CAN CONTRACTUAL OBLIGATIONS BE POSTPONED OR CANCELLED DUE TO COVID-19?

Two clauses to look for when determining whether a contract can be cancelled due to COVID-19 are a “break” or “termination clause” and a “force majeure clause.” Under normal circumstances, contracts typically end upon the completion of services or after a set period of time. One possible escape hatch is a “break clause” which would enable a party to terminate after a specified period of time but prior to the contract’s expiration. Sometimes a defined reason (“with cause,” i.e. a material breach) is required for termination and sometimes a party is able to simply terminate for convenience (“without cause”). Check this clause for notice requirements which will dictate the first step you need to take.

WHAT IS FORCE MAJEURE?

A force majeure clause is a risk allocation term designed to deal with events that could arise while the contract is in effect that might prevent performance of contract obligations. Force majeure language varies from contract to contract. The clause or provision, if included at all, can be broad or narrow in scope and courts tend to interpret these clauses narrowly. Look to see if your contract’s force majeure clause uses the terms “disease,” “epidemic,” “pandemic,” “quarantine,” “act of government,” or “state of emergency.” If it does, the parties may be able to assert force majeure as a defense to non-performance or contract breach because of the COVID-19 pandemic. Under Illinois law, the party claiming the force majeure defense must make a good faith attempt to resolve the event causing delay or inability to perform before invoking force majeure as a defense. If successfully invoked, a party’s obligation to perform would be suspended for the duration of the force-majeure event but would resume after the event is over.

WHEN SHOULD A FORCE MAJEURE NOTICE BE ISSUED AND WHAT STEPS SHOULD BE TAKEN IN RESPONSE TO A FORCE MAJEURE NOTICE?

Information about what notice is required and timing of that notice will be included in the force majeure clause of the contract. Pay specific attention to the required timing of the notice, whether it must be a certain number of days in advance of performance due or within a certain number of days of the triggering event. More information about where notice should be directed, method of transference, and form of notice allowed may be found in a separate “notice” clause in the contract.

WHAT IF NEITHER OPTION APPLIES?

If the contract in question does not contain a force majeure clause, a break clause, or the clauses as written do not excuse performance, then each party is required to perform its respective obligations or risk being sued for non-performance breach of contract. Look for a price adjustment clause or similar mechanism that might allow for an adjustment of contract prices or obligations, and also look for a “liquidated damages” provision. The “liquidated damages” provision might offer a reasonable “out” from the contract if the amount of liquidated damages to be paid is less than the anticipated cost of full performance.

If your business is sued and your contract does not have a force majeure clause, you may also be able to argue as a defense “impracticability of performance” or “frustration of purpose” due to COVID-19 or the governmental response to COVID-19. Timing of the contract will be critical here as many courts require the supervening event (in this case COVID-19 or the governmental response) to be unforeseeable at the time of contracting. The impact on the contract in question will have to be substantial and interfere with the core purpose of the contract in order for either of these defenses to apply. Like the force majeure clause, when the supervening event is temporary, courts will typically find the excuse from performance to be temporary as well.

WHAT SHOULD A BUSINESS DO IF IT IS UNABLE TO OPERATE, HAS LITTLE TO NO REVENUE AND THEREFORE CANNOT FULFILL ITS CONTRACTUAL OBLIGATIONS?

Look into new federal government programs designed to help small businesses get through the COVID-19 pandemic. One program is the Paycheck Protection Program (learn more about it and how to apply for funds here: https://www.mayerbrown.com/en/perspectives-events/blogs/2020/03/paycheck-protection-program-faqs-for-small-businesses). Another option is the
Economic Injury Disaster Loan program which has been expanded to include the option of a $10,000 advance that will not have to be repaid (learn more about it and how to apply here: [https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/economic-injury-disaster-loan-emergency-advance](https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/economic-injury-disaster-loan-emergency-advance)). For more information on all of the new federal programs designed to help small businesses weather COVID-19, check out the COVID-19 page of the SBA website here: [https://www.sba.gov/funding-programs/loans/coronavirus-relief-options](https://www.sba.gov/funding-programs/loans/coronavirus-relief-options).

**WHO IS RESPONSIBLE FOR LOSSES WHEN A PARTY IS UNABLE TO MEET ITS OBLIGATIONS DUE TO COVID-19?**

To avoid losses, you should look to government programs (examples include PPP and EIDL, discussed above) and insurance policies for assistance. Review your insurance policies to see if there is anything that might apply to the specific situation your business is in because of COVID-19. If anything seems like it might apply, file a claim with your insurer.

If losses are unavoidable and your organization is unable to meet its obligations, the business structure of the organization becomes important. An entity organized as a corporation or an LLC both have limited liability for owners of the entity, which means that if the entity is unable to meet its obligations, the owners or shareholders will not be held responsible for the entity’s losses in the event the business faces bankruptcy or lawsuits. On the other hand, if your business is structured as a partnership or sole proprietorship, individual owners may be held personally liable for losses sustained by the business. You can check out the SBA website for more information on liability and business structure: [https://www.sba.gov/business-guide/launch-your-business/choose-business-structure](https://www.sba.gov/business-guide/launch-your-business/choose-business-structure).

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