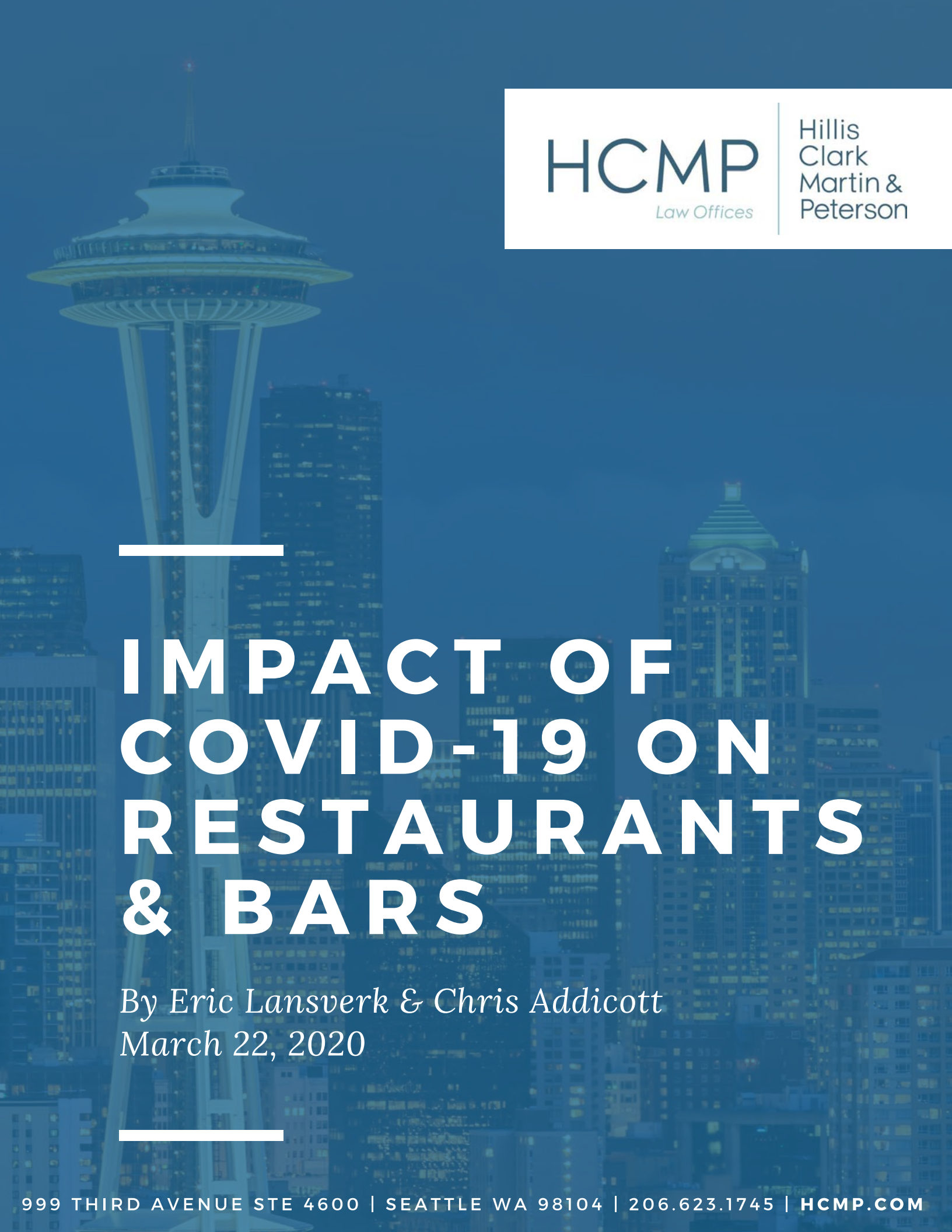

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IMPACT OF COVID-19 ON RESTAURANTS & BARS

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INTRODUCTION

The coronavirus (COVID-19) pandemic has impacted the ability of businesses around the world to maintain operations and fulfill existing contractual obligations. In just a matter of days, the World Health Organization declared COVID-19 a pandemic, governments imposed unprecedented travel and large-gathering restrictions, cities and states prohibited dine-in service at restaurants and bars, and companies from all sectors experienced severe business interruptions or canceled events due to a combination of government regulations on large gatherings and pandemic concerns. The fast-paced evolution of the COVID-19 pandemic gives rise to new events every day that affect a business' ability to perform its contractual obligations.

Seattle recently issued a temporary moratorium on small business and nonprofit evictions for non-payment of rent (https://durkan.seattle.gov/wp-content/uploads/sites/9/2020/03/Civil-Emergency-Order-Moratorium-on-Small-Business-Tenant-Evictions-3.17.20.pdf). During these next few weeks, it is important to put a plan in place to address these issues once the moratorium ends. Accordingly, this memorandum looks at alternative common law excuses of nonperformance under Washington law where contracts are silent on the issue, *i.e.* do not include "force majeure" clauses.

BACKGROUND

A. Doctrine of Impossibility

In Washington, all parties to a contract have an affirmative, good faith obligation to perform all conditions precedent in the contract. *Egbert v. Way*, 15 Wn. App. 76, 79 (1976). The doctrine of impossibility, or impracticability, discharges a party from contractual obligations when a basic assumption of the contract is destroyed and such destruction makes performance impossible or impractical, provided the party seeking relief does not bear the risk of the unexpected occurrence. *Pub. Util. Dist. No. 1 v. Washington Pub. Power Supply Sys.*, 104 Wn.2d 353, 363–64 (1985) (citing Restatement (Second) of Contracts §§ 261, 263 (1981)). In other words, performance of a contract may be excused under this doctrine based upon "extreme and unreasonable difficulty, expense or injury." *Pub. Util. Dist.*, 104 Wn.2d at 364. However, performance will not

be excused merely because it has become "more difficult or expensive than originally anticipated." *Id.; see also Washington State Hop Producers, Inc. Liquidation Trust v. Goschie Farms, Inc.*, 51 Wn. App. 484 (1988). Rather, "[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." *Thornton v. Interstate Sec. Co.*, 35 Wn. App. 19, 31 (1983) (quoting *Schmeltzer v. Gregor*y, 266 Cal. App. 2d 420 (1968)).

Simply put, under Washington law the "ultimate inquiry for purposes of the impossibility defense is whether the intervening changes of circumstance were so unforeseeable that the risk of increased difficulty or expense should not properly be borne by the promisor." *Taylor-Edwards Warehouse & Transfer Co., of Spokane, Inc v. Burlington Northern, Inc.*, 715 F.2d 1330 (9th. Cir. 1983). Thus, a party's nonperformance will not be excused under these principles where the event preventing performance was expected or was a foreseeable risk at the time of the contract's execution.

B. Doctrine of Commercial Frustration and Doctrine of Frustration Purpose

Another common law alternative in the absence of a "force majeure" clause is the "doctrine of commercial frustration" or the "doctrine of frustration of purpose." Washington's Supreme Court has adopted the doctrine of frustration of purpose as stated in Restatement (Second) of Contracts § 265 (1979). *Hop Producers*, 112 Wn.2d at 700. This section, entitled "Discharge by Supervening Frustration," states:

> Where, after a contract is made, a party's principal purpose is substantially frustrated 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 remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.

Restatement (Second) of Contracts § 265 (1979).

Comment *a* to this section gives a detailed explanation of how the rule should be applied. It states, in part:

> First, the purpose that is frustrated must have been a principal purpose of that party in making the contract. It is not enough that he had in mind some specific object without which he would not have made the contract. The object must be so completely the basis of the contract that, as both parties understand, without

> it the transaction would make little sense. Second, the frustration must be substantial. It is not enough that the transaction has become less profitable for the affected party or even that he will sustain a loss. The frustration must be so severe that it is not fairly to be regarded as within the risks that he assumed under the contract. Third, the non-occurrence of the frustrating event must have been a basic assumption on which the contract was made....

In *Felt v. McCarthy*, 130 Wn.2d 203 (1996), the purchaser on a promissory note defaulted by arguing that his plans to develop a business park were frustrated by new wetlands regulations. The Court found that if he wanted the real estate deal to be conditioned upon his successful development of a business park, he clearly had the power to include that condition in the contract. However, the purchaser failed to assign any risk of his business park failure to the seller in the contract the purchaser drafted, and the Court held that it will not correct a mistake by using the "frustration doctrine" to implicitly read something new into a contract.

Alternatively, in *Weyerhaeuser Real Estate v. Stoneway Concrete*, 96 Wn.2d 558 (1981), a concrete company executed a multi-year mineral lease that required lease payments whether or not the lessee removed any minerals. During the permitting process, SEPA became law dramatically increasing the cost and significantly diminishing the likelihood of obtaining the permit. The concrete company abandoned the project, and the property owner brought suit for the lease payments.

In this case Washington's Supreme Court applied the doctrine of commercial frustration, which it summarized by citing a different section in the Restatement of Contracts:

> Where the assumed possibility of a desired object or effect to be attained by either party to a contract forms the basis on which both parties enter into it, and this object or effect is or surely will be frustrated, a promisor who is without fault in causing the frustration, and who is harmed thereby, is discharged from the duty of performing his promise unless a contrary intention appears. Restatement of Contracts s 288, at 426-27 (1932).

The Court then concluded that there "can be no doubt of the desired object or purpose of Stoneway in entering the mineral lease with Weyerhaeuser. Nor is there any question that the purpose of Stoneway forms the basis on which both parties entered the lease." Accordingly, "disposition of this case turns on whether the frustrating event was foreseeable." Unlike in the *Felt* case above, here the Court held it would be "inequitable to cast upon Stoneway the entire risk of the commercial

frustration of its purpose under this lease caused by the unanticipated circumstances." Therefore, the Court set a date upon which the lease was terminated. These are two of many cases that illustrate the fact-specific nature of the Court's inquiries and the difficulty of predicting the outcome based on how the Court ultimately views the equities of the situation.

ANALYSIS

As the COVID-19 pandemic continues to develop, businesses should take proactive steps to ensure continuity of operations sufficient to meet existing contractual obligations and evaluate whether their counterparties are doing the same. If companies expect that COVID-19 may result in their own or their counterparties' inability to satisfy contractual obligations, they should assess the viability of these common law principles of nonperformance excuses. This assessment may also be rendered more complicated by the fact that many companies will be on both sides of this issue, as the performing party in some cases or the receiving party in others. Companies will therefore need to be mindful of the broader implications in other potential matters of asserting these provisions and principles.

From a practical standpoint, now that dine-in service at restaurants and bars in Washington has been shut down there is no replacement restaurant or bar waiting to fill the leasehold space. By evicting the current tenant and demanding full ongoing payments since the space will not likely be re-let, the landlord eliminates the possibility of working with the current tenant who will be unable to meet the financial obligations of the lease even if it is bringing in some income through curbside and take-out service. Likewise, if the tenant chooses to walk away and then fight its payment obligations in court, it will have no space to return to when the economy picks back up, whether that is weeks or months.

Further, depending on the language in the underlying contract at issue and the specific circumstances involved, the legal authorities described above likely allow room for arguments to be made on both sides, often leading to uncertainty in the eventual outcome. All of these factors must be evaluated in assessing a proper course of action.

A FINAL NOTE ABOUT INSURANCE

Companies experiencing or anticipating potential business interruption may want to review potentially applicable insurance policies.

Generally, business interruption insurance is intended to cover losses resulting from direct interruptions to a business' operations, and typically covers lost revenue, fixed

expenses such as rent and utilities, or expenses from operating from a temporary location. Similarly, contingent business interruption insurance is intended to cover lost profits and costs that indirectly result from disruptions in a company's supply chain, including failures of suppliers or downstream customers. While these policies most frequently relate to physical property damage, businesses have increasingly submitted claims for coverage of losses due to business interruptions such as those resulting from COVID-19. The viability of these claims depends on the terms of the insurance policy at issue, but the historical trend appears to be against coverage for business interruptions related to a pandemic like COVID-19.

Following the Severe Acute Respiratory Syndrome (SARS) outbreak in 2002-2003, many insurers excluded viral or bacterial outbreaks from standard business interruption and contingent business interruption policies. Now insurers will likely take the position that communicable diseases not expressly delineated in the policy at issue are not covered. Some states, including New Jersey, are considering laws that would require insurers to pay COVID-19 business interruption claims:

https://www.insurancejournal.com/news/east/2020/03/19/561643.htm

In light of these developments, it is critical that companies proactively assess the specific terms and conditions of their governing insurance policies to determine whether interruptions from the COVID-19 pandemic would be covered, and review their policies' notice requirements to ensure their compliance with those provisions in the event coverage is needed.

These are the opinions of the author, not HCMP. Statements here do not represent specific legal advice. Contact the appropriate lawyers at HCMP if we can be of assistance.

Best,

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