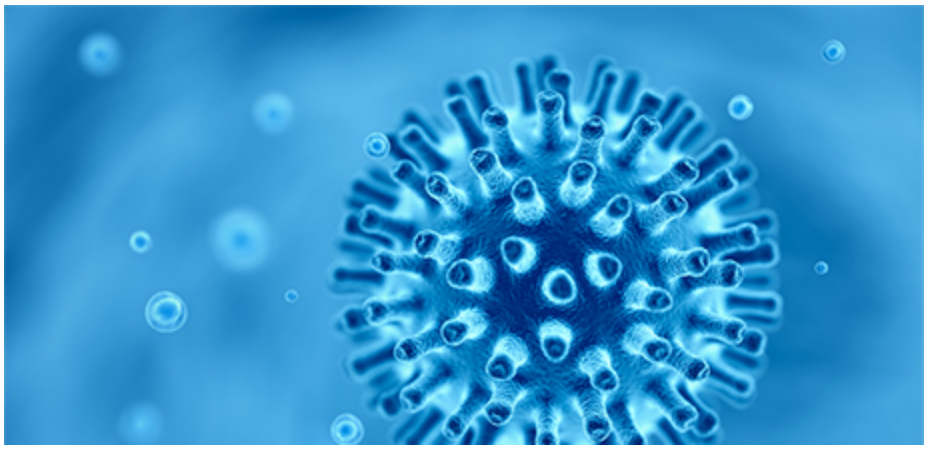

Examining the defense of impracticability: Does the COVID-19 pandemic qualify as an "unforeseen event" that could render a UCC contract impractical?

March 20, 2020

For buyers and sellers of goods, the COVID-19 pandemic is causing increasing disruption to supply chains on a local, national and international level. Factories have been shut down, workforces have been downsized, flights have been delayed or canceled, and restrictions have been imposed at ports of entry. Delays and cancellations in the production and distribution of materials and supplies will have a ripple effect across the economy, as vendors and suppliers struggle to fill orders and perform contractual duties owed to their customers.

As companies evaluate risk exposure and plan for business continuity, it is important to consider the legal remedies available to excuse performance under certain circumstances. The first option would be to evaluate the issue of force majeure. As detailed in a previous publication, force majeure clause in a specific contract may delay the timing of performance or excuse performance altogether.

For buyers and sellers of goods under the Uniform Commercial Code (UCC), another issue to consider is the defense of impracticability under UCC 2-615.

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What is the defense of impracticability?

Ohio's version of UCC 2-615 (Revised Code Section 1302.73) codifies the defense of impracticability and provides:

> Except so far as a seller may have assumed a greater obligation and subject to section 1302.72 of the Revised Code on substituted performance:
>
> > (A) Delay in delivery or non-delivery in whole or in part by a seller who complies with divisions (B) and (C) of this section is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.
> >
> > (B) Where the causes mentioned in division (A) of this section affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.
> >
> > (C) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under division (B) of this section, of the estimated quota thus made available for the buyer.

In order to meet the threshold requirements of section (A), a party asserting the defense of commercial impracticability must prove:

1) That an unforeseeable event occurred
2) That the non-occurrence of the event was a basic assumption underlying the agreement
3) That the event rendered performance impracticable
4) That the unforeseeable event upon which excuse is predicated is due to factors beyond the party's control

See Roth Steel Prod. v. Sharon Steel Corp., 705 F.2d 134, 150–51 (6th Cir. 1983); see also, Bruno v. Piedmont Plant Co., 1986 WL 8537, at *2–3 (Ohio 9th App. Dist., July 30, 1986) (unreported).

In addition, the party asserting the defense must also comply with the express terms of O.R.C. Sec. 1302.73(B) and (C). Under Section (B), a seller whose performance becomes partially impracticable must allocate production and deliveries in order for contractual obligations to be excused. Generally, O.R.C. Sec. 1302.73(B) requires that

the seller devise a system of allocation which is "fair and reasonable." Although this statutory provision does not list all of the factors to be considered in determining whether a particular allocation system is fair and reasonable, it does require sellers to limit participation in the allocation system to customers under contract and regular customers. Thus, an allocation system that includes participants other than customers under contract and regular customers is presumptively unreasonable. Under Section (C), a party must provide notice of delays or non-deliveries and, if allocations are made, the estimated quota available to the buyer.

Did COVID-19 cause the failure of any presupposed conditions in your contract?

The first element of the impracticability defense requires an unforeseeable event. Here, the COVID-19 pandemic was certainly unforeseeable through most of 2019. For contracts executed after the spread of COVID-19, the issue of foreseeability will depend on the facts of your specific situation. As to the second element of the defense, barring some unique situation, the non-occurrence of COVID-19 (and the various and evolving governmental containment strategies announced in response thereto) was likely a basic assumption underlying the agreement. Thus, the first two elements are likely met for most contracts executed more than a few months ago.

A deeper analysis will be required, however, for the third and fourth elements of the defense-related to causation. Was performance under the contract rendered more difficult or more challenging, or was performance rendered truly impracticable? Was there another intervening cause? Did the party asserting the defense contribute to the delayed delivery or non-delivery? The fact-specific inquiries must be considered to determine whether the threshold elements of the defense of impracticability can be established under Ohio law.

Did the seller allocate production in a fair and reasonable manner?

If the threshold elements under Section 1302.72(A) are established, the seller must also comply with the allocation and notice requirements of the statute. Under Section 1302.72(B), a seller must devise a "fair and reasonable" allocation system for the production and delivery of any available goods. The allocation system must be limited to the following:

1) Customers under contract
2) Regular customers not under contract
3) The seller's own requirements for further manufacture

So long as allocation does not extend beyond these three classes of recipients, the seller has the discretion to devise a system of allocation that is appropriate under the circumstances.

Did the seller provide the buyer with adequate notice?

Finally, the seller is required to provide reasonable notice to the buyer of any delay

or non-delivery. If there will be an allocation of available goods, the seller must also provide notice of the estimated quota available.

Practical guidance for sellers anticipating supply chain disruptions

Supply chain disruptions are an inevitable consequence of the governmental containment strategies being employed to combat the COVID-19 pandemic. Contract parties must be proactive in evaluating the impact on their businesses. As always, early and effective documentation and communication with your legal counsel prior to taking any action are recommended. When evaluating your legal options, consider the following:

- Conduct a risk exposure assessment to evaluate and determine the short to medium-term obligations owed, your current capabilities for both production and delivery related to these obligations, potential supply chain disruptions and the impact such disruptions will have on your ability to perform.
- Investigate and document the connection between any supply chain disruptions and the COVID-19 pandemic.
- Take reasonable measures to mitigate the disruption, seek alternative suppliers or delivery options and document your efforts.
- Determine whether disruptions will cause delays in deliveries, partial deliveries or non-delivery.
- Provide prompt notice to your buyers of any disruptions and explain any connection to the COVID-19 pandemic.
- To the extent you are able to partially perform and as early as possible, devise a reasonable allocation system for the production and delivery of your available goods. Limit the allocation to:
    - Customers under contract
    - Regular customers not under contract
    - Your own requirements for further manufacture
- Provide prompt notice to buyers of any available quotas under your allocation system.