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Client Alert: Excuse by Failure of a Presupposed Condition and Mutual Mistake in the Era of COVID-19

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Delays, government closures, supply chain interruptions, loss of supply, elimination of demand, idled employment force, illness, etc., COVID-19 has turned the world on its head. Businesses are scrambling to figure out how to deal with this temporary reality and what it means for them and their contractual obligations. There is nothing like a good crisis to get a company to review its contracts to see what they actually say. Businesses are feverishly reviewing contract provisions for any insight into where a global pandemic might fit in. Chances are most people will not find it. The reason being, very few people in the business community contemplated that a global pandemic of this magnitude would ever occur during their lifetime. Many are finding that their force majeure clauses may not provide them any respite.

That does not mean all hope is lost. The Uniform Commercial Code includes a provision under 2-615 titled, "Excuse by Failure of Presupposed Conditions." What does that mean? It allows a party to delay or otherwise breach a sales contract if performance is made impractical by the occurrence of an event that the non-occurrence of, was a basic assumption of the parties. It also allows a party to delay or otherwise breach when required by foreign or domestic governmental regulations or orders, regardless of whether those regulations or orders are later determined to be invalid. It seems likely that most parties to modern sales contracts assumed the non-occurrence of a pandemic and could not have assumed or even imagined the world would be swept by the Coronavirus Pandemic and related governmental shutdowns, regulations, and limitations. If a company can still partially perform, it needs to do so and allocate production among its customers, existing and new, in a fair and reasonable manner. In order to benefit from this provision, such company must provide reasonable notice of delay or non-delivery and if producing under limited allocation, it must provide the estimated quota. If a company notifies a buyer of a partial performance, the buyer has the right to terminate the contract if it substantially impairs the value of the whole contract. Therefore, proceed with caution. This is not a panacea for extracting a business from its contractual obligations, but it certainly is an arrow in the quiver as you analyze your ability to perform under your contracts and what the ramifications of a breach may be.

A less clear defense is one of mutual mistake. Courts may reform a written contract where the contract did not accurately reflect the parties' intent due to a mistake of fact. The evidence of this mistake must be clear and convincing and it also must be mutual. Some jurisdictions require the mistake to be of a then existing fact as opposed to an erroneous prediction of future events. As a result, the timing of when a contract was entered may be important. It is vital that the contract did not contemplate any risk of loss during a pandemic, as the mere contemplation of a virus or pandemic is evidence that this was a contingency anticipated by the parties. The court will look at the parties' intent and, therefore, it quickly becomes an issue of fact. This may provide significant leverage in disputes because whether there was a mutual mistake likely becomes a jury issue. If so, a party making this claim can be assured of a full-blown piece of litigation with all of the associated costs, aggravation, distraction, and uncertainty of outcome that accompanies the same. Parties at that point may want to rethink any hardened positions and work towards a resolution short of having the court system decide their fates.

These legal concepts are affected by different laws and rulings in various jurisdictions at both the State and Federal level. This is not intended to be an exhaustive review of potential excuses for nonperformance. You are encouraged to have your contracts reviewed by a skilled attorney against the relevant applicable State and Federal law to see how these concepts may impact your position.

I can tell you that I could not have imagined in my wildest dreams that the world would come to a grinding halt in the first quarter of 2020 due to a deadly pandemic. I am guessing most of you didn't either. We all made the same mistake.

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