

RENEGOTIATING CONTRACTS IN A TIME OF CRISIS

A Litigator's Perspective




During this unprecedented time of the COVID-19 pandemic and the United States' efforts to "flatten the curve," many businesses find themselves unable to fulfill previously signed contracts that are no longer viable or for which performance of the contract has been disrupted or made excessively burdensome. We've fielded questions from clients about supplier contracts, business contracts, executive contracts, and property leasing contracts from suppliers, business owners, executives, and commercial tenants alike.



While our advice differs based on the specific factual circumstances of each client, the starting point and next steps are almost always the same:

01 **Be Human.**

Reach out to the other side over the phone or set up a videoconference to have a personal and authentic conversation about your unique situation. Express your desire to work together and come up with a reasonable, workable solution.



02 **Attempt Compromise.**

A workable solution when one party has become unable to fulfill a certain term of the contract is often to modify or amend the contract. Why? Because it's beneficial for both parties. For the party trying to enforce the contract—if you press too hard and want to commence legal action, you won't be able to file a complaint because many courts are currently closed, with an exception for emergency hearings¹. So, take the time to work out a solution. For those seeking to get out of the contract—you cannot just throw caution to the wind and terminate a contract without proper legal grounds, thinking that COVID-19 is an absolute excuse to performance. If you do this, you are just asking for a lawsuit in a few months when things calm down.

¹ On March 23, 2020, the Chief Justice of California Tani G. Cantil-Sakauye signed a statewide order to suspend and continue all jury trials for sixty days. Then, on April 3, 2020, The Honorable Lorna A. Alksne, Presiding Judge of the San Diego Superior Court, signed a general order extending the closure of all San Diego county courthouses and courtrooms until April 30, 2020. With the exception of time-sensitive, essential functions, all matters will be continued and reset until after April 30, 2020.



03 Advocate.

Bring forth your arguments for why a modification or amendment to the contract is the best solution. For a party seeking to excuse performance, the following arguments are worth considering:

Force Majeure

A force majeure clause is a mechanism contracting parties use to allocate risk and mitigate the effects of certain events outside of the control of each party. You will often see reference to war, an “Act of God,” or an unavoidable or inevitable accident in these clauses. “The test is whether under the particular circumstance 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.”² However, a mere increase in expense or an inconvenience does not excuse performance of an obligation under the contract. There must be “extreme and unreasonable difficulty, expense, injury or loss involved.”³

Impossibility/Impracticality

In California, “a thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost.”⁴ The impossibility must not exist at the time the agreement was made. Further, a party’s performance may not be excused “simply because it is more costly than anticipated or results in a loss.”⁵ Literal impossibility of performance is not required, but the party looking to be excused must show that performance of the contract “require[s] excessive and unreasonable expense” for this defense to apply.⁶

Frustration of Purpose

The defense of frustration of purpose applies when performance of the contract is admittedly possible, but the anticipated value of the performance to the party seeking to be excused has been destroyed by an unexpected event that causes “an actual but not literal failure of consideration.”⁷ Courts have required a promisor seeking to excuse his performance to prove that the risk of the frustrating event was not reasonably

² *Pacific Vegetable Oil Corp. v. C.S.T., Ltd.* (1946) 29 Cal.2d 288, 238.

³ *Butler v. Nepple* (1960) 54 Cal.2d 589, 599, citing *Oosten v. Hay Haulers etc. Union* (1955) 45 Cal.2d 784, 788.

⁴ *Habitat Tr. for Wildlife, Inc. v. City of Rancho Cucamonga* (2009) 175 Cal.App.4th 1306, 1336, citing *Mineral Park Land Co. v. Howard* (1916) 172 Cal. 289, 293.

⁵ *Id.*

⁶ *Id.* citing *City of Vernon v. City of Los Angeles* (1955) 45 Cal.2d 710, 717.

⁷ *Lloyd v. Murphy* (1944) 25 Cal.2d 48, 53 (internal citations omitted).

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Advocate (continued)

Frustration of Purpose (continued)

foreseeable and that the value of counter-performance is totally or nearly totally destroyed.⁸ Thus, frustration of purpose is no defense “if it was foreseeable or controllable by the promisor, or if counter-performance remains valuable.”⁹ Contracts in California are adjudged in light of the “relation of the parties, terms of the contract, and circumstances surrounding this formation . . . to determine whether it can be fairly inferred that the risk of the event that has supervened to cause the alleged frustration was not reasonably foreseeable.”¹⁰

Unconscionability

Unconscionability is a defense to the enforcement of an entire contract or particular provisions of a contract.¹¹ “Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.”¹² Courts consider both procedural unconscionability and substantive unconscionability when determining if a contract is unconscionable.¹³ The procedural element of unconscionability is concerned with “the circumstances of contract negotiation and formation, focusing on oppression and surprise due to unequal bargaining power. In contrast, the substantive element is concerned with the fairness of the agreement’s actual terms and assesses whether they are overly harsh or one-sided.”¹⁴

Fraud in the Inducement

If you feel like you were unlawfully persuaded into entering a contract, consider the claim for fraud in the inducement. A person or company making a claim for fraud in the inducement must prove the following elements: (a) a misrepresentation (false representation, concealment, or on disclosure); (b) scienter or knowledge of its falsity; (c) intent to defraud, i.e., to induce reliance; (d) justifiable reliance; and (e) resulting damage.¹⁵ One of the remedies for fraud in the inducement is rescission of contract. “Rescission extinguishes the contract (Civ. Code, § 1688), terminates further liability, and restores the parties to their former positions by requiring them to return whatever consideration they have received.”¹⁶

⁸ *Id.* at p. 54.

⁹ *Id.*

¹⁰ *Id.*

¹¹ Civ. C. § 1670.5(a).

¹² *Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc.* (2015) 232 Cal.App.4th 1332, 1346 (internal quotations and citation omitted).

¹³ *Id.* at pp. 1346-1347.

¹⁴ *Id.* at p. 1347 (internal quotations and citation omitted).

¹⁵ *Lazar v. Superior Court* (1996) 12 Cal.4th 631, 638.

¹⁶ *Sharabianlou v. Karp* (2020) 181 Cal.App.4th 1133, 1145.



03 Advocate (continued)

Condition Precedent

A condition precedent is either an act of a party that must be performed, or a certain event that must take place before contractual rights accrue or a contractual duty arises.¹⁷ “Under the law of contracts, parties may expressly agree that a right or duty is conditional upon the occurrence or nonoccurrence of an act or event.”¹⁸ Conditions precedent can excuse the entire contract or just the condition, depending on the circumstances.¹⁹



04 Resolve It.

If one-on-one negotiation fails, you still have the option of video-based mediation.²⁰ Mediation is much less expensive than full-on litigation and can often result in the parties coming to a reasonable agreement.



05 Secure It.

A party delivering goods or services without having received collateral may now be faced with a customer who cannot pay. We've heard a variety of explanations, including, that the customer will pay when they get paid. In such a scenario, a reasonable workout could include entering into a Security Agreement with the other party. Such a Security Agreement could be based on the good provided, expected accounts receivable payments by a third party, or both. Not only does this provide reasonable relief and assurances for both parties, but it protects the company that has already provided the good from the customer filing for bankruptcy, since secure claims have priority in a bankruptcy proceeding.

¹⁷ *Platt Pacific, Inc. v. Andelson* (1993) 6 Cal.4th 307, 313.

¹⁸ *Id.*

¹⁹ See, e.g., *Rains v. Arnett* (1961) 189 Cal.App.2d 337, 347-348.

²⁰ See <https://www.judicatemw.com//Newsroom/NewsroomArticle/170>, <https://www.jamsadr.com/coronavirus>.



06 Stall It.

If a one-on-one compromise or mediation don't work, it may be best to stall litigation during this unprecedented time. Consider tolling the statute of limitations and enforcing the status quo. Parties can negotiate tolling agreements to preserve claims. You can also agree that neither party will commence with legal action until the courts are reopened and things are more certain. Parties can also enter into Forbearance Agreements to forestall payments for a temporary period of time.



07 Litigate.

If you can't get to a fair and reasonable resolution, then you can still seek court intervention when the courts reopen. It may be worth asking the court to interpret performance under the contract in a declaratory relief action.

Each situation our clients bring to us has its own factual nuances and legal angles, as will yours, so we strongly recommend seeking trusted counsel to help you maneuver through these uncharted waters. If you have any questions, please reach out to Juan Castañeda at juan@venture-llp.com.



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