-your-contract/#_edn9>.

40 Robert B. Milligan & Darren W. Dummit, *COVID-19 Update: Force Majeure Under California Law in Business and Commercial Disputes* (Mar. 26, 2020) <https://www.seyfarth.com/news-insights/covid-19-update-force-majeure-under-california-law-in-business-and-commercial-disputes.html>.

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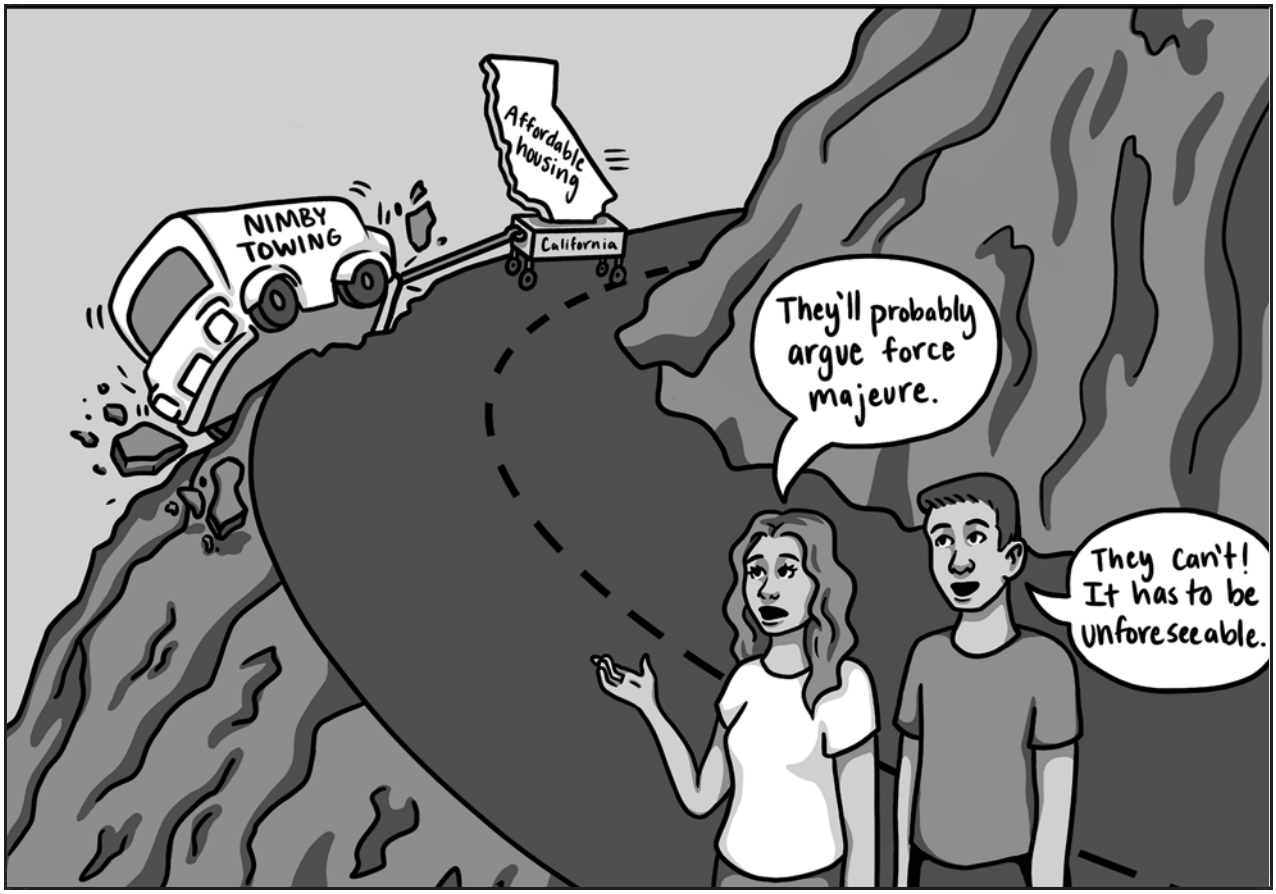

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