

COVID-19, AN EXCUSE FOR NON-PERFORMANCE?

by Jacob L. Ouzts

The Coronavirus (COVID-19) has disrupted most major facets of life as we know it. The State of California has issued a state-wide shelter in place order for all non-essential activities and businesses. Businesses are closing their doors, businesses are unable to timely complete projects and otherwise comply with the terms of their contractual obligations. While disruption and its impact on our ability to carry on most businesses activities is fast becoming first hand knowledge, what remains unknown for many California based businesses and individuals whom have ongoing contracts (construction contracts, leases, development agreements, purchase and sale agreements, etc.) is to what extent ongoing and timely performance is excused or required in light of COVID-19? This article is intended to provide a brief overview of certain laws and facts that businesses and individuals should consider in trying to ascertain the answer to this pen-ultimate question.

Act of God-Force Majeure

California Courts have long held that an “act of God” (also known as a “force majeure”) may be an excuse for non-performance of a contract. The test for determining whether a particular event constitutes a “force majeure” is “whether under the particular circumstances there was such an insuperable interference occurring without the party's intervention as could not have been prevented by the exercise of prudence, diligence and care.” *National Carbon Co. v. Bankers' Mortgage Co.*, 77 F.2d 614, 617 (1935). This common law was largely developed in the early to mid 1900's as a consequence of shipment delays and government takeovers of certain industries occasioned by the First and Second World Wars. During this period of time, Courts refused to permit parties to escape their contractual obligations solely on the basis of performance becoming more difficult or burdensome as a result of the War. Courts did

however excuse non-performance in those situations where a force-majeure rendered a business's activities "impossible."

For example, an order by the United States Government halting the manufacturing of new automobiles during World War II (as the military needed the steel) was held by the California Supreme Court in *Lloyd v. Murphy* to not excuse an automobile dealer's obligations under a lease, despite the fact that new car sales amounted to over 80% of the car dealers business. The Court reasoned that because the business operations were still possible, albeit frustrated (the tenant could still sell used cars and cars to military workers), the lease was still supported by valuable consideration and thus enforceable. *Lloyd v. Murphy*, 25 Cal. 2d 48 (1944). Contrastingly, the Court in *Lloyd* indicated that it would permit a party to escape its contractual obligations (absent specific contractual terms dictating a different result) in the event a government order rendered carrying on the business "impossible." (*Id.*). This common law is known to legal practitioners as the doctrine of "impossibility of performance," which has since been largely codified by statute in California into California Civil Code Section 1511.

California Civil Code Section 1511 generally provides that performance, or a delay in performance, may be excused under certain circumstances. Such circumstances include delays arising by the operation of law or the occurrence of a "superhuman" interference. Given that COVID-19 is by and large an unforeseen event beyond a party's control, the question becomes whether this current pandemic will provide an excuse for non-performance or a delay in performance? While the answer to this question will ultimately later be decided by courts in this state following litigation on this very issue, it is likely that California Civil Code Section 1511 will excuse performance or timely performance for many businesses. Governor Newsome's executive order mandating the closure of "Non-Essential" businesses, and the specifics of that order, will inevitably play a large role in a court's determination as to whether a particular business's performance obligation may be excused under California Civil Code Section 1511. Even if a business is deemed essential and is not forced to shut down, the impact of that Order

or COVID-19 on an essential business's ongoing operations could still justify the application of Civil Code Section 1511, or other legal defenses.

The Terms and Timing of the Parties Contract.

The ability of a party to be excused will in large part be dictated by the terms of the parties' agreement/contract. While many aspects of California Civil Code Section 1511 are not waivable, the parties' contract may contain numerous material terms applicable to a delay in performance or excuse for non-performance. For example, the parties' contract may contain notice requirements requiring that they be notified of any anticipated delay or non-performance. Such notice requirements are specifically permitted under California Civil Code 1511 subdivision 1. Failure to comply with applicable notice procedures in a contract could preclude a party's ability to be excused for delay or non-performance. The parties' contract might also provide specific definitions applicable to what constitutes a "force majeure" or an excuse for non-performance. The parties may also specifically contract for the occurrence of an event which might otherwise be deemed "unforeseeable." *Lloyd v. Murphy*, 25 Cal. 2d 48, 55 (1944). Such contractual language could broaden, limit or otherwise impact a party's ability to be excused for non-performance or a delay in performance.

The timing of the execution of the contract could also affect the ability of a party to be excused for performance or a delay thereof. It is reasonable to expect that any parties to contracts that have been entered into after the declaration of the COVID-19 pandemic will be deemed to have foreseeable knowledge of potential delays and performance issues associated with COVID-19. Because such potential business disruptions are now "foreseeable," a party may be bound to perform the contract irrespective of any future business disruptions caused by COVID-19 and any associated governmental orders. See e.g., *Lloyd v. Murphy*, 25 Cal. 2d 48 (1944). Any contracting party should be careful to ensure that their agreement properly reflects the parties' intentions with respect to the parties' obligations to perform in the event of

any further future business disruptions caused by COVID-19 and any governmental orders issued in relation thereto.

Executive Orders and Bills

Another factor to consider in determining to what extent performance may be justifiably excused or delayed are what executive orders and bills that might apply to the particular performance obligation. For example, Executive Order N-28-20, signed by Gov. Newsom on March 16, 2020, allows for local governments to impose eviction protections for tenants who are unable to pay rent because of the coronavirus or loss of income as a result of the outbreak. Similarly, the Federal Department of Housing and Urban Development recently placed a sixty (60) day moratorium on foreclosures arising out of certain federally backed mortgages for single family residences. Gov. Newsom also issued an executive order on May 19, 2020 requiring that all non-essential businesses close except for certain minimum baseline tasks. A copy of that Order is attached hereto as Appendix A. It is also anticipated that the President's use of his war-time powers to marshal certain industrial capabilities in the private sector for the construction of ventilators and other medical equipment will undoubtedly affect many businesses ability to perform their obligations under existing contracts. Such orders may in and of themselves may waive any liability those businesses might have to comply with their existing contracts, or they may provide a party with an "excuse" for non-performance by reason of their inability to perform. The content of such orders and their applicability to a party's obligation to perform depends on each order, which are evolving daily. In California, we are seeing new executive orders come out daily which impact a business's ability to perform, and such orders could provide grounds for excusing performance or a delay in performance of certain businesses' ongoing contractual obligations.

In sum, there are many factors for both businesses and individuals to consider in determining whether they have any ongoing businesses obligations that they might be excused from performing, and whether any parties they are currently contracting with similarly have a

valid ongoing obligations to perform. This article was written by attorney Jacob L. Ouzts. Mr. Ouzts is a principal in the Wagner Kirkman Blaine Klomprens & Youmans Firm handling both transaction and litigation matters primarily concerning businesses, contracts, and real-property. This article is not intended to and does not constitute legal advice.

APPENDIX A

CALIFORNIA CIVIL CODE §1511. What excuses performance, etc.

The want of performance of an obligation, or of an offer of performance, in whole or in part, or any delay therein, is excused by the following causes, to the extent to which they operate:

- 1.** When such performance or offer is prevented or delayed by the act of the creditor, or by the operation of law, even though there may have been a stipulation that this shall not be an excuse; however, the parties may expressly require in a contract that the party relying on the provisions of this paragraph give written notice to the other party or parties, within a reasonable time after the occurrence of the event excusing performance, of an intention to claim an extension of time or of an intention to bring suit or of any other similar or related intent, provided the requirement of such notice is reasonable and just;
- 2.** When it is prevented or delayed by an irresistible, superhuman cause, or by the act of public enemies of this state or of the United States, unless the parties have expressly agreed to the contrary; or,
- 3.** When the debtor is induced not to make it, by any act of the creditor intended or naturally tending to have that effect, done at or before the time at which such performance or offer may be made, and not rescinded before that time.

EXECUTIVE DEPARTMENT
STATE OF CALIFORNIA

EXECUTIVE ORDER N-33-20

WHEREAS on March 4, 2020, I proclaimed a State of Emergency to exist in California as a result of the threat of COVID-19; and

WHEREAS in a short period of time, COVID-19 has rapidly spread throughout California, necessitating updated and more stringent guidance from federal, state, and local public health officials; and

WHEREAS for the preservation of public health and safety throughout the entire State of California, I find it necessary for all Californians to heed the State public health directives from the Department of Public Health.

NOW, THEREFORE, I, GAVIN NEWSOM, Governor of the State of California, in accordance with the authority vested in me by the State Constitution and statutes of the State of California, and in particular, Government Code sections 8567, 8627, and 8665 do hereby issue the following Order to become effective immediately:

IT IS HEREBY ORDERED THAT:

- 1) To preserve the public health and safety, and to ensure the healthcare delivery system is capable of serving all, and prioritizing those at the highest risk and vulnerability, all residents are directed to immediately heed the current State public health directives, which I ordered the Department of Public Health to develop for the current statewide status of COVID-19. Those directives are consistent with the March 19, 2020, Memorandum on Identification of Essential Critical Infrastructure Workers During COVID-19 Response, found at: <https://covid19.ca.gov/>. Those directives follow:

ORDER OF THE STATE PUBLIC HEALTH OFFICER
March 19, 2020

To protect public health, I as State Public Health Officer and Director of the California Department of Public Health order all individuals living in the State of California to stay home or at their place of residence except as needed to maintain continuity of operations of the federal critical infrastructure sectors, as outlined at <https://www.cisa.gov/identifying-critical-infrastructure-during-covid-19>. In addition, and in consultation with the Director of the Governor's Office of Emergency Services, I may designate additional sectors as critical in order to protect the health and well-being of all Californians.

Pursuant to the authority under the Health and Safety Code 120125, 120140, 131080, 120130(c), 120135, 120145, 120175 and 120150, this order is to go into effect immediately and shall stay in effect until further notice.

The federal government has identified 16 critical infrastructure sectors whose assets, systems, and networks, whether physical or virtual, are considered so vital to the United States that their incapacitation or



destruction would have a debilitating effect on security, economic security, public health or safety, or any combination thereof. I order that Californians working in these 16 critical infrastructure sectors may continue their work because of the importance of these sectors to Californians' health and well-being.

This Order is being issued to protect the public health of Californians. The California Department of Public Health looks to establish consistency across the state in order to ensure that we mitigate the impact of COVID-19. Our goal is simple, we want to bend the curve, and disrupt the spread of the virus.

The supply chain must continue, and Californians must have access to such necessities as food, prescriptions, and health care. When people need to leave their homes or places of residence, whether to obtain or perform the functions above, or to otherwise facilitate authorized necessary activities, they should at all times practice social distancing.

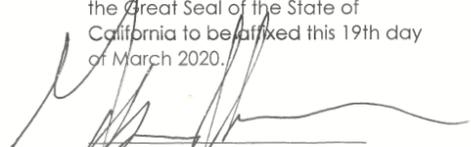
- 2) The healthcare delivery system shall prioritize services to serving those who are the sickest and shall prioritize resources, including personal protective equipment, for the providers providing direct care to them.
- 3) The Office of Emergency Services is directed to take necessary steps to ensure compliance with this Order.
- 4) This Order shall be enforceable pursuant to California law, including, but not limited to, Government Code section 8665.

IT IS FURTHER ORDERED that as soon as hereafter possible, this Order be filed in the Office of the Secretary of State and that widespread publicity and notice be given of this Order.

This Order is not intended to, and does not, create any rights or benefits, substantive or procedural, enforceable at law or in equity, against the State of California, its agencies, departments, entities, officers, employees, or any other person.

IN WITNESS WHEREOF I have hereunto set my hand and caused the Great Seal of the State of California to be affixed this 19th day of March 2020.




GAVIN NEWSOM
Governor of California

ATTEST:



ALEX PADILLA
Secretary of State

