

# Client Alert

March 2020

## COVID-19: Contract Cancellation and the Doctrines of Impossibility and Frustration of Purpose

Contracts are essential to business. They formalize obligations, eliminate risks, and provide a measure of certainty in what can be an uncertain world. The law expects parties to keep their bargains, and when they don't, damages are the typical remedy. But unexpected, supervening events happen, and they can profoundly affect the parties' obligations. The law has long accounted for this scenario—one which bears a close resemblance to the events unfolding today around the SARS-CoV-2 virus.

On March 11, the World Health Organization elevated the status of the novel coronavirus outbreak that causes COVID-19 to a "pandemic," and on March 13, the President of the United States declared the COVID-19 outbreak a [national emergency](#). As supply chains, public health, and economic stability are increasingly compromised, many businesses may find themselves in an unexpected position: either unable to perform a contract they agreed to before the outbreak, or concerned their contract partners may be unable to fulfill their contractual obligations.

Our previous [client alert](#) focused on force majeure clauses. Force majeure clauses are common commercial-contract provisions that excuse a party's non-performance under exceptional circumstances without penalty. But failure to perform may also be excused under the common-law defenses of impossibility and frustration of purpose. Businesses anticipating contract disputes should carefully consider whether these doctrines may apply to their agreements. It is important to note that these doctrines can *also* apply where parties have no force majeure provision in their written contract, or where they have only an oral contract. And special provisions may apply to contracts involving the sale of goods, both domestically (Uniform Commercial Code § 2-615) and internationally (United Nations Convention on Contracts for the International Sale of Goods Art. 79).

### Impossibility

The common law doctrine of impossibility provides that a party's contractual obligations are excused when supervening circumstances make the performance impossible or impracticable. Courts around the country routinely refer to the definition set out by the Restatement (Second) of Contracts § 261:

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 to the contrary.

The doctrine contains several important requirements. Chief among them is that the parties must have shared a basic assumption that the supervening event would *not* occur. The supervening event must not have been reasonably foreseeable, nor is it enough that performance is more difficult or expensive than the parties had originally anticipated. The Restatement illustrates the "basic assumption" requirement as follows:

On June 1, A agrees to sell and B to buy goods to be delivered in October at a designated port. The port is subsequently closed by quarantine regulations during the entire month of

October, no commercially reasonable substitute performance is available (see Uniform Commercial Code § 2-614(1)), and A fails to deliver the goods. A's duty to deliver the goods is discharged, and A is not liable to B for breach of contract.

Courts also draw an important distinction between objective impossibility (performance *cannot* be done) and subjective impossibility (*I* cannot perform), requiring the defense to be premised upon the former but not the latter. And while the common law strictly limited the defense to instances of physical or legal impossibility, courts in more recent times have utilized a more lenient standard premised upon impracticability.

## Frustration of Purpose

Closely related to impossibility, frustration of purpose applies when a change in circumstances makes one party's contract performance worthless to the other party. See Restatement (Second) of Contracts § 265. The defense commonly contains three elements:

1. the party's principal purpose in making the contract is frustrated;
2. an event occurred whose non-occurrence was a basic assumption underlying the contract; and,
3. the party invoking the defense was not at fault.

The validity of the defense often turns on the first element. The principal purpose of a contract must be something which is so completely the basis of the contract that, without it, the transaction between the parties would make little sense. Thus, while impossibility is primarily concerned with "the nature of the event and its effect upon performance," frustration is concerned with "the impact of the event upon the failure of consideration."

The famous "Coronation Cases" provide a royal example of frustrated purpose. In *Henry v. Krell*, a British court excused a defendant from his promise to pay fifty pounds to watch the coronation parade of King Edward VII from the plaintiff's flat when the coronation was abruptly cancelled due to the King's health. *Krell* demonstrates that frustration is not substantial when the disadvantaged party merely stands to gain less than the bargained-for performance. Rather, the frustration must be so total, and caused by an event so wildly unpredictable and outside the scope of either party's reasonable expectations, that it would be unfair to enforce the terms of the contract. The Second Circuit, for example, limits the doctrine to "virtually cataclysmic, wholly unforeseeable events."

## Key Considerations for Clients

- Determine whether the contract contains any provisions expressly excluding impossibility or frustration of purpose;
- Check the law in the jurisdiction that governs the contract, as state law may vary; and
- Document facts that show how the pandemic has affected the ability to perform.

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