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Frustration, the MAC Clause, and COVID-19

Andrew A. Schwartz*

COVID-19's impact on business has been exasperating — but is it Frustrating? The Frustration doctrine of contract law excuses a party from its contractual obligations when an extraordinary event completely undermines its principal purpose in making the deal. This doctrine has long been a marginal player in contract litigation, as parties rarely invoked it — and usually lost when they did.

The COVID-19 pandemic, however, is precisely the type of extraordinary event that Frustration was designed to address, and the courts have been inundated over the past year by a wave of colorable Frustration claims. This timely Article describes the Frustration doctrine and explores its application to the countless contracts whose purpose was undercut by the pandemic, such as leases for restaurant spaces in cities that banned dining service. The case law that develops out of the COVID-19 pandemic will define the Frustration doctrine for the next fifty years, and this Article provides an early assessment of the reported cases.

*Similarly, the Material Adverse Change (“MAC”) clause, a standard term in corporate acquisitions, allows a buyer to back out of a deal if the target company suffers a “material adverse change” between signing and closing. In prior work, the present author argued that the MAC clause should be understood as a liberalized version of the Frustration doctrine, and this claim was adopted in the first Delaware case to find that a MAC had occurred, *Akorn v. Fresenius*.*

Like Frustration claims, MAC clauses have rarely been litigated, and claimants were almost universally unsuccessful. The COVID-19 pandemic,

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combined with the Akorn precedent, has led to numerous high-profile MAC claims, including one against jeweler Tiffany & Co. As with Frustration, the present wave of MAC litigation may establish the standards for MAC claims for years to come. This Article accordingly examines the merits of MAC claims premised on COVID-19 and reports on the one case decided to date.

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INTRODUCTION

Countless contracts were undermined by the COVID-19 pandemic of 2020 — and governmental orders to contain it. What good is a set of “Swan Lake” costumes when the ballet cannot be staged due to a ban on live performances? Can the costume order be cancelled, or is the ballet company bound to take and pay for them? What about a restaurant that was ordered to shut down to contain the spread of COVID-19? Must it still abide by its lease and pay rent to the landlord?

The answer to these questions turns on the application of contract law’s “Frustration” (or “Frustration-of-Purpose”) doctrine, which was originally established a century ago in English case law.¹ This doctrine excuses a party from its contract when an extraordinary event, beyond its control, completely destroys its principal purpose in making the contract. In other words, Frustration applies when a contract could still be performed in a literal sense, but, given unexpected circumstances, the contract’s execution has become totally worthless. Notably, the law imposes a very high standard in Frustration cases, and there are very few cases where it has been invoked successfully. For this reason, the Frustration doctrine has long been a marginal player in contract law and litigation.

COVID-19, however, has brought the Frustration doctrine to the fore, as a once-in-a-lifetime global pandemic is precisely the type of rare and extraordinary event the doctrine is designed to address. Contracting parties have accordingly filled the courts with Frustration claims, including many high-profile and high-stakes lawsuits. Major commercial tenants in Manhattan, including The Gap and Victoria’s Secret, have asserted that the pandemic and related orders frustrated their ability to operate their stores and have demanded to be excused from paying rent, which sometimes amounts to \$1 million per month.² A party that agreed to purchase a hotel in Puerto Rico claims that the purpose of the contract has been frustrated because the hotel had closed

¹ See *Krell v. Henry* (1903) 2 K.B. 740, 754; see also *In re Fontana D’Oro Foods, Inc.*, 472 N.Y.S.2d 528, 532 (Sup. Ct. 1983) (“Frustration of purpose . . . has its origin in . . . *Krell v. Henry* . . .”), *aff’d as modified*, 107 A.D.2d 808 (N.Y. App. Div. 1985), *aff’d*, 65 N.Y.2d 886 (1985).

² See, e.g., *Valentino U.S.A., Inc. v. 693 Fifth Owner LLC*, No. 652605/2020, 2021 WL 668788 (N.Y. Sup. Ct. Jan. 27, 2021) (luxury boutique seeking declaratory judgment of lease termination based on Frustration of Purpose); *Victoria’s Secret Stores v. Herald Square Owner LLC*, No. 651833/2020, 2021 WL 69146 (N.Y. Sup. Ct. Jan. 7, 2021) (complaint referencing monthly rent of roughly \$940,000).

down due to the pandemic.³ A Brazilian bank sued a major US airline, seeking to terminate its contract to purchase frequent-flyer miles that it would provide to credit-card customers on the basis of Frustration, as the lack of air travel caused customers to stop trying to accumulate such miles.⁴

Numerous COVID-related Frustration cases have been decided, and the doctrine has been rejected almost every time. (The exception is *UMNV v. Caffé Nero*, where a Massachusetts court applied the Frustration doctrine to excuse a restaurant tenant from its obligation to pay rent while indoor service was barred by state order.⁵) Many cases remain unresolved, however, so the final tally cannot yet be announced. As these cases are resolved over the coming years, we should get a better understanding of the contours of the Frustration doctrine. In the meantime, this timely Article explains the Frustration doctrine and discusses how it is likely to apply to contracts undermined by the current pandemic. Because the current wave of Frustration claims will define the doctrine for the next several decades, this Article provides a report on the emerging case law in the field. This Article also addresses whether a *force majeure* clause overrides the Frustration doctrine, an issue that has split the courts and asserts that a typical *force majeure* clause does not supersede the Frustration doctrine.

The most economically important context for a Frustration claim is in the area of corporate acquisitions — when one company agrees to purchase another — as such deals can run to the tens of billions of dollars. The primary purpose of such a contract is to acquire a valuable business with good prospects — but what if the COVID-19 pandemic has suddenly decimated the business you planned to acquire? In most cases, even a significant downturn in the target’s business will not amount to Frustration. So long as the target company still retains some value, the purpose of the contract has not been completely obliterated, and so the law will not let the acquirer back out of the deal.

Faced with this reality, corporate merger agreements commonly include a so-called “Material Adverse Change” (“MAC”) clause.⁶ The

³ *In re Condado Plaza Acquisition LLC*, 620 B.R. 820, 839-40 (Bankr. S.D.N.Y. 2020).

⁴ *Banco Santander (Brasil), S.A. v. Am. Airlines, Inc.*, No. 20-CV-3098, 2020 WL 4926271, at *1 (E.D.N.Y. Aug. 21, 2020).

⁵ *UMNV 205-207 Newbury, LLC v. Caffé Nero Ams. Inc.*, No. 2084CV01493-BLS2, 2021 WL 956069, at *1 (Mass. Super. Feb. 8, 2021).

⁶ The MAC clause is sometimes called a Material Adverse Effect (“MAE”) clause, but this is merely a difference in nomenclature. Andrew A. Schwartz, A “*Standard Clause Analysis*” of the Frustration Doctrine and the Material Adverse Change Clause, 57 *UCLA L. REV.* 789, 817 n.149 (2010) [hereinafter “*Standard Clause Analysis*”].

MAC clause was previously viewed as something of a mystery. A decade ago, in A “*Standard Clause Analysis*” of the Frustration Doctrine and the Material Adverse Change Clause,⁷ I claimed that a MAC clause functions as a way to “contract around” the Frustration doctrine.⁸ As I argued in that article, “the MAC clause is a standard clause analog of the frustration doctrine, which customizes the elements of that default rule.”⁹ Rather than requiring a total or complete loss of value, as in the case of the Frustration doctrine, the MAC clause will permit the acquirer to walk away if the target’s business has deteriorated “materially.”¹⁰

MAC clauses have been a fixture in corporate acquisition agreements for years, though only very rarely did acquirers attempt to declare MACs to back out of deals. Moreover, in the very few litigated cases where the MAC clause had been invoked, the courts always sided with the target and found that no MAC had occurred — at least in Delaware, the most important jurisdiction for corporate matters. In a landmark opinion issued in 2018, however, the Delaware Court of Chancery finally agreed with an acquirer and found that its target had indeed suffered a MAC.¹¹ That case, *Akorn v. Fresenius*, expressly adopted my analysis of the MAC clause as a standard clause analog to the Frustration doctrine.¹²

The combination of the *Akorn* decision and the COVID-19 pandemic led many acquirers in 2020 to attempt to declare a MAC and try to get out of their promise to purchase weakened target companies. Numerous high-profile and high-stakes corporate mergers — including multi-billion-dollar deals involving household names like Tiffany & Co. — have been upset by MAC claims based on the business impact of the COVID-19 pandemic. Like with Frustration, the present wave of MAC litigation may establish the standards for MAC claims for years to come. This Article accordingly examines the merits of MAC claims premised

⁷ *Id.*

⁸ *Id.* at 825.

⁹ *Id.*

¹⁰ *Akorn, Inc. v. Fresenius Kabi AG*, No. 2018-0300-JTL, 2018 WL 4719347, at *57 (Del. Ch. Oct. 1, 2018), (“In lieu of the default rule [the Frustration doctrine] that performance may be excused only where a contract’s principal purpose is completely or nearly completely frustrated, a contract could [use a MAC clause to] ‘lower this bar to an achievable level by providing for excuse when the value of counterperformance has “materially” (or “considerably” or “significantly”) diminished.’ That is what the parties did in this case.” (quoting Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 807)), *aff’d*, 198 A.3d 724 (Del. 2018).

¹¹ *Id.*

¹² *Id.* (following and quoting Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 807).

on COVID-19 and reports on the one Delaware case decided since the onset of the pandemic, *AB Stable v. Maps Hotels & Resorts*.¹³

This Article proceeds as follows: Part I will describe the business disruption and economic carnage inflicted by the COVID-19 pandemic and related government orders. Part II will introduce the Frustration doctrine, use hypothetical examples to consider how it may apply to contracts capsized by COVID-19, and report on the emerging case law in the area. Part III will focus on corporate acquisitions and explore whether the COVID-19 pandemic would allow an acquirer to back out of a deal on the basis of a MAC clause, using both a recently issued judicial opinion and a hypothetical example.

I. THE BUSINESS IMPACT OF THE COVID-19 PANDEMIC

The COVID-19 pandemic, and the governmental response thereto, is unprecedented in modern history. Originating in December 2019 in Wuhan, China, this novel and highly contagious virus spread out of control in Europe, the United States, and across the globe across the following year. Over the course of 2020, COVID-19 infected extraordinary numbers of people, causing widespread illness and many deaths.

The number of cases and fatalities grew at astonishing speed. In early March 2020, the United States counted fewer than fifty confirmed cases of COVID-19, with just six fatalities.¹⁴ Seven weeks later, the US had nearly one million cases, and the national death toll surpassed 50,000.¹⁵ By the end of 2020, the US had tallied about 18 million confirmed cases of COVID-19 and more than 300,000 deaths.¹⁶ On a global basis, at the close of 2020, the World Health Organization reported roughly 80 million cases and nearly two million deaths caused by COVID-19.¹⁷

¹³ *AB Stable VIII LLC v. Maps Hotels & Resorts One LLC*, No. 2020-0310-JTL, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020).

¹⁴ Jennifer Calfas, Jim Carlton & Lucy Craymer, *U.S. Coronavirus Death Toll Climbs to Six as Virus Spreads World-Wide*, WALL ST. J. (Mar. 2, 2020, 10:27 PM ET), <https://www.wsj.com/articles/coronavirus-spreading-faster-outside-china-than-within-11583142293> [<https://perma.cc/YB9A-8TZJ>].

¹⁵ Talal Ansari, Lucy Craymer & Jimmy Vielkind, *U.S. Coronavirus Death Toll Tops 50,000*, WALL ST. J. (Apr. 24, 2020, 8:43 PM ET), <https://www.wsj.com/articles/coronavirus-latest-news-04-24-2020-11587719555> [<https://perma.cc/2GSR-GPHA>].

¹⁶ *WHO Coronavirus Disease (COVID-19) Dashboard*, WHO, <https://covid19.who.int/> (last updated Dec. 25, 2020) [<https://perma.cc/CM35-D3QM>] (reporting that the United States had 18,311,405 confirmed cases of COVID-19 and 323,527 deaths, as of December 25, 2020).

¹⁷ *Id.* (reporting a global total of “78,194,947 confirmed cases of COVID-19, including 1,736,752 deaths,” as of December 25, 2020).

The pandemic is truly a cataclysmic and historic event, and the governmental response was forceful. In late January 2020, the Secretary of Health and Human Services declared COVID-19 to be a “public health emergency for the entire United States.”¹⁸ In March 2020, the World Health Organization (“WHO”) officially declared COVID-19 to be a pandemic — meaning that it was prevalent throughout the world.¹⁹ At around the same time, President Trump proclaimed that the COVID-19 outbreak in the United States constituted a national emergency,²⁰ and governors around the country likewise declared the pandemic to be a statewide disaster.²¹

In addition to broad emergency declarations, governments imposed strict and sweeping limits on social behavior as an attempt to curb COVID-19’s spread. In New York, for example, the governor issued an executive order that required all events with more than fifty people to be cancelled or postponed;²² this was soon amended to temporarily prohibit all “non-essential gatherings of individuals of any size for any reason.”²³ Many states and cities issued orders similar to that of New York, requiring people to remain at home and avoid gathering together.²⁴ National borders were closed, and most international airline

¹⁸ *Secretary Azar Declares Public Health Emergency for United States for 2019 Novel Coronavirus*, U.S. DEP’T OF HEALTH & HUM. SERVS. (Jan. 31, 2020) <https://www.phe.gov/emergency/news/healthactions/phe/Pages/2019-nCoV.aspx> [https://perma.cc/MV5S-NUSR].

¹⁹ *WHO Announces COVID-19 Outbreak a Pandemic*, WHO (Mar. 12, 2020), <https://www.euro.who.int/en/health-topics/health-emergencies/coronavirus-covid-19/news/news/2020/3/who-announces-covid-19-outbreak-a-pandemic> [https://perma.cc/Y4U5-2GCB]. An “epidemic” is a localized outbreak of disease, while a “pandemic” is a global outbreak of disease.

²⁰ *Proclamation on Declaring a National Emergency Concerning the Novel Coronavirus Disease (COVID-19) Outbreak*, THE WHITE HOUSE (Mar. 13, 2020), <https://trumpwhitehouse.archives.gov/presidential-actions/proclamation-declaring-national-emergency-concerning-novel-coronavirus-disease-covid-19-outbreak/> [https://perma.cc/C9Y2-7BW6].

²¹ *E.g.*, N.Y. Exec. Order No. 202 (Mar. 7, 2020), https://www.governor.ny.gov/sites/default/files/atoms/files/EO_202.pdf [https://perma.cc/7M8F-DHWP].

²² N.Y. Exec. Order No. 202.3 (Mar. 16, 2020), https://www.governor.ny.gov/sites/default/files/atoms/files/EO_202.3.pdf [https://perma.cc/HEN5-WL3W].

²³ N.Y. Exec. Order No. 202.10 (Mar. 23, 2020), https://www.governor.ny.gov/sites/default/files/atoms/files/EO_202.10.pdf [https://perma.cc/3NPJ-W7QB].

²⁴ *E.g.*, Md. Exec. Order No. 20-03-30-01 (Mar. 30, 2020), <https://governor.maryland.gov/wp-content/uploads/2020/03/Gatherings-FOURTH-AMENDED-3.30.20.pdf> [https://perma.cc/QX3V-EYUG] (“All persons living in the State of Maryland are hereby ordered . . . to stay in their homes or places of residences Social, community, spiritual, religious, recreational, leisure, and sporting gatherings and events . . . of more than 10 people are hereby prohibited at all locations and venues”); Or. Exec. Order No. 20-12 (Mar. 23, 2020), https://www.oregon.gov/gov/admin/Pages/eo_20-12.aspx

traffic was prohibited.²⁵ American public schools and universities closed down and shifted classes online.²⁶ Across the U.S., many states ordered people to stay at home and avoid gathering with others outside their household.²⁷ Most businesses were ordered to suspend operations.²⁸

These sorts of “stay-at-home,” “lockdown,” and similar governmental orders were unprecedented in American history prior to 2020.²⁹ As one

[<https://perma.cc/M77M-JDMD>] (directing “that, to the maximum extent possible, individuals stay at home” and prohibiting “[n]on-essential social and recreational gatherings of individuals . . . regardless of size, if a distance of at least six feet between individuals cannot be maintained”).

²⁵ See, e.g., *Proclamation on Suspension of Entry as Immigrants and Nonimmigrants of Persons Who Pose a Risk of Transmitting 2019 Novel Coronavirus*, THE WHITE HOUSE (Jan. 31, 2020), <https://trumpwhitehouse.archives.gov/presidential-actions/proclamation-suspension-entry-immigrants-nonimmigrants-persons-pose-risk-transmitting-2019-novel-coronavirus/> [<https://perma.cc/8CM9-UGRF>] (refusing entry to aliens traveling from China); *Proclamation — Suspension of Entry as Immigrants and Nonimmigrants of Certain Additional Persons Who Pose a Risk of Transmitting 2019 Novel Coronavirus*, THE WHITE HOUSE (Mar. 11, 2020), <https://trumpwhitehouse.archives.gov/presidential-actions/proclamation-suspension-entry-immigrants-nonimmigrants-certain-additional-persons-pose-risk-transmitting-2019-novel-coronavirus/> [<https://perma.cc/7K2A-AXZV>] (refusing entry to aliens traveling from Europe); Press Release, Gov’t of N.Z., Stronger Border Measures to Protect NZers from COVID-19 (Mar. 19, 2020), <https://www.beehive.govt.nz/release/stronger-border-measures-protect-nzers-covid-19> [<https://perma.cc/CDC2-CE9R>] (“The Government has taken further measures to protect New Zealanders from the COVID-19 virus, effectively stopping all people from boarding a plane to New Zealand from 11:59pm today, except for returning New Zealanders . . .”).

²⁶ See Michael Gartland, Denis Slattery & Michael Elsen-Rooney, *NYC School Buildings Will Close at Least Through Thanksgiving Weekend Over Rising COVID-19 Rates*, N.Y. DAILY NEWS (Nov. 18, 2020), <https://www.nydailynews.com/news/politics/new-york-elections-government/ny-coronavirus-nyc-cuomo-de-blasio-20201118-unlr5dqvonff3b7ytaocmd6tv4-story.html> [<https://perma.cc/85H6-54WM>]; Melissa Korn, *Coronavirus Prompts Colleges to Send Students Home*, WALL ST. J. (Mar. 10, 2020, 5:39 PM ET), <https://www.wsj.com/articles/coronavirus-prompts-colleges-to-send-students-home-11583862936> [<https://perma.cc/SK2V-CUQS>].

²⁷ See *United States v. Hicks*, No. 20-20024-JAR-1, 2020 WL 1528619, at *2 (D. Kan. Mar. 31, 2020) (“[T]he country has taken unprecedented action to curtail the spread of COVID-19. The President has declared a national emergency, and many governors have declared statewide emergencies and issued varying levels of ‘stay-at-home’ orders”); see, e.g., Md. Exec. Order No. 20-03-30-01, *supra* note 24 (prohibiting large gatherings, ordering residents to stay at home, and closing non-essential businesses).

²⁸ See, e.g., Md. Exec. Order No. 20-03-30-01, *supra* note 24 (“[A]ll Non-Essential Businesses shall remain closed to the general public.”); Or. Exec. Order No. 20-12, *supra* note 24 (“prohibit[ing] the operation” of various types of businesses, including “furniture stores,” “indoor and outdoor malls,” “museums,” and “ski resorts”).

²⁹ See *Calvary Chapel Dayton Valley v. Sisolak*, 140 S. Ct. 2603, 2604 (2020) (Alito, J., dissenting) (“For months now, States and their subdivisions have responded to the

court explained in a case striking down certain orders as unconstitutional:

Although this nation has faced many epidemics and pandemics and state and local governments have employed a variety of interventions in response, there have never previously been lockdowns of entire populations — much less for lengthy and indefinite periods of time. . . .

[A]n examination of the history of mitigation efforts in response to the Spanish Flu — by far the deadliest pandemic in American history — reveals that nothing remotely approximating lockdowns were imposed. . . .

[T]he lockdowns imposed across the United States in early 2020 in response to the COVID-19 pandemic are unprecedented in the history of our Commonwealth [of Pennsylvania] and our Country. They have never been used in response to any other disease in our history. . . . They were unheard of by the people this nation until just this year. . . .

The intrusions into the fundamental liberties of the people of this Commonwealth effectuated by these orders are of an order of magnitude greater than any of the ordinances examined in [prior] cases. [The state's] stay-at-home and business closure orders subjected every Pennsylvanian to a lockdown where he or she was involuntarily committed to stay-at-home unless he or she was going about an activity approved as an exception by the orders. This is, quite simply, unprecedented in the American constitutional experience.³⁰

Historically restrictive government orders, not to mention the direct effects of the pandemic itself, played havoc with business operations across the country, inhibiting their ability to stay open and serve customers. The United States suffered its first economic recession after more than a decade of growth.³¹ In just one month — April 2020 —

pandemic by imposing unprecedented restrictions on personal liberty”); Holman W. Jenkins, Jr., *Elon Musk Is Our New ACLU*, WALL ST. J. (May 12, 2020, 6:22 PM ET), <https://www.wsj.com/articles/elon-musk-is-our-new-aclu-11589322149> [https://perma.cc/6GXF-TMFM] (describing government orders to contain the COVID-19 pandemic as “the most sweeping, authoritarian and undemocratic restrictions on individual liberty ever contemplated”).

³⁰ Cnty. of Butler v. Wolf, 486 F. Supp. 3d 883, 913-17 (W.D. Pa. 2020).

³¹ *Determination of the February 2020 Peak in US Economic Activity*, NAT'L BUREAU OF ECON. RSCH. (June 8, 2020), <https://www.nber.org/news/business-cycle-dating->

more than 20 million people lost their jobs, and the unemployment rate shot up from under four percent in February to nearly fifteen percent in April.³²

Restaurants were hit particularly hard, as customers were legally barred from in-restaurant dining, leading to a huge drop in revenue.³³ By November 2020, more than one-sixth of all restaurants — over 100,000 establishments — had closed permanently.³⁴ Airlines were similarly devastated, with passenger traffic dropping more than ninety percent in 2020 from the year before.³⁵ Collectively, global airlines lost more than \$100 billion during the year and laid off more than 400,000 people,³⁶ while dozens of airlines went out of business entirely.³⁷ Additionally, almost all major (and minor) sporting events were cancelled or postponed, including the Tokyo Olympics,³⁸ the Boston Marathon,³⁹ and the NBA basketball season.⁴⁰ Many more examples could be given of businesses disrupted by COVID-19, but these should suffice to show that the pandemic devastated business and commerce in 2020.

committee-announcement-june-8-2020 [https://perma.cc/SKZ7-RWE6] (announcing officially that the United States entered a recession in February 2020).

³² Sarah Chaney & Eric Morath, *April Unemployment Rate Rose to a Record 14.7%*, WALL ST. J. (May 8, 2020, 2:35 PM ET), <https://www.wsj.com/articles/april-jobs-report-coronavirus-2020-11588888089> [https://perma.cc/8ZVQ-DGQT].

³³ See Press Release, Nat'l Rest. Ass'n, *Restaurant Industry in Free Fall; 10,000 Close in Three Months* (Dec. 7, 2020), <https://restaurant.org/news/pressroom/press-releases/restaurant-industry-in-free-fall-10000-close-in> [https://perma.cc/BY4C-VK8A] (reporting that restaurants had suffered an “average 36% drop in sales revenue”).

³⁴ *Id.*

³⁵ Angus Whitley & Christopher Jasper, *2020 Is Year Airlines Would Rather Forget, as These Charts Show*, BLOOMBERG NEWS (Dec. 21, 2020, 1:00 PM PST), <https://www.bloomberg.com/news/articles/2020-12-21/how-covid-ripped-apart-global-airlines-business> [https://perma.cc/MZP4-VKT3].

³⁶ *Id.*

³⁷ *Id.* (reporting that forty-two airlines declared bankruptcy in 2020, twenty-five of which were in North America or Europe).

³⁸ Peter Landers & Rachel Bachman, *Japan, IOC Agree to Postpone 2020 Tokyo Olympics by About One Year*, WALL ST. J. (Mar. 24, 2020, 5:57 PM ET), <https://www.wsj.com/articles/japans-abe-agreed-with-ioc-to-delay-tokyo-olympics-by-about-one-year-11585052548> [https://perma.cc/6T7B-CWXM].

³⁹ Talya Minsberg & Matthew Futterman, *Boston Marathon Canceled for the First Time*, N.Y. TIMES (May 28, 2020), <https://www.nytimes.com/2020/05/28/sports/boston-marathon-canceled.html> [https://perma.cc/RK64-8G2Y].

⁴⁰ Ben Cohen, *NBA Suspends Season Due to Coronavirus*, WALL ST. J. (Mar. 11, 2020, 10:04 PM ET), <https://www.wsj.com/articles/nba-suspends-season-due-to-coronavirus-11583978349> [https://perma.cc/RN2Q-3XW2].

II. COVID-19 AND THE FRUSTRATION DOCTRINE

The last Part described the incredible impact that the COVID-19 pandemic had on business operations. The remainder of the Article will discuss whether these extraordinary circumstances should excuse affected parties from their contracts, either under the Frustration doctrine (Part II) or pursuant to a MAC clause (Part III).

This Part begins by introducing the Frustration doctrine, including its doctrinal elements and its development in case law.⁴¹ It then walks through four hypothetical examples of contracts upset by the COVID-19 pandemic and analyzes whether the parties should be relieved of their obligations pursuant to the Frustration doctrine.⁴² Finally, it reports on the developing case law on Frustration under COVID-19.⁴³

A. *The Frustration Doctrine*

The first principle of contract law is *pacta sunt servanda* — “a contract must be observed.”⁴⁴ Even if a party changes its mind or the market moves against it, a contract remains legally enforceable. That is what makes a contract a contract.⁴⁵ There are exceptions to this rule, however, including the “twin doctrines” of Impossibility and Frustration.⁴⁶

The twin doctrines are closely related — and, confusingly, are called by each other’s names in the UK and other countries⁴⁷ — but they are conceptually distinct.⁴⁸ The Impossibility doctrine excuses a party from her contract when events or changed circumstances make performance impossible (or effectively so).⁴⁹ And the Frustration doctrine excuses a

⁴¹ See *infra* Parts II.A.1–2.

⁴² See *infra* Part II.B.1.

⁴³ See *infra* Part II.B.2.

⁴⁴ 14 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 74.2 (Joseph M. Perillo ed., rev. ed. 2021).

⁴⁵ See *Dermott v. Jones*, 69 U.S. 1, 6 (1864); *Stees v. Leonard*, 20 Minn. 494, 451 (1874).

⁴⁶ E. ALLAN FARNSWORTH, WILLIAM F. YOUNG, CAROL SANGER, NEIL B. COHEN & RICHARD R.W. BROOKS, CASES ON CONTRACTS 856 (7th ed. 2008).

⁴⁷ Wenqing Liao, *Efficient Breach in the Common European Sales Law*, 41 SYRACUSE J. INT’L L. & COM. 335, 360 n.98 (2014).

⁴⁸ See *Glenn R. Sewell Sheet Metal, Inc. v. Loverde*, 451 P.2d 721, 728 n.13 (Cal. 1969) (observing that although Frustration may “appear to overlap” with Impossibility, “[i]t is, however, a separate doctrine”).

⁴⁹ Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 800; Andrew A. Schwartz, *Contracts and COVID-19*, 73 STAN. L. REV. ONLINE 48, 49 (2020) [hereinafter *Contracts and COVID-19*].

party from her contract when events or changed circumstances render the other party's counterperformance worthless (or effectively so).⁵⁰ In other words, Frustration applies when an unexpected event, beyond the party's control, completely undermines the party's primary purpose in making the contract.⁵¹

In general, the twin doctrines excuse the performance of opposite parties bound by a contract. While the Impossibility doctrine "operates to the advantage of parties that are bound to furnish goods, land, services, or some similar performance," the Frustration doctrine "operates to the advantage of parties that are to pay money in return for those performances."⁵² Furthermore, unlike Impossibility, the Frustration doctrine excuses a party from a contract even though it is perfectly possible to perform as promised.⁵³ The effect may be limited, however, as the Frustration doctrine only excuses a party from further performance due to occur after the frustrating event.⁵⁴ Prior to that time, the party is still bound.

Finally, if a party is excused on the grounds of Frustration, that does not mean that it can just walk away. At that point, the law would apply the doctrine of Restitution, which is designed to prevent unjust enrichment at the expense of another.⁵⁵ Under the Restitution doctrine, the excused party must account for any performance already received prior to the frustrating event and pay the other side the reasonable value of it.⁵⁶ By contrast, pure reliance damages — the money required to

⁵⁰ Schwartz, "Standard Clause Analysis," *supra* note 6, at 800.

⁵¹ RESTATEMENT (SECOND) OF CONTS. § 265 (AM. L. INST. 1981) ("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.").

⁵² 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 9.7, at 650 (3d ed. 2004).

⁵³ Nicholas R. Weiskopf, *Frustration of Contractual Purpose — Doctrine or Myth?*, 70 ST. JOHN'S L. REV. 239, 240 (1996) ("[I]t is not that either party's performance has become impossible or significantly more difficult than originally contemplated. Rather, the party seeking discharge on frustration grounds . . . can still do that which the contract requires, but no longer has the motivation to do so which originally induced its participation in the bargain.").

⁵⁴ RESTATEMENT (SECOND) OF CONTS. § 265 (AM. L. INST. 1981) ("[H]is *remaining duties* to render performance are discharged.") (emphasis added).

⁵⁵ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 (AM. L. INST. 2011) ("A person who is unjustly enriched at the expense of another is subject to liability in restitution.").

⁵⁶ RESTATEMENT (SECOND) OF CONTS. § 377 (AM. L. INST. 1981) ("A party whose duty of performance does not arise or is discharged as a result of . . . frustration of purpose . . . is entitled to restitution for any benefit that he has conferred on the other party by

return the performing party to its position when the contract was made, including costs spent in anticipation of performing the contract — are generally not recoverable in Frustration cases, since those were not paid over to the other side ahead of the frustrating event.⁵⁷

1. Case Law

Case law on Frustration is sparse, since it is very rarely invoked, and rarely successful when it is. This is as it should be, since the doctrine is only meant to apply in truly extraordinary circumstances, rather than run-of-the-mill cases. For these reasons, there are only a few key precedents on point, and the successful ones have arisen in unusual circumstances, such as a cancelled royal coronation or World War II.

The most famous Frustration case — also the first to recognize the doctrine — is *Krell v. Henry*.⁵⁸ The English case from a century ago relates to a grand procession to commemorate a new king's coronation. Krell, the owner of an apartment overlooking the procession route, entered into a contract to rent his apartment to Henry for the days of the procession so Henry could observe the historic event. Unfortunately, the king fell ill, and the coronation procession was postponed. Henry, suddenly having no use for Krell's flat on the appointed days, refused to take the apartment or pay the rent, and Krell sued him for breach of contract.⁵⁹ The court ruled for Henry on the basis of Frustration: Because the apartment was rented for the specific "purpose of seeing the Royal procession," once it was cancelled, the court held, the "foundation" of the contract was "frustrated," and Henry was accordingly excused from his promise to pay the rent.⁶⁰

way of part performance."); see *Ask Mr. Foster Travel Serv. v. Tauck Tours*, 43 N.Y.S.2d 674, 675 (Sup. Ct. 1943) (holding sightseeing company, which made a two-year contract with publicity agent, was bound to pay for agent's services performed prior to a governmental ban on sightseeing in the second year).

⁵⁷ See RESTATEMENT (SECOND) OF CONTS. § 377 illus. 5 (AM. L. INST. 1981) (showing by example that pure reliance damages are not recoverable); Victor P. Goldberg, *After Frustration: Three Cheers for Chandler v. Webster*, 68 WASH. & LEE L. REV. 1133, 1161-62 (2011) (explaining — and criticizing — the rule that reliance damages are not recoverable).

⁵⁸ *Krell v. Henry* (1903) 2 K.B. 740, 740; see also *In re Fontana D'Oro Foods, Inc.*, 472 N.Y.S.2d 528, 532 (Sup. Ct. 1983) ("Frustration of purpose . . . has its origin in . . . *Krell v. Henry* . . ."), *aff'd as modified*, 107 A.D.2d 808 (N.Y. App. Div. 1985), *aff'd*, 65 N.Y.2d 886 (1985).

⁵⁹ Henry put down £25 as a deposit and promised to pay the remaining £50 two days before the coronation; Krell's suit was for the £50. *Krell*, 2 K.B. at 741.

⁶⁰ *Id.* at 750-51, 754. The purpose of the contract need not be stated expressly in its terms; a court may look to extrinsic evidence to determine the purpose. *Id.* at 749 ("I

For a somewhat more modern example, consider *20th Century Lites v. Goodman*, in which the defendant leased from the plaintiff a neon sign and installed it on the roof of his drive-in restaurant in Los Angeles.⁶¹ The parties entered into a three-year agreement in 1941, just a few months before the attack on Pearl Harbor, which led the United States to enter World War II.⁶² About one year into the lease, “the Government of the United States, as an emergency war measure, ordered a cessation of all outside lighting, including neon illuminated signs, at all hours between sunset and sunrise, covering the district in which defendant’s place of business is located.”⁶³ As a result, the defendant was not allowed to illuminate his neon sign during the night — and he never illuminated the sign in the daytime anyway.⁶⁴ The defendant stopped paying for the sign and offered to return it to the plaintiff, but the latter refused and sued him for breach of contract.⁶⁵

As a defense, the restaurant owner invoked the Frustration doctrine, asserting that the “dim-out” order totally destroyed the purpose of the contract, which was to provide an illuminated sign, visible at night, and thereby attract traffic to the restaurant.⁶⁶ The plaintiff countered that the sign was visible during the day, as it had “block lettering” as well as neon, and that the neon could still be lit during the day.⁶⁷

The court sided with the restaurant owner.⁶⁸ While it was true that the sign was visible during the day, that was of essentially no value, for the principal purpose of a neon sign is for use at night: “The merely incidental facts, that it remained physically possible to illuminate the display with electricity in the daytime and the signs were visible even though unlighted during the daylight hours, are of such inconsequential moment as to have no effect on the application of the rule.”⁶⁹ The court accordingly excused the restaurant owner from the contract.

think that you first have to ascertain, not necessarily from the terms of the contract, but, if required, from necessary inferences, drawn from surrounding circumstances recognised by both contracting parties, what is the substance [purpose] of the contract”).

⁶¹ *20th Century Lites, Inc. v. Goodman*, 149 P.2d 88, 90 (Cal. Ct. App. 1944).

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.* at 91.

⁶⁵ *Id.* at 90.

⁶⁶ *Id.* at 91.

⁶⁷ *Id.*

⁶⁸ *Id.* at 92.

⁶⁹ *Id.* (“[The Frustration] doctrine may be invoked whenever official governmental action prevents the hirer from using the property for the primary and principal purpose

Krell v. Henry and *20th Century Lites v. Goodman* are exceptional. In most cases, courts have gone the other way and refused to excuse parties from their contracts under the Frustration doctrine.⁷⁰ In one edifying example, *Swift Canadian Co. v. Banet*, an American company based in Philadelphia contracted to purchase a quantity of lamb pelts from a Canadian supplier for a fixed price.⁷¹ After the first part of the order was duly shipped to the buyer in Philadelphia, the United States government issued an order that prevented the rest of the pelts from being imported into the country.⁷² Based on this unexpected turn of events, the buyer thought itself excused from the contract on the basis of Frustration, leading the seller to sue for breach — and the court sided with the seller.⁷³

The court accepted that the buyer had expected to receive the pelts in Philadelphia and that the intervening importation ban had thrown a wrench into its plans.⁷⁴ But the court understood the buyer's principal purpose in much broader terms, suggesting that its goal was simply to trade in lamb pelts, and not only in America.⁷⁵ Although the United States was unavailable, "the rest of the world was free to the buyer . . . as destination for the shipment," and so its contractual purpose was not completely frustrated.⁷⁶ Because the pelts could be resold elsewhere, the contract retained some significant value to the buyer, and it remained bound to the contract.

Swift Canadian illustrates the extremely high bar for a Frustration claim, and it also explains why the high bar is appropriate. In that case, the market price of Canadian lamb pelts had apparently dropped precipitously due to the import ban — bad news for the buyer. But events surely could have turned out differently. Had wool sweaters

for which it was hired. In such event the contract of hiring is terminated even though other incidental uses might remain available for the thing hired.").

⁷⁰ See Schwartz, "Standard Clause Analysis," *supra* note 6, at 804 (noting claims of Frustration "almost never succeed" in court); Weiskopf, *supra* note 53, at 242 ("[C]ourts typically do not permit purchasers of goods and services to escape contractual liability because of supervening frustration of bargaining objective.").

⁷¹ *Swift Canadian Co. v. Banet*, 224 F.2d 36, 37 (3d Cir. 1955).

⁷² *Id.*

⁷³ *Id.* Note that performance was not illegal, as the buyer had the right to direct the remainder of the shipment within Canada or to another country that did not prohibit the importation of lamb pelts.

⁷⁴ *Id.* at 38.

⁷⁵ *Id.*

⁷⁶ *Id.*; see Schwartz, "Standard Clause Analysis," *supra* note 6, at 807 ("[T]he frustration doctrine only provides relief if the destruction in contract value is total or near-total.").

suddenly come into vogue and the market price of lamb pelts tripled, the buyer would have been able to quickly flip the lamb pelts for a tremendous profit. There is thus good sense in the court holding the buyer to the contract, regardless of how things turned out: The nature of the parties' fixed-price contract was that "the risk of loss and the possibility of profit if the market advanced, were in the buyer."⁷⁷

2. Elements

Cases like *Krell v. Henry* and the others have broken down the Frustration doctrine into four elements: (1) A party's principal purpose in making the contract was (2) totally frustrated (or nearly so) by an (3) extraordinary and (4) exogenous event.⁷⁸ The law demands a very high showing for each of these elements, leading to courts only very rarely excusing parties on the basis of Frustration.⁷⁹ This strict approach makes sense, as the Frustration doctrine chips away at the foundational concept that contracts are legally enforceable through thick and thin.⁸⁰ Even so, when a truly extraordinary and unexpected event completely destroys the anticipated value of a contract, the Frustration doctrine may come to the aid of a party seeking to be excused.

a. *Principal Purpose Frustrated*

To be excused under the Frustration doctrine, a party must first show that its "principal purpose" in making the contract was frustrated by an unexpected change in circumstances. To qualify as a party's "principal purpose," 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 . . . without it the

⁷⁷ *Swift Canadian Co.*, 224 F.2d at 38.

⁷⁸ Schwartz, "Standard Clause Analysis," *supra* note 6, at 803-04; *see, e.g.*, PPF Safeguard, LLC v. BCR Safeguard Holding, LLC, 924 N.Y.S.2d 391, 394 (App. Div. 2011) ("The doctrine applies 'when a change in circumstances makes one party's performance virtually worthless to the other, frustrating his purpose in making the contract.'" (quoting RESTATEMENT (SECOND) OF CONTRS. § 265 cmt. a (AM. L. INST. 1981))).

⁷⁹ Arthur Anderson, *Frustration of Contract — A Rejected Doctrine*, 3 DEPAUL L. REV. 1, 21 (1953); Schwartz, "Standard Clause Analysis," *supra* note 6, at 804; *id.* at 806 (explaining "[n]othing short of a cataclysm or catastrophe" will suffice); Weiskopf, *supra* note 53, at 239-40. *But see, e.g.*, Pieper, Inc. v. Land O'Lakes Farmland Feed, LLC, 390 F.3d 1062, 1066 (8th Cir. 2004) (applying the Frustration doctrine to excuse performance); Viking Supply v. Nat'l Cart Co., 310 F.3d 1092, 1096-97 (8th Cir. 2002) (same).

⁸⁰ *See* Crown IT Servs., Inc. v. Koval-Olsen, 782 N.Y.S.2d 708, 711 (App. Div. 2004) ("[T]his doctrine is a narrow one.").

transaction would make little sense.”⁸¹ In addition, a party’s principal purpose must be known or apparent to the other side at the time of contracting.⁸²

Importantly, courts often construe a party’s principal purpose broadly, as the *Swift Canadian* case demonstrates.⁸³ This tendency, in connection with the second element requiring near-total frustration of that broad purpose, makes it very difficult to successfully invoke the Frustration doctrine.⁸⁴ This is because, if the purpose is a broad one, it takes a lot to completely frustrate every aspect of that purpose.

b. Total or Near-Total Frustration

Under the second element of the Frustration doctrine, a party must demonstrate that its contractual purpose was completely frustrated — that is, that the change in circumstances has totally or nearly totally destroyed the value of counterperformance.⁸⁵ Mere unprofitability or even significant losses are insufficient.⁸⁶ Rather, a party’s contractual objectives must have been so completely thwarted by the changed conditions such that the other party’s performance is rendered essentially worthless.⁸⁷

⁸¹ RESTATEMENT (SECOND) OF CONTS. § 265 cmt. a (AM. L. INST. 1981). “Essence” is sometimes used in lieu of “principal purpose.” See, e.g., *Murphy Door Bed Co. v. Interior Sleep Sys., Inc.*, 874 F.2d 95, 102-03 (2d Cir. 1989) (“[T]here is no indication that a transfer of trademark rights was the essence of the distributorship agreement.”).

⁸² *Hillsborough Cnty. v. Star Ins. Co.*, 847 F.3d 1296, 1305 (11th Cir. 2017); *Chang v. Pacificorp*, 157 P.3d 243, 248 (Or. Ct. App. 2007) (noting a party’s purpose must be “mutually understood, even if not mutually shared”); cf. *Hadley v. Baxendale* (1854) 156 Eng. Rep. 145 (CE) (holding that a contracting party may only recover losses that arise naturally from the breach or are within the parties’ contemplation when contracting).

⁸³ See *supra* Part II.A.1.

⁸⁴ CORBIN, *supra* note 44, § 77.3; see, e.g., *Swift Canadian Co. v. Banet*, 224 F.2d 36, 38 (3d Cir. 1955) (ruling that because the international market was open to the parties, the contract could not be frustrated by United States regulations); *Cooper v. Mundial Trading Co.*, 172 N.Y.S. 378, 381 (App. Term 1918) (“[A]ny loss suffered by the defendant, because of its failure to procure the license, must be borne wholly by itself.”).

⁸⁵ E.g., *St. Paul Mercury Ins. Co. v. Capitol Sprinkler Inspection, Inc.*, 573 F. Supp. 2d 152, 172 (D.C. 2008); *Lloyd v. Murphy*, 153 P.2d 47, 50 (Cal. 1944); CORBIN, *supra* note 44, § 77.4; JOSEPH M. PERILLO, CALAMARI & PERILLO ON CONTRACTS § 13.12, at 466 (6th ed. 2009).

⁸⁶ See *Felt v. McCarthy*, 922 P.2d 90, 94 (Wash. 1996); CORBIN, *supra* note 44, § 77.4.

⁸⁷ E.g., *Seaboard Lumber Co. v. United States*, 308 F.3d 1283, 1296 (Fed. Cir. 2002); *United States v. Gen. Douglas MacArthur Senior Vill., Inc.*, 508 F.2d 377, 381 (2d Cir. 1974); *RIV VIL, Inc. v. Tucker*, 979 F. Supp. 645, 656 (N.D. Ill. 1997). In other

The Frustration doctrine only provides relief if the destruction in contract value is total or near-total.⁸⁸ This may be a temporary situation, in which case the claimant will be excused for the duration of the frustration.⁸⁹ In most cases, the counterperformance retains at least some real value despite a change in circumstances,⁹⁰ especially when the purpose of the contract is construed broadly (as in *Swift Canadian*).⁹¹ Thus, parties that invoke the Frustration doctrine have a tough row to hoe.⁹²

c. *Extraordinary Event*

The third element is that the Frustration doctrine applies only to extraordinary events or changed circumstances.⁹³ This element is satisfied when an extraordinary circumstance makes the other party's counterperformance "so vitally different from what was reasonably to be expected as to alter [its] essential nature."⁹⁴ The standard for "extraordinary" is extremely high; in the words of one court, only a "virtually cataclysmic" event will suffice.⁹⁵

Beyond the extreme nature of the event, many cases suggest that the Frustration doctrine is limited to situations that were "unforeseeable" at the time of contracting.⁹⁶ At first blush, this makes good sense. Foreseeable risks are part and parcel of entering into a contract. The world is unpredictable and, if courts excused parties on the basis of

words, the expected benefit of the contract must have been reduced to zero, or nearly zero, due to the changed circumstances.

⁸⁸ *United States v. Sw. Elec. Coop., Inc.*, 869 F.2d 310, 315 (7th Cir. 1989).

⁸⁹ RESTATEMENT (SECOND) OF CONTS. § 269 (AM. L. INST. 1981) ("[F]rustration of purpose that is only temporary suspends the obligor's duty to perform while the impracticability or frustration exists.").

⁹⁰ *See Jones v. Fuller-Garvey Corp.*, 386 P.2d 838, 839-40 (Alaska 1963).

⁹¹ *See supra* Part II.A.1.

⁹² *See sources cited supra* note 79.

⁹³ *See* RESTATEMENT (SECOND) OF CONTS. ch. 11, intro. note (AM. L. INST. 1981); 30 RICHARD A. LORD, WILLISTON ON CONTRACTS § 77:95 (4th ed. 2004).

⁹⁴ RESTATEMENT (SECOND) OF CONTS. ch. 11, intro. note (AM. L. INST. 1981); *see also* *Lloyd v. Murphy*, 153 P.2d 47, 52 (Cal. 1944) (distinguishing between restriction and total destruction of a contract's primary purpose); PERILLO, *supra* note 85, § 9.26, at 314-15.

⁹⁵ *United States v. Gen. Douglas MacArthur Senior Vill., Inc.*, 508 F.2d 377, 381 (2d Cir. 1974).

⁹⁶ *See, e.g., United States v. Winstar Corp.*, 518 U.S. 839, 905 n.53 (1996) (examining a select case history of the foreseeability issue); *Arabian Score v. Lasma Arabian Ltd.*, 814 F.2d 529, 531 (8th Cir. 1987); *Lloyd*, 153 P.2d at 54 (noting that "[i]f it was foreseeable there should have been provision for it in the contract"); *N. Am. Cap. Corp. v. McCants*, 510 S.W.2d 901, 905 (Tenn. 1974); FARNSWORTH, *supra* note 52, at 655 (examining a select case history of the foreseeability issue).

things that they knew might happen, this would destabilize the idea that a contract is a legally enforceable promise.

That line of reasoning is superficially attractive but not ultimately convincing. The better argument regarding foreseeability is that it is “a relevant, but not dispositive, factor.”⁹⁷ For one thing, the original case that established the Frustration doctrine was premised on the “extraordinary event” of the king falling ill⁹⁸ — which is certainly foreseeable. For another, anything and everything is foreseeable, in a cosmic sense, so a strict nonforeseeability requirement would mean that the Frustration doctrine could never apply.⁹⁹ But it does, at least sometimes, and so unforeseeability simply cannot serve as a strict requirement for a successful claim of Frustration.

All that said, foreseeability does matter to the Frustration analysis. The best way to understand the relevance of foreseeability is that it relates to whether the risk of the extraordinary event was implicitly allocated to the party claiming Frustration.¹⁰⁰ A risk that is clearly foreseeable, such as the government denying a necessary permit or license, may, depending on the circumstances, be implicitly allocated to one party.¹⁰¹ If that risk eventuates, the party may not then look to the

⁹⁷ *Winstar Corp.*, 518 U.S. at 905 n.53; see also *Opera Co. of Bost. v. Wolf Trap Found. for the Performing Arts*, 817 F.2d 1094, 1100-01 (4th Cir. 1987) (explaining why requiring absolute nonforeseeability abrogates the Frustration doctrine); *Transatlantic Fin. Corp. v. United States*, 363 F.2d 312, 318 (D.C. Cir. 1966) (“Foreseeability or even recognition of a risk does not necessarily prove its allocation.”); LORD, *supra* note 93, § 77:113, at 663 (“[T]he mere fact that the event was foreseeable does not compel the conclusion that its nonoccurrence was not such a basic assumption.” (citing RESTATEMENT (SECOND) OF CONTS. § 265 cmt. a (AM. L. INST. 1981))).

⁹⁸ *Krell v. Henry* (1903) 2 K.B. 740, 754 (using the king falling ill days before his coronation as the extraordinary event undermining the purpose of a contract to rent an apartment to watch the coronation parade).

⁹⁹ Schwartz, *Contracts and COVID-19*, *supra* note 49, at 50 (“If aliens from outer space land on Earth, that might not be foreseen, but it is certainly foreseeable — after all, countless books and movies specifically entertain that very possibility.” (citations omitted)); cf. *L. N. Jackson & Co. v. Royal Norwegian Gov’t*, 177 F.2d 694, 699 (2d Cir. 1949) (“Carried to its logical limits such a view would practically destroy the doctrine [of Impossibility].”).

¹⁰⁰ *Scott v. Petett*, 816 P.2d 1229, 1236 (Wash. Ct. App. 1991) (“[T]he doctrine of frustration of purpose is inapplicable when one of the parties to a contract has been allocated the risk of . . . frustration.”); see RESTATEMENT (SECOND) OF CONTS. § 265 (AM. L. INST. 1981) (explaining that Frustration gives rise to excuse “unless . . . the circumstances indicate the contrary”).

¹⁰¹ E.g., *McCants*, 510 S.W.2d at 905 (holding the Frustration doctrine inapplicable when federal officials refused to approve a site for use as a federal savings and loan association; that rent must be paid); *Wichita Props. v. Lanterman*, 633 P.2d 1154, 1160-61 (Kan. Ct. App. 1981) (finding no Frustration because the “inability to obtain a retail

doctrine of Frustration for relief. It is not merely that the frustrating event was foreseeable, but rather that its risk was implicitly assigned to the complaining party.¹⁰²

In the end, this element means that Frustration does require an “extraordinary event” or “changed circumstances,” regardless of whether such was foreseeable. Unforeseeable events are more likely to serve as grounds for a claim of Frustration, but even foreseeable events could qualify if they are sufficiently extraordinary, and their risk was not implicitly allocated to the party seeking relief.

d. Exogenous Event

Frustration, being an equitable doctrine, is restrained by traditional equitable principles.¹⁰³ For this reason, a party seeking to be excused under the Frustration doctrine must not himself be the cause of the frustrating event.¹⁰⁴ This final element of the Frustration doctrine traditionally requires that the frustration “resulted without the fault of the party seeking to be excused.”¹⁰⁵ In other words, the frustration must have been caused by an exogenous — rather than endogenous — event.¹⁰⁶

B. COVID-19 as Frustration

The COVID-19 pandemic, and governmental efforts to contain it, had a historic impact on business and commerce, as described above in Part I. Countless people and companies found that their contracts signed before the pandemic suddenly lost their *raison d’être*. The lovely flower

liquor license to operate the premises as a retail liquor store was . . . foreseeable at the time the lease was executed”; that the tenant “should have provided in the contract for such contingency”).

¹⁰² *W. L.A. Inst. for Cancer Rsch. v. Mayer*, 366 F.2d 220, 225 (9th Cir. 1966) (describing as a “widely accepted view” that “foreseeability of the frustrating event is not alone enough to bar rescission if it appears that the parties did not intend the promisor to assume the risk of its occurrence”).

¹⁰³ See *Karl Wendt Farm Equip. Co. v. Int’l Harvester Co.*, 931 F.2d 1112, 1120 (6th Cir. 1991); *Murphy v. N. Am. Co.*, 24 F. Supp. 471, 479 (S.D.N.Y. 1938).

¹⁰⁴ See *Red River Wings, Inc. v. Hoot, Inc.*, 751 N.W.2d 206, 226-27 (N.D. 2008); RESTATEMENT (SECOND) OF CONTS. § 265 (AM. L. INST. 1981) (stating that Frustration occurs when, “after a contract is made, a party’s principle purpose is substantially frustrated *without his fault* . . .” (emphasis added)).

¹⁰⁵ FARNSWORTH, *supra* note 52, at 652-53; see also *id.* at 653 n.11 (providing a select case history of the fault issue).

¹⁰⁶ See, e.g., LORD, *supra* note 93, § 77:95, at 596 (“[To] invoke the doctrine of commercial frustration, the happening of an event . . . must not be caused by either party or by something that is under the control of either party.”).

arrangements ordered for a wedding are useless if the nuptials must be cancelled due to the pandemic. A shipment of inventory is of no value when your store has been ordered to close. And who needs a “Go Red Sox” banner when the baseball season has been cancelled?

Should parties like these be released from their contracts on the grounds of Frustration? As a way to think through how these cases might be resolved, this Part analyzes a set of simplified hypotheticals that raise the issue of Frustration in the context of the COVID-19 pandemic.

1. Examples and Analyses

a. Restaurant Lease

Consider a restaurant in New York City, which saw some of the worst outbreaks of COVID-19 and, accordingly, some of the strictest limits on business activity. The governor of New York barred restaurants from “serving patrons food or beverage on-premises” for several months in 2020, although the order allowed for takeout and delivery.¹⁰⁷ That order was subsequently modified in June 2020 to permit outdoor dining¹⁰⁸ and in September to allow indoor dining within New York City at twenty-five percent capacity.¹⁰⁹ In December 2020, the governor reinstated the original order and banned all indoor dining once again.¹¹⁰

The restaurant might claim that these governmental orders provide grounds to be excused from its lease pursuant to the Frustration doctrine. How might such a claim play out? Recall the four elements of the Frustration doctrine provide that a party can be excused if (1) its principal contractual purpose was (2) totally frustrated (or nearly so)

¹⁰⁷ N.Y. Exec. Order No. 202.3 (Mar. 16, 2020), https://www.governor.ny.gov/sites/default/files/atoms/files/EO_202.3.pdf [<https://perma.cc/2UXH-K4QF>].

¹⁰⁸ N.Y. Exec. Order No. 202.38 (June 6, 2020), http://dmna.ny.gov/covid19/docs/all/EXEC_COVID19_ExecutiveOrder202.38_060620.pdf [<https://perma.cc/PX5S-4BG3>].

¹⁰⁹ *Governor Cuomo Announces Indoor Dining in New York City Allowed to Resume Beginning September 30 with 25 Percent Occupancy Limit*, OFF. OF THE N.Y. STATE GOVERNOR (Sept. 9, 2020), <https://www.governor.ny.gov/news/governor-cuomo-announces-indoor-dining-new-york-city-allowed-resume-beginning-september-30-25> [<https://perma.cc/C3KM-PMPN>].

¹¹⁰ N.Y. Exec. Order No. 202.81 (Dec. 11, 2020), https://www.governor.ny.gov/sites/default/files/atoms/files/EO_202.81.pdf [<https://perma.cc/RD2P-EGG6>].

by an (3) extraordinary and (4) exogenous event.¹¹¹ Also recall that the law imposes a high bar on parties seeking to invoke the doctrine.¹¹²

For the first element, the primary purpose of renting space for a restaurant is to serve food to paying customers. That purpose is obvious and would have been clear to both the landlord and the restaurant when they entered into the lease. Assuming the premises includes a large dining area, it should also be clear that the restaurant intends to serve food to patrons dining in the establishment.

The second element may be difficult for the restaurant to demonstrate. The Frustration doctrine requires that a party's contractual purpose be effectively obliterated by the changed conditions, making the contract practically worthless. Diminution in business is not enough.

Here, the restaurant's main business derives from serving patrons at tables in the dining space within the restaurant, which the governor's orders declared illegal, at least for a time. On the other hand, takeout and delivery are also common components of the restaurant business, especially in New York City, and the restaurant's offering of these services would weaken its claim of total frustration. Also, if the restaurant was able to serve diners at outside tables, it would likewise undercut the restaurant's ability to establish the second element. Hence, although the primary expected form of customer service — diners at indoor tables, served by waiters — was frustrated, it seems likely that a court would rule against the restaurant for the second element.

Depending on the precise nature of the restaurant and its business, however, it may be able to demonstrate total frustration. If the restaurant is located on a building's upper floor, making outdoor dining impossible, it would have a stronger Frustration claim. Similarly, if the restaurant is a fancy one where people come as much for the service and the "experience" of multiple courses as for the food itself, it would have a stronger claim that its business has been completely frustrated (presuming the landlord was aware of all this when it entered into the lease).

Assuming that the restaurant succeeds in establishing the first two elements, it would have an easier time establishing the last two elements. For the third element — extraordinary event — the COVID-19 pandemic is clearly a cataclysm of historic proportions and akin to an unexpected Act of God or natural disaster, similar to a hurricane or

¹¹¹ Schwartz, "Standard Clause Analysis," *supra* note 6, at 803-04; *see also* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300, 2018 WL 4719347, at *57 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).

¹¹² *See supra* text accompanying notes 70–77.

avalanche.¹¹³ The governmental orders issued in response are likewise “extraordinary”; there is little doubt that the widespread and intense limitations on social conduct are radically different from anything we have seen in living memory.¹¹⁴

There is nevertheless ground for disagreement on this third element. Some might argue that the present pandemic does not qualify as an “extraordinary” event because its severity depends on human action¹¹⁵ or because the pandemic was foreseeable.¹¹⁶ As for the former argument related to human action, an earthquake is still a natural disaster that qualifies as an extraordinary event, even though the damage it causes depends on human action, such as the structural sophistication of our buildings. Similarly, the coronation in *Krell v. Henry* was postponed because the king fell ill; it did not matter whether his sickness was due to poor dietary habits, poor medical care, or just bad luck. So too the COVID-19 pandemic is an extraordinary event, and it does not matter that it was spread through human contact or exacerbated by human behavior (e.g., taking a cruise). In addition, the unprecedented governmental orders relating to the pandemic also qualify as “extraordinary,” even though they are the product of human agency.

Nor does it matter that pandemics are foreseeable and, in fact, have been predicted.¹¹⁷ The same is true of all types of Acts of God that would ordinarily satisfy the third element. Fires, hurricanes, landslides, and kings getting sick have all happened before and will surely happen again. This does not prevent them from qualifying as extraordinary

¹¹³ *JN Contemp. Art LLC v. Phillips Auctioneers LLC*, 507 F. Supp. 3d 490, 501 (S.D.N.Y. 2020) (“It cannot be seriously disputed that the COVID-19 pandemic is a natural disaster.”); *Pa. Democratic Party v. Boockvar*, 238 A.3d 345, 370 (Pa. 2020) (“We have no hesitation in concluding that the ongoing COVID-19 pandemic equates to a natural disaster.”); Schwartz, *Contracts and COVID-19*, *supra* note 49, at 58.

¹¹⁴ See *supra* text accompanying notes 29–30.

¹¹⁵ Cf. David B. Saxe & Michael Mix, *Contractual Force Majeure Provisions and the Spreading Coronavirus*, N.Y. L.J. (Mar. 9, 2020, 1:32 PM), <https://www.law.com/newyorklawjournal/2020/03/09/contractual-force-majeure-provisions-and-the-spreading-coronavirus/> [https://perma.cc/QD52-SH32] (suggesting that “coronavirus might not be considered an act of God” for purposes of a *force majeure* clause).

¹¹⁶ See, e.g., Victoria Y. Fan, Dean T. Jamison & Lawrence H. Summers, *Pandemic Risk: How Large Are the Expected Losses?*, 96 BULL. WORLD HEALTH ORG. 129, 129 (2018) (“Few doubt that major epidemics and pandemics will strike again”); Katherine Harmon, *What Will the Next Influenza Pandemic Look Like?*, SCI. AM. (Sept. 19, 2011), <https://www.scientificamerican.com/article/next-influenza-pandemic/> [https://perma.cc/93JW-EM3K] (reporting that “scientists and public health experts seemed to agree” that the relevant question regarding “the next influenza pandemic” “is *when*, not *if*,” it will occur).

¹¹⁷ See *supra* notes 96–102.

events for the purposes of the Frustration doctrine.¹¹⁸ Similarly, the mere fact that governmental “stay-at-home” orders are foreseeable (and are specifically guarded against in the Constitution¹¹⁹) does not affect their status as “extraordinary.”

Finally, the restaurant is likely to have a pretty easy time of demonstrating the fourth element of Frustration — exogeneity. After all, the restaurant did not cause the pandemic nor, presumably, did it lobby the governor to shut down its primary business of indoor dining. Still, depending on the facts, the landlord might be able to show that the restaurant is at least partially at fault for its own frustration. For example, if the restaurant declines to rent tables or heat lamps for outdoor use, the landlord would have a colorable argument that the restaurant cannot establish exogeneity.

In short, the outcome of a restaurant’s claim to be excused from its lease depends on the nature of its business as well as the specific government orders in place. In general, though, restaurants that can still cater to paying customers in some way or another are unlikely to succeed on a Frustration claim.

b. Sports Television Subscription

Many sports fans pay a fixed monthly subscription fee to television channels (or apps) like ESPN or Sky Sports primarily to watch live sporting events as they happen. Nearly all of these events — including Major League Baseball and NBA Basketball — were cancelled or postponed due to COVID-19 in March 2020,¹²⁰ with the result that access to these channels were worth much less than the fans anticipated when they subscribed. Does this amount to Frustration?

In terms of the first two elements relating to total frustration of the contract’s principal purpose, subscribers might have considered the principal purpose of their contracts — seeing live sports on television — as frustrated upon these cancellations. However, as noted earlier,

¹¹⁸ Cf. Schwartz, *Contracts and COVID-19*, *supra* note 49, at 50 (observing that “anything and everything is foreseeable, at least to those with good imaginations”).

¹¹⁹ E.g., U.S. CONST. amend. I (“Congress shall make no law . . . abridging . . . the right of the people peaceably to assemble.”).

¹²⁰ Benjamin Mullin & Lillian Rizzo, *Sports TV Networks Take a Hit as Major Leagues Suspend Operations over Coronavirus*, WALL ST. J. (Mar. 12, 2020, 6:51 PM ET), <https://www.wsj.com/articles/espn-tnt-face-lost-revenue-from-nba-season-suspension-over-coronavirus-11584032874> [<https://perma.cc/H6JY-QHVG>] (“In quick succession over the past 24 hours, the National Basketball Association, National Hockey League and Major League Baseball announced they were suspending operations due to concerns about the coronavirus pandemic, and the NCAA canceled its men’s and women’s basketball tournaments.”).

courts tend to interpret a contract's principal purpose broadly to avoid invalidation on Frustration grounds. That is, access to these sports channels still retained some significant value, as they showed documentaries, talk shows,¹²¹ classic games from the archives, and some of the live sporting events still taking place during that time, like professional baseball from Korea.¹²²

While the channels may not have been worth as much as viewers had hoped, subscribers who sought to be excused based on Frustration are unlikely to succeed. Just as in *Swift Canadian*, the subscribers could have been particularly fortunate; for their fixed fee, they might have seen six holes-in-one at The Masters, a record-setting run at the Kentucky Derby, and the first team to score 200 points in an NBA game. So, they are likewise bound even if they were only able to watch the NFL Draft, classic games, and documentaries. They are much closer to achieving their principal purpose than the drive-in owner in *Goodman*.¹²³ His neon sign, only for use during the day, had essentially no value to him, while this type of alternative programming is closely related to the essence of the contract.

For the same reasons discussed in Part II.B.1.a, sports subscribers seeking to be excused from their contracts on the grounds of Frustration will likely be able to meet the third element by establishing that the COVID-19 pandemic is an extraordinary event. Similarly, such subscribers are almost certainly not to blame for their own frustration and so will succeed on the fourth element of exogeneity.

In sum, sports television subscribers are unlikely to win a Frustration claim.

c. *Event-Specific Purchase*

Next, consider a hypothetical involving the NCAA, which organizes the annual "March Madness" college basketball tournament.¹²⁴ Assume that the NCAA had contracted with a printer to produce 100,000 paper programs for the tournament, full of information on the teams and

¹²¹ *Id.* ("After several college basketball tournaments were canceled, ESPN put its 'SportsCenter' program on throughout the day on its main network and the ESPN2 channel simulcast programming from ESPN and ESPNNews to fill the airtime.")

¹²² Victor Mather, *ESPN's Live Sport Savior: Korean Baseball*, N.Y. TIMES (May 7, 2020), <https://www.nytimes.com/2020/05/04/sports/espns-live-sport-savior-korean-baseball.html> [<https://perma.cc/CM4Y-SXBR>].

¹²³ See *supra* text accompanying notes 61–69.

¹²⁴ See Jason Gay, *Sports Shut Down, and March Is Suddenly Less Mad*, WALL ST. J. (Mar. 13, 2020, 8:29 PM ET), <https://www.wsj.com/articles/sports-shut-down-and-march-is-suddenly-less-mad-11584050027> [<https://perma.cc/VZQ7-B33U>].

players, with payment due upon delivery. Due to the COVID-19 pandemic, however, the NCAA cancelled the tournament for the first time in its history, which dates back to 1939.¹²⁵

Should the NCAA be excused from the contract on the basis of Frustration? It would appear so. Because the contract's one and only purpose was to obtain 100,000 programs for use in the tournament, when the tournament was cancelled, the purpose was totally and completely obliterated. In other words, the programs are essentially valueless because the tournament will never be held, and so the NCAA should be excused pursuant to the Frustration doctrine.¹²⁶ A century-old case with similar facts came to just that conclusion.¹²⁷

Even so, it was the NCAA itself that decided to cancel the tournament, which may undermine the fourth element of exogeneity, requiring that the extraordinary event frustrating the contract's principal purpose be outside the control of the parties. A closer look at the facts, however, suggests that the NCAA was effectively forced to cancel the tournament based on governmental orders and decisions by top college basketball teams and conferences to shut down for the year.¹²⁸ Thus, the NCAA would probably be excused from the program-printing contract under the Frustration doctrine.

Finally, what if the printer had already commenced work on the programs, such as drafting the text or laying out the pages? Must the NCAA compensate the printer for the reasonable value of its effort, even though it was all for naught? Case law suggests that the answer is no, because the payment was only due once the programs were delivered,

¹²⁵ *Id.*

¹²⁶ It is possible that the programs would have retained some value as novelty items, though they are more likely effectively worthless. *Cf.* Mihir Zaveri & Alan Yuhas, *Where Does All the Swag Go After Campaigns Fail? Everywhere*, N.Y. TIMES (Feb. 25, 2020), <https://www.nytimes.com/2020/02/25/us/politics/leftover-campaign-shirts-hats-mugs.html> [<https://perma.cc/V9Y3-SA47>] (reporting on what happens to buttons, shirts, bumper stickers, and other political campaign "swag": some items are donated to charity or end up in storage but "99 percent" of such items are thrown away).

¹²⁷ See *Alfred Marks Realty Co. v. Hotel Hermitage Co.*, 156 N.Y.S. 179, 180 (App. Div. 1915) (excusing hotel from contract to pay for advertisement in program for yacht race postponed due to the outbreak of war); RESTATEMENT (SECOND) OF CONTS. § 265 illus. 2 (AM. L. INST. 1981) (illustration based on *Alfred Marks* and similar cases).

¹²⁸ *Gay*, *supra* note 124 ("Late Thursday afternoon, the NCAA finally called off its March Madness men's and women's basketball tournaments. That handwriting had been collecting on the wall. First, the conference tournaments went poof: ACC, Big Ten, SEC, Big East, etc. Then traditional powerhouses Duke and Kansas — the Jayhawks are currently ranked No. 1 in the country — announced they were shutting down their athletic teams, including basketball. Love them or hate them, you can't have the tournament without Duke and Kansas . . .").

which never happened on account of the tournament being cancelled.¹²⁹ The uncompensated work done by the printer on the programs is an example of reliance damages, not restitution, because it was never given to the NCAA and is of no benefit to the sports organization.¹³⁰

d. Corporate Acquisition

Finally, a corporate acquisition — a contract to purchase an entire company — presents an important and difficult case for the Frustration doctrine. Such a contract's essential purpose is that the acquiring company obtains a valuable target with solid business prospects. But this purpose can be frustrated if the target's business drops precipitously during the so-called executory period (after the contract has been signed but before the deal has closed). Could this give rise to a valid Frustration claim?

For example, imagine a party contracted to purchase a massage-therapy company (call it Massage Inc.) but sought to back out of the deal due to the pandemic and related government orders. Massage therapy, by its nature, requires close physical contact between practitioner and client. Because this contact has a high potential to spread COVID-19, it was expressly prohibited by legal “social distancing” orders,¹³¹ with the immediate effect of shutting down the entire massage-therapy industry and many practitioners going out of business.¹³²

¹²⁹ *Hotel Hermitage Co.*, 156 N.Y.S. at 179-80 (holding no obligation to pay for advertisement in program for cancelled event when party “agreed to pay ‘upon publication and delivery,’” even though program was finished with some copies already “printed and bound”).

¹³⁰ See *supra* note 57 and accompanying text. For business reasons, especially if it plans to work with the printer in future years, the NCAA might nonetheless agree to give it some compensation.

¹³¹ E.g., *Additional Guidance on Essential Services*, OFF. OF THE ARIZ. GOVERNOR (Apr. 3, 2020), <https://azgovernor.gov/governor/news/2020/04/additional-guidance-essential-services> [<https://perma.cc/2ZM5-XCJH>] (specifically ordering all massage therapist services to cease operations pursuant to COVID-19 physical distancing requirements).

¹³² E.g., John Ewoldt, *CenterPoint Massage School in St. Louis Park Closing End of June*, STAR TRIB. (June 9, 2020, 6:35 PM), <https://www.startribune.com/centerpoint-massage-school-in-st-louis-park-stops-enrolling-students/571130912/> [<https://perma.cc/4T6A-7ALD>] (reporting that “COVID-19 restrictions were too much to handle financially for CenterPoint Massage and Shiatsu School & Clinic in St. Louis Park,” leading it to close down); Allison Steinberg, *These Massage Therapists Worry About the Effects of COVID-19 on the Future of Their Industry*, ALLURE (June 16, 2020), <https://www.allure.com/story/massage-therapists-covid-19> [<https://perma.cc/B7V5-PZ5W>] (“[M]assage therapists saw their business wiped out entirely in the blink of an eye when social distancing became a nearly ubiquitous mandate.”).

Would this turn of events give a party who agreed to acquire Massage Inc. grounds to walk away under the Frustration doctrine? It is a close case, and the answer is unclear. On the one hand, the acquiring company's primary purpose of buying Massage Inc. was to generate income from operating the business and conducting massages — and that purpose has been frustrated by the pandemic and social-distancing orders. It is analogous to an agreement to acquire all the shares of a corporation whose only store burns down during the executory period, and there is precedent that such a circumstance gives rise to relief under the Frustration doctrine.¹³³

On the other hand, the legal bars on massage therapy were only temporary, lasting only weeks or months.¹³⁴ Unlike a fire that literally destroys a store, the social-distancing orders merely imposed a temporary shutdown of Massage Inc. That said, there may be reason to think that Massage Inc.'s business will remain in a depressed state for a while. Even if it is legal to obtain a massage, many potential clients may decline to do so while COVID-19 remains in circulation.¹³⁵ This would suggest that the acquirer may well succeed in invoking the Frustration doctrine to get out of the contract. Yet, like ESPN without live sports, once government restrictions are lifted, Massage Inc. would still retain at least some value to the acquirer, thus undermining a claim of Frustration.¹³⁶ How much value would be enough to avoid the invocation of the Frustration doctrine? If business falls off by ninety-five percent and remains that way indefinitely, this may lead a court to excuse the acquirer based on Frustration, given that Frustration's second element requires total or near-total frustration.¹³⁷ But if business

¹³³ *In re Fontana D'Oro Foods, Inc.*, 472 N.Y.S.2d 528, 532 (Sup. Ct. 1983) (“As a result of that fire, the purpose of the contract has been frustrated since there is no longer a functioning business to purchase.”).

¹³⁴ E.g., *Governor Ducey Announces Next Phase of Arizona Recovery*, OFF. OF THE ARIZ. GOVERNOR (May 12, 2020), <https://azgovernor.gov/governor/news/2020/05/governor-ducey-announces-next-phase-arizona-recovery> [<https://perma.cc/5GQG-J66N>] (permitting massage therapy businesses to reopen roughly six weeks after ordering them to close).

¹³⁵ Steinberg, *supra* note 132 (reporting that, even after legal limits were lifted, “[i]t isn't business as usual,” and one massage therapist “has seen just a small number of clients compared to her pre-COVID volume”); *id.* (“Some worry that a lingering fear of touch will remain even after social distancing measures are lifted. People may not rush to pay strangers to touch them right away.”).

¹³⁶ See Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 807 (“[B]ecause almost every counterperformance will retain at least some value despite a change in circumstances, parties that invoke the frustration doctrine almost always lose.”).

¹³⁷ Cf. Robert T. Miller, *Material Adverse Effect Clauses and the COVID-19 Pandemic: How Sophisticated Commercial Parties Allocate Risk by Contract* 1, 16 (Univ. of Iowa Coll. of L., Working Paper No. 2020-33, 2020) (“[I]f the target had been rendered insolvent

only falls significantly — say by forty percent — that is likely not enough to qualify as a Frustration event.¹³⁸

2. Emerging Case Law

The preceding hypothetical examples speculated as to the application of the Frustration doctrine to contracts upended by the COVID-19 pandemic. The true outcome is uncertain, however. Very few Frustration claims have actually been litigated over the past century, resulting in limited case law on the subject. In addition, the factual background for real cases is nuanced and not as simple as those just considered.

Fortunately (in a perverse sense), the onset of the COVID-19 pandemic has led to a significant uptick in the number of real-life Frustration claims asserted in court.¹³⁹ Many of these are still in the process of being litigated, but at least a few have generated judicial decisions that illuminate the application of the Frustration doctrine to contracts undermined by COVID-19.

This Subsection describes the emerging case law addressing Frustration in the context of COVID-19. As will appear, the courts have maintained the same extraordinarily high standard for a Frustration claim that they have traditionally required. Indeed, the present author knows of only one case where a court issued a final judgment in favor of a Frustration claim based on the COVID-19 pandemic¹⁴⁰ — and many have gone the other way.¹⁴¹ That said, many cases remain pending

or nearly so, as has happened to so many businesses since March of 2020, then the acquirer could likely argue that the doctrine of frustration applies.”).

¹³⁸ Cf. Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 807 (“Prohibition-era cases involving saloon leases illustrate the rule. If the terms of the lease required that the premises be used solely for serving alcohol, the tenant was generally excused from the lease because the value of the lease was totally destroyed by Prohibition. But if the lease permitted other uses unaffected by Prohibition — the sale of cigars, for instance — the tenant was held to the lease because the change in the law merely decimated, but did not destroy, the value of the lease.”).

¹³⁹ See *supra* text accompanying notes 2–4.

¹⁴⁰ *UMNV 205-207 Newbury, LLC v. Caffé Nero Ams. Inc.*, No. 2084CV01493-BLS2, 2021 WL 956069, at *1 (Mass. Super. Ct. Feb. 8, 2021).

¹⁴¹ E.g., *In re NTS W. USA Corp.*, No. 20-CV-6692, 2021 WL 4120676, at *6 (S.D.N.Y. Sept. 9, 2021) (expressly disagreeing with *Caffé Nero*); see *id.* at *4 (“Many New York courts assessing commercial lease disputes amidst the COVID-19 pandemic have held that the temporary and evolving restrictions on a commercial tenant’s business do not warrant rescission or other relief based on the frustration-of-purpose doctrine.” (collecting cases)).

before the courts, so it may be premature to draw firm conclusions from the cases decided to date.

a. Restaurant Leases

In *UMNV v. Caffé Nero*, a Boston café claimed that a pandemic-related state order barring on-premises consumption of food or beverages frustrated the purpose of its lease.¹⁴² The fifteen-year lease, signed in 2017, specifically required that the tenant use the leased premises only to operate a “Caffé Nero themed café” where customers could “enjoy and linger over” coffee and food; no other purpose was permitted.¹⁴³ Effective March 24, 2020, Massachusetts issued a COVID-related order that barred on-premises consumption of food or beverages, leading the tenant to close the café and stop paying rent.¹⁴⁴ A few months later, once the state orders were relaxed, the café reopened for outdoor table service in early June, and then finally reopened for indoor service on June 22.¹⁴⁵

The landlord, for its part, protested the nonpayment of rent and ultimately evicted the café.¹⁴⁶ The landlord also sued the tenant for the unpaid rent, leading the latter to assert Frustration as a defense.¹⁴⁷ After carefully recounting the legal standard for Frustration,¹⁴⁸ the court sided with the tenant, holding that it was excused from paying rent “at least from March 24 to June 22, 2020, because the entire purpose of the Lease was completely frustrated while the Governor’s COVID-19 orders barred restaurants from serving customers indoors.”¹⁴⁹

On the first element of the Frustration doctrine (principal purpose frustrated¹⁵⁰), the court found that the “main object or purpose” of the contract was quite narrow because the lease specifically required the tenant to use the premises to operate a café with a sit-down restaurant menu and did not permit any other purpose.¹⁵¹ This was a vital finding, because “[i]f UMNV had allowed Caffé Nero to use the leased premises

¹⁴² *UMNV*, 2021 WL 956069, at *1.

¹⁴³ *Id.* at *1-2.

¹⁴⁴ *Id.* at *2.

¹⁴⁵ *Id.* at *3.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*

¹⁴⁸ *Id.* at *4-5.

¹⁴⁹ *Id.* at *5.

¹⁵⁰ *See supra* Part II.A.2.a.

¹⁵¹ *UMNV*, 2021 WL 956069, at *5 (“The entire purpose of the Lease was for Caffé Nero to use space inside the basement or walk-down level of UMNV’s building to serve high quality coffee, other drinks, and food to customers who could sit and consume them on the premises.”).

for other purposes not barred by government order, then the fact that Caffé Nero's intended use was frustrated might not have discharged its obligation to pay rent."¹⁵²

As for the second element (total frustration¹⁵³), the court held that the tenant's purpose was "destroyed or frustrated while the Governor's COVID-19 orders barred Caffé Nero from allowing customers to consume food or drink inside the leased premises."¹⁵⁴

Finally, on the third and fourth elements (extraordinary and exogenous event¹⁵⁵), the court observed that "the absence of government orders barring all restaurants from serving customers inside, was a basic assumption underlying the Lease," and "there is no evidence that the risk of a global viral pandemic coming to Massachusetts and leading to a government order shutting down the entire restaurant industry was something the parties contemplated when they entered into the Lease."¹⁵⁶ Thus all elements of the Frustration doctrine were satisfied, and the court excused the tenant from paying rent for the period when indoor dining was banned in Massachusetts.¹⁵⁷

UMNV v. Caffé Nero represents the exception, not the rule. Other courts have rejected similar Frustration claims asserted by restaurants whose business was severely interrupted by the pandemic.

In *Dr. Smood New York LLC v. Orchard Houston, LLC*, a café located in Manhattan stopped paying rent after March 2020, claiming that the state of New York's limitations on restaurant service in response to COVID-19 amounted to contractual Frustration.¹⁵⁸ The lease had been signed in 2017 with a ten-year term, and the landlord demanded that the café continue paying rent. In response, the café sued the landlord and moved for a preliminary injunction to prevent the landlord from collecting rent.

In an opinion issued in November 2020, the court denied the motion and ordered the café to continue to pay the rent due under the lease.¹⁵⁹ According to the court, the relevant government orders only barred the café from "operating indoor dining services," and it was allowed to

¹⁵² *Id.* at *6.

¹⁵³ *See supra* Part II.A.2.b.

¹⁵⁴ *UMNV*, 2021 WL 956069, at *5.

¹⁵⁵ *See supra* Parts II.A.2.c–d.

¹⁵⁶ *UMNV*, 2021 WL 956069, at *5

¹⁵⁷ *Id.* at *8.

¹⁵⁸ *Dr. Smood N.Y., LLC v. Orchard Hous., LLC*, No. 652812/2020, 2020 WL 6526996, at *1 (N.Y. Sup. Ct. Nov. 2, 2020).

¹⁵⁹ *Id.* at *2-3.

“remain open for both counter service and pickup of orders submitted online,” which, in fact, it was doing.¹⁶⁰

Citing World War II-era case law, the court observed that the Frustration doctrine only applies where there has been a “complete destruction of the basis of the underlying contract; partial frustration such as a diminution in business, where a tenant could continue to use the premises for an intended purpose, is insufficient to establish the defense as a matter of law.”¹⁶¹ Here, because the café was able to operate in a limited capacity, the government orders only amounted to “partial frustration,” and the café’s claim of Frustration was “without merit.”¹⁶²

Another restaurant lease case, *In re CEC Entertainment Inc.*,¹⁶³ arose from the bankruptcy proceedings for the company CEC, which operates the nationwide chain of “Chuck E. Cheese” restaurants. Chuck E. Cheese is known for providing arcade games and entertainment, in addition to meals, and is “primarily geared towards entertaining groups of children,” especially for birthday parties.¹⁶⁴ The suit’s outcome was the same as *Dr. Smood*.

Government orders relating to the pandemic devastated all aspects of CEC’s business: “First, the regulations prohibit the operation of gaming and arcade establishments. Second, the regulations restrict the capacity of in person dining. Third, the regulations prohibit large group gatherings.”¹⁶⁵ Certain jurisdictions allowed for in-person dining up to certain capacities, but CEC’s business model centered on its combination of food and arcade games.¹⁶⁶ The company, in response to the pandemic, declined to offer dining on its own on the reasonable belief that the off-limit arcade games would create a bad experience for

¹⁶⁰ *Id.* at *2.

¹⁶¹ *Id.* (quoting *Robitzek Inv. Co. v. Colonial Beacon Oil Co.*, 40 N.Y.S.2d 819, 822 (App. Div. 1943)).

¹⁶² *Id.* For another restaurant lease case from the same court reaching the same conclusion, see *BKNY1, Inc. v. 132 Capulet Holdings, LLC*, No. 508647/16, 2020 WL 5745631, *2 (N.Y. Sup. Ct. Sept. 23, 2020) (denying preliminary injunction because “a temporary closure of plaintiff’s business for two months (April and May 2020) in the penultimate year of its initial [nine-year] term could not have frustrated its overall purpose.”).

¹⁶³ *In re CEC Ent., Inc.*, 625 B.R. 344, 344 (Bankr. S.D. Tex. Dec. 14, 2020).

¹⁶⁴ *Id.* at 349.

¹⁶⁵ *Id.* at 349-50.

¹⁶⁶ *Id.* at 349 (“Each CEC location is designed to offer traditional restaurant services along with gaming and entertainment in an integrated and experiential environment.”).

patrons and cause lasting damage to the business.¹⁶⁷ Ultimately, Chuck E. Cheese restaurants limited their offerings to take-out food service.¹⁶⁸

Given this state of affairs, the company claimed that it should be relieved, pursuant to the Frustration doctrine, of its obligation to pay rent to its various landlords.¹⁶⁹ “Without the ability to operate the gaming and entertainment aspects,” CEC argued that its ability to run its business was “fully frustrated.”¹⁷⁰ The federal bankruptcy court, applying the law of several states where CEC restaurants are located, rejected CEC’s argument in an opinion handed down in December 2020.

In the court’s view, had CEC closed down its restaurants in response to pandemic-related government limitations under the belief its leases were completely “valueless,” the Frustration doctrine may have allowed CEC to rescind the leases and walk away.¹⁷¹ In that scenario, “there would arguably have been a ‘permanent’ or ‘total’ loss of the value of the lease,” and the Frustration doctrine would apply.¹⁷² But CEC did not take that route, suggesting that the leases retained some value to it:

In the context of the pandemic, CEC chose to retain its leasehold rights for use after the pandemic and its associated governmental regulations subside. This suggests that CEC believes that any destruction of value is limited to the period where the government regulations are in effect. The destruction is temporary, not total. This Court has located no case in which such a temporary reduction in the value of the lease was adequate for the Court to determine that there had been a frustration of purpose.

Moreover, there is no evidence that CEC considered other uses for the leased premises. The principal obstacle alleged by CEC is that it cannot operate a Chuck E. Cheese restaurant at the venue. Although it might not be consistent with CEC’s long term best interests or business plan, nothing in the lease precludes CEC from opening another style of pizza restaurant or other potential uses of the facility, without gaming.¹⁷³

¹⁶⁷ *Id.* at 350.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* at 357.

¹⁷⁰ *Id.* at 358.

¹⁷¹ *Id.* at 360.

¹⁷² *Id.*

¹⁷³ *Id.*

In short, because “the governmental restrictions here restrict, rather than destroy, the purpose of CEC’s . . . leases,” its contractual purposes were not “entirely frustrated,” and the court denied its claim of Frustration.¹⁷⁴

Looking at these restaurant lease cases as a group, we can see that they are consistent with prior case law holding that a party’s principal purpose must be totally frustrated to succeed on a Frustration claim.¹⁷⁵ A century ago, Prohibition destroyed the business of bars and saloons that served alcohol, leading some tenants to invoke the Frustration doctrine as a way to avoid paying rent.¹⁷⁶ When the terms of the lease required that the premises be used solely for serving alcohol, the courts ruled in favor of Frustration claims, as Prohibition totally destroyed the value of the lease.¹⁷⁷ When a lease allowed other uses, such as the sale of cigars, the courts rejected such claims, because the value of the lease was not completely obliterated.¹⁷⁸ This same line of reasoning explains the differential outcomes in *UMNV v. Caffé Nero*, where the lease called for an in-person experience, compared with *Dr. Smood* and *CEC*, where the tenant had more freedom in its use of the premises.

b. Office Leases

1140 Broadway LLC v. Bold Food, LLC involved an office tenant in Manhattan, which provided services to a group of restaurants.¹⁷⁹ When local governmental orders relating to the pandemic banned indoor dining, the tenant’s business was “devastated” because its clients no longer needed its services.¹⁸⁰ The tenant ceased making rent payments and then vacated the premises with several years still left on the lease, leading the landlord to bring suit for the unpaid rent.¹⁸¹

In its defense, the tenant asserted that the Frustration doctrine excused its contractual obligation to pay rent. However, in an opinion issued in December 2020, the trial court disagreed and granted summary judgment to the landlord.¹⁸² The court began by citing New

¹⁷⁴ *Id.* at 351, 363.

¹⁷⁵ *See supra* Parts II.A.2.a–b.

¹⁷⁶ Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 807.

¹⁷⁷ *E.g.*, *Indus. Dev. & Land Co. v. Goldschmidt*, 206 P. 134, 135 (Cal. Ct. App. 1922).

¹⁷⁸ *See Grace v. Croninger*, 55 P.2d 940, 942 (Cal. Ct. App. 1936).

¹⁷⁹ *1140 Broadway LLC v. Bold Food, LLC*, No. 652674/2020, 2020 WL 7137817, at *1–2 (N.Y. Sup. Ct. Dec. 3, 2020).

¹⁸⁰ *Id.* at *2.

¹⁸¹ *See id.* at *1.

¹⁸² *Id.* at *3.

York case law, which established that the Frustration doctrine “is a narrow one which does not apply unless the frustration is substantial.”¹⁸³ Turning to the case at bar, the court held that, while “the tenant’s business was devastated by a pandemic,” the office-space lease “[did] not fit into the narrow doctrine of frustration of purpose.”¹⁸⁴

The court indicated that a “critical” factor in the case was that “the tenant merely provided restaurants with consulting services [and thus] was not [itself] shut down by any public health directives.”¹⁸⁵ In this way, “the tenant was one step removed from the governor’s public health orders relating to restaurants because their business assists restaurants.”¹⁸⁶ Although restaurants no longer needed the tenant’s services, leading to a financial crisis for the tenant, this was not the fault of the landlord.¹⁸⁷ “Sometimes that happens in business — an industry changes overnight,”¹⁸⁸ and the Frustration doctrine is not an insurance policy against such adverse business developments.

c. Retail Leases

In another case arising in Manhattan,¹⁸⁹ a high-end shoe store located on a prestigious block of Madison Avenue stopped paying rent in March 2020, and its landlord promptly brought suit.¹⁹⁰ The store was not prevented from operating by any government order, but its entire business model was premised on attracting customers walking by its store.¹⁹¹ Because of the pandemic, however, foot traffic largely dried up,

¹⁸³ *Id.* at *2 (quoting *Crown IT Servs., Inc. v. Koval-Olsen*, 782 N.Y.S.2d 708, 711 (App. Div. 2004)). “Substantial,” as used here, is meant to imply “near-total.”

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* Even so, the court clarified in a footnote that it took “no position on whether a restaurant could successfully rely on the doctrines of impossibility or frustration of purpose” because that issue was not before the court. *Id.* at *2 n.1.

¹⁸⁷ *See id.* at *2.

¹⁸⁸ *Id.* (“The [Frustration doctrine] does not apply here, where the tenant rented office space, the tenant’s industry experienced a precipitous downfall and the tenant to no longer be able pay the rent.”).

¹⁸⁹ It is not surprising that there are a disproportionate number of COVID-19 lawsuits in New York City. New York is a major center of commerce that suffered a high level of COVID-19 cases and experienced some of the most restrictive governmental orders relating to the pandemic.

¹⁹⁰ *See* 35 E. 75th St. Corp. v. Christian Louboutin L.L.C., No. 155883/2020, slip op. at 2 (N.Y. Sup. Ct. Dec. 9, 2020).

¹⁹¹ *See id.* at 4.

“decimat[ing] the store’s revenues.”¹⁹² On this basis, the shoe store asserted the Frustration doctrine as a defense and a justification for not paying the rent due under the lease.¹⁹³ As in the preceding cases, however, the court held for the landlord in an opinion issued in December 2020:

Contrary to defendant’s argument, this doctrine [of Frustration] has no applicability here. This is not a case where the retail space defendant leased no longer exists, nor is it even prohibited from selling its products. Instead, defendant’s business model of attracting street traffic is no longer profitable because there are dramatically fewer people walking around due to the pandemic. But market changes happen all the time. Sometimes businesses become more desirable (such as the stores near the newly-completed Second Avenue subway stops) and other times less so (such as the value of taxi medallions with the rise of ride-share apps). But unforeseen economic forces, even the horrendous effects of a deadly virus, do not automatically permit the Court to simply rip up a contract signed between two sophisticated parties.¹⁹⁴

However, a flicker of hope for retail tenants can be found in *The Gap, Inc. v. 170 Broadway Retail Owner, LLC*,¹⁹⁵ a case with similar facts as the one just described. In this case, The Gap clothing store located in lower Manhattan stopped paying rent in March 2020 and sued for a declaration that it was justified by the Frustration doctrine to do so. The Gap explained its rationale in its complaint:

[I]n March 2020, everything changed. New York City became a ghost town and overnight, retail activity came to an abrupt halt. The COVID-19 pandemic, unmatched in scope and unprecedented in duration, resulted in government mandates that changed New York City — if not forever then for the foreseeable future. Because thousands of lives were at stake, Governor Cuomo and Mayor DeBlasio’s response to the COVID-19 pandemic was swift, severe and uncompromising. Since mid-March, emergency orders have mandated the complete closure of Tenant’s downtown retail location, and to

¹⁹² *Id.* at 2.

¹⁹³ *Id.* at 1.

¹⁹⁴ *Id.* at 4.

¹⁹⁵ *The Gap, Inc. v. 170 Broadway Retail Owner, LLC*, No. 652732/2020, 2020 WL 6435136, at * 2 (N.Y. Sup. Ct. Oct. 30, 2020).

this day, continue to prohibit non-essential retail establishments either from operating altogether or requiring them to operate in a manner drastically different from what was contemplated when [this] retail lease were negotiated. This shutdown utterly and irreversibly frustrated the purpose of the parties' agreement¹⁹⁶

The landlord moved to dismiss The Gap's claim of Frustration, but the court tersely denied that motion and allowed the matter to proceed:

[P]laintiff asserts that it is excused from performing under the Lease, *i.e.* remitting rent, as the result of the destruction of the means of performance of the contract of the contract, *i.e.*, its use of the premises as a retail store under the Lease. It alleges in some factual detail, that such performance has been [impacted] by an unanticipated event that could not have been foreseen or guarded against in the Lease, a credible description of the current worldwide pandemic, shutting down New York City "brick and mortar" retail stores. . . . [F]rustration of purpose is [therefore] a viable cause of action.¹⁹⁷

Whether The Gap will ultimately succeed on its Frustration claim remains to be seen. But the fact that it was not dismissed on the pleadings suggests that the claim is at least colorable.

Finally, another hopeful interim decision for retail tenants was issued in *International Plaza Associates L.P. v. Amorepacific US, Inc.*¹⁹⁸ In this case, arising again in New York, the commercial tenant was a "manufacturer and purveyor of cosmetic beauty supplies and part of its business includes allowing customers to test the product."¹⁹⁹ The tenant's shop was completely shut down from March to June 2020 pursuant to COVID-19-related governmental orders directed at "retail stores which sell and demonstrate cosmetics and personal products."²⁰⁰ Even after June 2020, the tenant's business remained inhibited due to official requirements that "people who walk into the store must wear a face mask and that they keep a six foot distance from each other."²⁰¹

¹⁹⁶ Complaint at 3, *The Gap, Inc.*, 2020 WL 3697623 (No. 652732/2020).

¹⁹⁷ *The Gap, Inc.*, 2020 WL 6435136, at *2.

¹⁹⁸ *Int'l Plaza Assocs. L.P. v. Amorepacific US, Inc.*, No. 155158/2020, slip op. at 2 (N.Y. Sup. Ct. Dec. 14, 2020).

¹⁹⁹ *Id.*

²⁰⁰ *Id.* at 1.

²⁰¹ *Id.* at 2.

The tenant only paid “partial rent” from March 2020 onward, and the landlord sued the tenant for the remainder; the tenant, for its part, asserted the Frustration doctrine in defense.²⁰² The landlord promptly moved for summary judgment, but the court denied the motion on the ground that it was premature to resolve the case absent discovery.²⁰³

In the course of its discussion, the court made several observations that seem favorable to the tenant. For one thing, the court said that the tenant’s “loss and lack of income due to [COVID-19] is not just part of the up and downs during a commercial tenant’s lease period,” suggesting that the tenant may be able to show that its principal purpose was completely frustrated.²⁰⁴ The court also stated that COVID-19 “could not have been foreseen” and represents a “crisis that has never occurred in most of our lifetimes,” suggesting that the tenant has a good chance of establishing the extraordinary event and exogeneity elements of the Frustration doctrine.²⁰⁵ As in *The Gap*, this was only a denial of summary judgment, but it may portend a positive outcome for the tenant.

3. The (Ir)relevance of a *Force Majeure* Clause

Frustration, like other common-law contract doctrines, can be displaced and superseded by an express term in a given contract.²⁰⁶ Thus, for example, the MAC Clause (discussed below in Part III) supersedes the Frustration doctrine that would ordinarily apply. But what is the effect of a *force majeure* clause — a “contractual provision allocating the risk of loss if performance becomes impossible . . .”?²⁰⁷ Far more common and found in many types of contracts, does an express *force majeure* clause supersede and displace a common-law claim of Frustration?

Currently, there is a split of authority on this important question. Several Frustration claims arising out of COVID-19, including that of

²⁰² *Id.* at 1.

²⁰³ *Id.* at 2.

²⁰⁴ *Id.* at 1.

²⁰⁵ *Id.* at 1, 2.

²⁰⁶ RESTATEMENT (SECOND) OF CONTS. § 265 (AM. L. INST. 1981) (declaring that the Frustration doctrine may excuse a party “unless the language [of the contract] . . . indicate[s] the contrary”). *See generally, e.g.*, IU N. Am., Inc. v. Gage Co., No. CIV.A. 00-3361, 2002 WL 1277327, at *8 (E.D. Pa. June 4, 2002) (observing that “the express terms of [a] contract supersede the common law”); Schwartz, *Contracts and COVID-19*, *supra* note 49, at 54 (“Freedom of contract’ allows private parties to change or shape the default rules of contract law that would otherwise apply.”).

²⁰⁷ *Force-Majeure Clause*, BLACK’S LAW DICTIONARY (11th ed. 2019).

Victoria's Secret, have already been rejected on the ground that a *force majeure* clause displaces the doctrine.²⁰⁸ *UMNV v. Caffé Nero*, discussed above in Part II.B.2.a, went the other way and expressly held that a *force majeure* clause has no effect on a Frustration claim.²⁰⁹

As I explain in this Subsection, I believe the latter view is correct: A *force majeure* clause has no bearing on the Frustration doctrine and does not supersede a claim based on it.²¹⁰ Preliminarily, we must observe that many cases analyze Frustration claims on their merits despite the presence of a *force majeure* clause.²¹¹ This necessarily implies that a Frustration claim is not displaced by a *force majeure* clause.

a. *The Force Majeure Clause and the Frustration Doctrine*

Stepping back, all agree that a typical *force majeure* clause covers the same ground as and supersedes the common-law Impossibility doctrine, a relative of Frustration which excuses a party when an extraordinary event renders its contractual performance impossible through no fault of its own.²¹² In other words, when parties include a *force majeure* clause in a contract, the precise terms of the clause, rather than the common-law doctrine of Impossibility, control whether a party should be

²⁰⁸ *Victoria's Secret Stores, LLC v. Herald Square Owner LLC*, No. 651833/2020, 2021 WL 69146, at *1-2 (N.Y. Sup. Ct. Jan. 7, 2021); e.g., *In re CEC Ent., Inc.*, 625 B.R. 344, 351 (Bankr. S.D. Tex. 2020) (“[F]rustration of purpose does not apply because the force majeure clauses supersede application of the doctrine.”).

²⁰⁹ *UMNV 205-207 Newbury, LLC v. Caffé Nero Ams. Inc.*, No. 2084CV01493-BLS2, 2021 WL 956069, at *6 (Mass. Super. Ct. Feb. 8, 2021) (“UMNV insists that the defense of frustration of purpose is barred by the force majeure [clause] The Court disagrees.”).

²¹⁰ See, e.g., *Rembrandt Enters., Inc. v. Dahmes Stainless, Inc.*, No. C15-4248-LTS, 2017 WL 3929308, at *12 (N.D. Iowa Sept. 7, 2017) (rejecting the argument that “the force majeure clause supersedes . . . frustration of purpose” as not “well-grounded in facts or law”).

²¹¹ See, e.g., *Pieper, Inc. v. Land O'Lakes Farmland Feed, LLC*, 390 F.3d 1062, 1066 (8th Cir. 2004) (analyzing and holding that there was a frustration of purpose in a pig-purchasing agreement); *Beardslee v. Inflection Energy, LLC*, 904 F. Supp. 2d 213, 219-21 (N.D.N.Y. 2012) (analyzing whether a *force majeure* event took place and holding that it did not and subsequently analyzing Frustration of Purpose); *Coker Int'l, Inc. v. Burlington Indus., Inc.*, 747 F. Supp. 1168, 1170-71 (D.S.C. 1990) (analyzing the *force majeure* clause of a contract and then analyzing Frustration of Purpose); *B.F. Goodrich Co. v. Vinyltech Corp.*, 711 F. Supp. 1513, 1519 (D. Ariz. 1989) (analyzing the *force majeure* clause and then moving to analyze Frustration of Purpose).

²¹² See *In re Hitz Rest. Grp.*, 616 B.R. 374, 377 (Bankr. N.D. Ill. 2020) (“Force majeure clauses in contracts supersede the common law doctrine of impossibility.”).

excused from performing on the grounds that doing so has become impossible.²¹³

By contrast, a *force majeure* clause should not supersede, displace, or override a common-law Frustration claim, because Frustration is a separate doctrine that speaks to a different issue.²¹⁴ That is, a Frustration claim is not based on performance being impossible; it is based on the contract being pointless because the counterperformance has become worthless.

In the COVID-19 context, consider a commercial tenant whose store was shuttered due to governmental stay-at-home orders. When claiming Frustration, the tenant is not arguing that his performance of paying the rent is literally impossible due to the pandemic. It is not as if the virus has paralyzed his check-writing hand! Rather, the tenant is making a very different argument: He should be excused from paying his rent because the COVID-19 pandemic and related governmental orders rendered the lease *worthless* to him. Because his claim is focused on the lease losing value — that is, his principal purpose of entering the lease (to operate his store) has been totally undermined by the pandemic — it falls under the category of Frustration rather than Impossibility.

In short, the Frustration doctrine is in no way superseded or displaced by a typical *force majeure* clause. A party should be allowed to assert a claim of Frustration even after assenting to an express *force majeure* clause.

b. COVID-19 Case Law on Force Majeure and Frustration

Several recent cases arising out of COVID-19 have understandably — but mistakenly — held that a party whose contract includes a *force majeure* clause cannot assert the Frustration doctrine as a ground for being excused from the contract.

The most well-developed of this group is *In re CEC Entertainment Inc.*, a federal bankruptcy case regarding CEC, the operator of the Chuck E. Cheese chain of arcade-pizzerias.²¹⁵ In that case, CEC argued that it should be excused from numerous leases on the ground of Frustration. Each of its various leases included a *force majeure* clause, and the court rejected CEC's claims on the ground that the *force majeure* clauses

²¹³ See Schwartz, *Contracts and COVID-19*, *supra* note 49, at 49.

²¹⁴ Glenn R. Sewell Sheet Metal, Inc. v. Loverde, 451 P.2d 721, 729 n.13 (Cal. 1969) (observing that although Frustration may “appear to overlap” with Impossibility, “[i]t is, however, a separate doctrine”).

²¹⁵ *In re CEC Ent., Inc.*, 625 B.R. 344, 349 (Bankr. S.D. Tex. 2020).

“supersede application of the [Frustration] doctrine.”²¹⁶ In its discussion of CEC’s lease concerning a North Carolina property, the court explained:

CEC argues that both the global pandemic itself and pandemic-related government regulations are frustrating events. However, *the force majeure clause . . . supersedes the frustration of purpose doctrine* because the parties specifically allocated the risk of unusual governmental regulation. The force majeure clause contemplates unusual government regulations and how they may alter the parties’ performance obligations. The parties specifically agreed [in the force majeure clause] that unusual government regulations shall not relieve CEC’s obligation to pay rent. [T]he exception of payment obligations from the force majeure clause precludes CEC’s reliance on frustration due to the alleged occurrence of a force majeure event.²¹⁷

The court went on to make similar rulings regarding leases in Washington and California.²¹⁸

In re CEC is not alone in holding that a *force majeure* clause supersedes the Frustration doctrine. Rather, it appears to be part of a trend, as numerous COVID-19 Frustration cases have been resolved on the same basis, including the Victoria’s Secret case discussed above.²¹⁹ These rulings are erroneous, but understandable, given that Impossibility and Frustration are “twin doctrines.”²²⁰

The distinction here is a fine one. In *In re CEC*, the court rejected CEC’s claim of Frustration based on restrictive governmental orders “because the parties specifically allocated the risk of unusual

²¹⁶ *Id.* at 351.

²¹⁷ *Id.* at 359-60 (emphasis supplied).

²¹⁸ *See id.* at 360-63.

²¹⁹ *See, e.g.,* Victoria’s Secret Stores, LLC v. Herald Square Owner LLC, No. 651833/2020, 2021 WL 69146 (N.Y. Sup. Ct. Jan. 7, 2021) (dismissing the complaint due to it being “premised on the mistaken theory that the parties did not allocate the risk of tenant not being able to operate its business and that tenant is therefore somehow forgiven from its performance by virtue of a state law” because that would be “contrary to the express allocation of these risks set forth in [the *force majeure* clause] of the Lease Agreement”); Univ. Square San Antonio, Tx. LLC v. Mega Furniture Dezavala, LLC, No. #E2020003170, slip op. at 4 n.1 (N.Y. Sup. Ct. Oct. 22, 2020) (rejecting a claim of Frustration because the *force majeure* clause of the “lease considered such risks and placed upon Defendants a continued obligation to pay rent despite ‘restrictive governmental laws or regulation.’”).

²²⁰ FARNSWORTH ET AL., *supra* note 46, at 856.

governmental regulation” in their *force majeure* clauses.²²¹ But this is not quite accurate. The only risk that was allocated in those *force majeure* clauses was that unusual governmental restrictions would prevent or delay CEC from paying the rent. That is, the *force majeure* clauses focused on unusual governmental orders making paying rent impossible to some degree. (This could occur, for example, if the government shut down CEC’s bank and froze its account.)

In contrast, by making its Frustration claim, CEC argued that pandemic-related governmental restrictions decimated the value of its leases, as it could no longer effectively operate its business out of those spaces — thereby frustrating CEC’s rationale for paying rent. The precipitous decline in the value of CEC’s leases due to governmental restrictions is a separate risk from an inability to pay rent and was not allocated by the *force majeure* clauses. Hence, CEC should have retained the right to assert a common-law Frustration claim based on unusual governmental restrictions. The same is true for the other cases that have followed *In re CEC* down this path.

At least one case has addressed this issue in the context of COVID-19 and came to what I think is the correct conclusion. The recent Massachusetts decision of *UMNV v. Caffé Nero* — discussed above in Part II.B.2.a — concerned a Boston café that claimed that a pandemic-related state order barring on-premises consumption of food or beverages frustrated the purpose of its lease.²²² The café sought to be excused from paying its rent while the order was in place, and the court granted summary judgment in its favor on the grounds of Frustration.²²³

Notably, the lease between UMNV and Caffé Nero included a *force majeure* clause. As in *CEC* and the cases discussed above, the landlord “insist[ed] that the defense of frustration of purpose is barred by the force majeure [clause].”²²⁴ In this instance, however, the court flatly disagreed.²²⁵ The court’s analysis closely follows the one set forth above:

[T]he *force majeure* provision addresses the risk that performance may become impossible, but does *not* address the distinct risk that the performance could still be possible even while [the] main purpose of the Lease is frustrated by events not in the parties’ control. . . . [F]rustration of purpose is a

²²¹ *In re CEC Ent., Inc.*, 625 B.R. at 359.

²²² *UMNV 205-207 Newbury, LLC v. Caffé Nero Ams. Inc.*, No. 2084CV01493-BLS2, 2021 WL 956069, at *1 (Mass. Super. Ct. Feb. 8, 2021).

²²³ *Id.*

²²⁴ *Id.* at *6.

²²⁵ *Id.*

different issue [than impossibility], arises under different circumstances, and is not addressed by the force majeure provision.²²⁶

UMNV v. Caffé Nero thus came to the correct conclusion, in my view.

In sum, because Frustration is not founded on impossibility or difficulty of performance, a *force majeure* clause should not supplant or overrule the Frustration doctrine. For this reason, I think that cases like *UMNV v. Caffé Nero* are right on this question, while rival cases like *In re CEC* are not.²²⁷

III. COVID-19 AND THE MAC CLAUSE

A merger agreement is a written contract between two corporations — the “acquirer” and the “target” — that describes their plan to combine their businesses. As Part II.B.1.d illustrated, the Frustration doctrine does not provide much solace for a corporate acquirer whose target suffers a business reversal during the “executory period” (meaning the time between signing and closing). If the target business is severely harmed by an extraordinary and exogenous event that takes place during the executory period, the acquirer may want to assert the Frustration doctrine and back out of the deal — but its chances of success are very poor.²²⁸ Unless the target corporation has essentially been destroyed, the acquirer’s claim of Frustration is almost certain to be denied.

In most cases, however, an acquirer in such a situation can invoke a common express contractual term to escape its contract: the Material Adverse Change (“MAC”) clause. This Part describes the MAC clause and explains that it is best understood as a “standard clause analog” to the Frustration doctrine, which gives acquirers greater latitude to walk away, at least as an analytical matter.²²⁹ It details the *Akorn* case, the first Delaware decision to find that a target had suffered a MAC,²³⁰ and

²²⁶ *Id.* (emphasis in original).

²²⁷ Tenants whose business was disrupted by the pandemic may well fail to establish all four elements of the Frustration doctrine, as was the case in *CEC*, but they should be allowed to try.

²²⁸ See Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 819 (“[C]orporate acquirers have a strong business need to avoid closing acquisitions with weakened partners, yet they cannot rely on the frustration doctrine to protect them.”).

²²⁹ See *infra* Parts III.A.1–2; see Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 819 (“[L]awyers created the MAC clause to serve as a standard clause analog of the frustration doctrine and provide acquirers greater latitude to walk away from a partner whose business deteriorates during the executory period.”).

²³⁰ See *infra* Part III.A.3.

analyzes whether harm to a target's business inflicted by the COVID-19 pandemic qualifies as a MAC.²³¹ Finally, it examines the developing case law on this question, with a focus on the one COVID-19 MAC case decided to date.²³²

A. The MAC Clause

1. Background²³³

The Material Adverse Change clause is a standard clause used in corporate merger agreements, the most economically significant private contracts on earth.²³⁴ Although the concept of a corporate merger derives from statutory law,²³⁵ a merger agreement is a private contract and is governed by the common law.²³⁶

The parties to a merger agreement do not immediately perform — that is, merge their business operations into a single unit — under the contract. Rather, there is always a delay from the time the parties enter into the merger agreement until the time they actually merge. It can often take several months or even a year or more, depending on the complexity of the deal, the need for regulatory approval, or other factors.²³⁷ This time span from signing to closing — the executory period — is frequently a time of high anxiety for acquirers, as they know that the world and the business climate is dynamic and unpredictable.²³⁸

²³¹ See *infra* Part III.B.1.

²³² See *infra* Part III.B.2.

²³³ Portions of this Subsection are adapted from Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 817-19.

²³⁴ See Ronald J. Gilson & Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisitions*, 21 J.L. ECON. & ORG. 330, 357 (2004) (noting that “[h]undreds of billions of dollars of assets transfer each year” pursuant to corporate merger agreements).

²³⁵ See, e.g., DEL. CODE ANN. tit. 8, § 251 (2020) (authorizing corporate mergers).

²³⁶ See James C. Freund, *A Turbulent Decade for Deals: Anatomy of a Merger Revisited*, NAT'L L.J., Nov. 11, 1987, at 3, 17 (“[A]n acquisition is still a deal between two parties.”).

²³⁷ Sheri Qualters, *Scrutiny of Mergers May Be Increased*, NAT'L L.J., Dec. 8, 2008, at 8 (explaining that premerger review by the DOJ or FTC begins with an initial 30-day screening and may expand to an investigation involving a second request for more information, which is “a six-to nine-month massive data-collection period”; after the investigation, the agency can challenge a deal in U.S. district court).

²³⁸ See Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2044 (2009) (“[T]he non-simultaneity of signing and closing in large corporate acquisitions generates deal risk, that is, the possibility of negative contingencies between signing and closing that can affect the value of the deal to the parties.”).

For this reason, a corporate acquirer has reason to fear that some unpredictable change or event during the executory period — like the COVID-19 pandemic — could harm the target’s business, leaving it with the unpleasant obligation to acquire a weakened companion. To address this risk, practically every merger agreement today includes a MAC clause, which conditions the acquirer’s duty to close — that is, tender the purchase price — on the target having experienced no material adverse change in its business or financial condition during the executory period. In this way, the MAC clause allows the acquirer to avoid closing the deal if the target’s business suffers a sufficiently adverse change during the executory period.

MAC clauses are carefully negotiated and complex terms, and there is no single model that is universally employed. Still, there is a standardized formulation common to most MAC clauses. Typically, the target makes a representation that, since the date of the merger agreement, there have not been any changes to the target that “individually or in the aggregate, has had or would reasonably be expected to have” a material adverse effect on the target’s business.²³⁹ An example is included in the footnotes.²⁴⁰

²³⁹ See *Akorn, Inc. v. Fresenius Kabi AG*, No. CV 2018-0300, 2018 WL 4719347, at *50 (Del. Ch. Oct. 1, 2018), *aff’d*, 198 A.3d 724 (Del. 2018).

²⁴⁰ The following is an example of a MAC clause, taken from *Akorn, Inc. v. Fresenius Kabi AG*, No. CV 2018-0300, 2018 WL 4719347, at *50-51 (Del. Ch. Oct. 1, 2018), *aff’d*, 198 A.3d 724 (Del. 2018):

“Material Adverse Effect” means any effect, change, event or occurrence that, individually or in the aggregate

(i) would prevent or materially delay, interfere with, impair or hinder the consummation of the [Merger] or the compliance by the Company with its obligations under this Agreement or

(ii) has a material adverse effect on the business, results of operations or financial condition of the Company and its Subsidiaries, taken as a whole; provided, however, that none of the following, and no effect, change, event or occurrence arising out of, or resulting from, the following, shall constitute or be taken into account in determining whether a Material Adverse Effect has occurred, is continuing or would reasonably be expected to occur: any effect, change, event or occurrence

(A) generally affecting (1) the industry in which the Company and its Subsidiaries operate or (2) the economy, credit or financial or capital markets, in the United States or elsewhere in the world, including changes in interest or exchange rates, monetary policy or inflation, or

(B) to the extent arising out of, resulting from or attributable to

As a glance at the note makes clear, a good portion of the MAC clause relates to exceptions. These exceptions “carve out” certain types of causes such that, even if they create a material adverse effect on the

(1) changes or prospective changes in Law or in GAAP or in accounting standards, or any changes or prospective changes in the interpretation or enforcement of any of the foregoing, or any changes or prospective changes in general legal, regulatory, political or social conditions,

(2) the negotiation, execution, announcement or performance of this Agreement or the consummation of the [Merger] (other than for purposes of any representation or warranty contained in Sections 3.03(c) and 3.04), including the impact thereof on relationships, contractual or otherwise, with customers, suppliers, distributors, partners, employees or regulators, or any litigation arising from allegations of breach of fiduciary duty or violation of Law relating to this Agreement or the [Merger],

(3) acts of war (whether or not declared), military activity, sabotage, civil disobedience or terrorism, or any escalation or worsening of any such acts of war (whether or not declared), military activity, sabotage, civil disobedience or terrorism,

(4) pandemics, earthquakes, floods, hurricanes, tornados or other natural disasters, weather-related events, force majeure events or other comparable events,

(5) any action taken by the Company or its Subsidiaries that is required by this Agreement or at [Fresenius Kabi's] written request,

(6) any change or prospective change in the Company's credit ratings,

(7) any decline in the market price, or change in trading volume, of the shares of the Company or

(8) any failure to meet any internal or public projections, forecasts, guidance, estimates, milestones, budgets or internal or published financial or operating predictions of revenue, earnings, cash flow or cash position

(it being understood that the exceptions in clauses (6), (7) and (8) shall not prevent or otherwise affect a determination that the underlying cause of any such change, decline or failure referred to therein (if not otherwise falling within any of the exceptions provided by clause (A) and clauses (B)(1) through (8) hereof) is a Material Adverse Effect);

provided further, however, that any effect, change, event or occurrence referred to in clause (A) or clauses (B)(3) or (4) may be taken into account in determining whether there has been, or would reasonably be expected to be, a Material Adverse Effect to the extent such effect, change, event or occurrence has a disproportionate adverse affect [sic] on the Company and its Subsidiaries, taken as a whole, as compared to other participants in the industry in which the Company and its Subsidiaries operate (in which case the incremental disproportionate impact or impacts may be taken into account in determining whether there has been, or would reasonably be expected to be, a Material Adverse Effect).

target, they will not serve to excuse the acquirer from its duty to close.²⁴¹ The effect is that a material adverse change caused by a carved-out cause does not “count” as a MAC under the typical definition; in other words, if the adverse change resulted from a carved-out cause, the acquirer would not be excused and must close the deal. The upshot is that the risk of a MAC resulting from a carved-out cause is allocated to the acquirer, and the risk of a MAC resulting from any other cause is allocated to the target.²⁴²

Historically, most MAC clauses include carveouts for broad changes in the economy or business in general, or in the target’s industry, as well as acts of war, “Acts of God,” terrorism, and changes in law.²⁴³ A minority of MAC clauses include other types of carveouts, such as changes in interest rates or political conditions, or “calamities.”²⁴⁴ Regarding COVID-19, “pandemics” were almost never included as a MAC carveout prior to 2020,²⁴⁵ and only a minority of MAC clauses from 2020 had such a carveout.²⁴⁶ Finally, MAC clauses often include an exception to some or all of the carveouts if the target company is “disproportionately” affected compared to its peers in the industry.²⁴⁷

For many years, the MAC clause went largely unnoticed in merger agreements and was not the subject of much, if any, litigation.²⁴⁸ Prior to the landmark *Akorn* case (discussed below), when MAC clauses did

²⁴¹ See *In re* IBP, Inc. S’holders Litig., 789 A.2d 14, 65-66 (Del. Ch. 2001) (“[M]any merger contracts contain specific exclusions from MAE clauses that cover declines in the overall economy or the relevant industry sector, or adverse weather or market conditions . . .”).

²⁴² Miller, *supra* note 238.

²⁴³ NIXON PEABODY, MAC SURVEY: NP 2020 REPORT 8-11 (2020), https://www.nixonpeabody.com/-/media/Files/PDF-Others/NP_MAC_SURVEY_2020.ashx?la=en&hash=41116207B7C918092071745EF5BF65B3 [<https://perma.cc/DL4P-9FSN>].

²⁴⁴ *Id.* at 8, 10.

²⁴⁵ Matthew Jennejohn, Julian Nyarko & Eric Talley, *Coronavirus Is Becoming a “Majeure” Headache for Pending Corporate Deals*, COLUM. L. SCH. BLUE SKY BLOG (Mar. 19, 2020), <https://clsbluesky.law.columbia.edu/2020/03/19/coronavirus-is-becoming-a-majeure-headache-for-pending-corporate-deals/> [<https://perma.cc/PS35-5P7R>] (“[L]ess than one out of 10 MAC/MAE provisions [from 2003–18] explicitly carve out pandemics.”).

²⁴⁶ NIXON PEABODY, *supra* note 243, at 9.

²⁴⁷ Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 821; Jennejohn et al., *supra* note 245 (“Many acquisition agreements, after expressly carving out contingency from the definition of a MAC/MAE, proceed then to *carve it back in if the pandemic affects the seller disproportionately*, usually relative to a benchmark of other competitors in the industry.”) (emphasis omitted).

²⁴⁸ Ronald J. Gilson & Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisitions*, 21 J.L. ECON. & ORG. 330, 331 (2005).

come before the courts, judges were not sure what to make of them. For example, one notable case described MAC clauses as “strange animals, sui generis among their contract clause brethren.”²⁴⁹ As a result, the sparse case law that developed around the MAC clause was viewed as “muddled” and “perplexing.”²⁵⁰

Nevertheless, this prior case law made it perfectly clear that the standard for finding a “material” adverse change was quite high:

A buyer faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close. A short-term hiccup in earnings should not suffice; rather the Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquirer. . . . The important consideration therefore is whether there has been an adverse change in the target’s business that is consequential to the company’s long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months. . . . Put differently, the effect should substantially threaten the overall earnings potential of the target in a durationally-significant manner.²⁵¹

This standard was so difficult to meet that no acquirer (until the *Akorn* case) had ever succeeded in persuading a Delaware court that a MAC has occurred.²⁵² Unless a target were to suffer a near-catastrophe, it seemed that acquirers would likely fail on their MAC claims.

²⁴⁹ *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715, 739 (Del. Ch. 2008).

²⁵⁰ Yair Y. Galil, *MAC Clauses in a Materially Adversely Changed Economy*, 2002 COLUM. BUS. L. REV. 846-47, 850, 865.

²⁵¹ *Akorn, Inc. v. Fresenius Kabi AG*, 198 A.3d 724 (Del. 2018) (internal quotation marks omitted) (first citing and quoting *Hexion Specialty Chems., Inc.*, 965 A.2d at 738; then citing and quoting *In re IBP, Inc. S’holders Litig.*, 789 A.2d 14, 68 (Del. Ch. 2001)).

²⁵² Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 827-28; William Kucera & Charles Wu, *MAE Clauses Have Their Value*, MAYER BROWN (June 23, 2008), <https://www.mayerbrown.com/en/perspectives-events/publications/2008/06/mae-clauses-have-their-value> [<https://perma.cc/R4J3-KMYU>] (“Despite the potential difficulty of establishing an MAE as illustrated by the judicial decisions . . . , this should not be taken by M&A practitioners to mean that MAE clauses do not have value in M&A agreements. In fact, quite the opposite is true: Even though, based on the precedent, it may ultimately be difficult for a buyer to establish that a target business suffered an MAE in a fully litigated case, in many instances the mere claim by a buyer that an MAE has occurred may provide the buyer with sufficient leverage and instill in the seller sufficient uncertainty that the parties come to a negotiated resolution long before a court has a chance to rule on the matter. This phenomenon is illustrated by several recent deals”). Even so, many acquirers, unhappy about what had happened to their targets after signing either publicly or, more frequently, privately, had told their targets

2. Relationship with the Frustration Doctrine

Looking closely at the confused state of MAC jurisprudence a decade ago, I published an article, A “*Standard Clause Analysis*” of the *Frustration Doctrine and the Material Adverse Change Clause*,²⁵³ in which I argued that the MAC clause was not sui generis. Rather, I claimed that the MAC clause is best understood as a way for parties to “contract around” the common-law Frustration doctrine.²⁵⁴

As I explained in that article, many (perhaps all) doctrinal rules of contract law have what I call “standard clause analogs” that parties can use to adjust and calibrate them.²⁵⁵ Take for example the doctrine of *lex loci contractus*, which provides that the validity and interpretation of a contract be governed by the law of the jurisdiction in which it was executed.²⁵⁶ The standard clause analog of that doctrine is the Choice of Law clause, by which parties can select an alternative body of law to resolve any issues that may arise under the contract.²⁵⁷ For another example, consider the rule that contract damages are ordinarily calculated based on the injured party’s expectation interest. This rule can be, and often is, supplanted by a Liquidated Damages clause negotiated between the parties. Many other examples can be given.²⁵⁸

Using this relationship between contract doctrines and standard clause analogs, I concluded that the MAC clause is a standard clause analog to the Frustration doctrine by allowing parties to adjust the elements and standards of that rule.²⁵⁹ Like the Frustration doctrine, the MAC clause excuses an acquirer from performing when its purpose in

that they thought they had suffered a MAC, and then received significant price reductions as a result. This would not have happened if it were virtually certain, had the matter been litigated, that the acquirer would lose. In that case, the discount would be de minimis. In other words, the paucity of successfully litigated MAC claims does not necessarily indicate that acquirers are certain to lose, but rather that the matter is very risky for both parties and the stakes are so high, making settlement — usually in the form of closing at a reduced price — in the interest of both parties.

²⁵³ Schwartz, “*Standard Clause Analysis*,” *supra* note 6.

²⁵⁴ *Id.* at 807, 828-29.

²⁵⁵ *Id.* at 796-98 (defining the concept of “standard clause analogs”).

²⁵⁶ *See, e.g.*, *Gen. Elec. Credit Corp. v. Home Indem. Co.*, 309 S.E.2d 152, 157 (Ga. Ct. App. 1983) (explaining *lex loci contractus*).

²⁵⁷ *See generally* Geoffrey P. Miller & Theodore Eisenberg, *The Market for Contracts*, 30 CARDOZO L. REV. 2073, 2077 (2009) (observing that courts generally enforce Choice of Law clauses).

²⁵⁸ *See* Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 797 (listing via chart numerous contract law doctrines and their standard clause analogs).

²⁵⁹ *Id.* at 825, 828-29 (“[T]he MAC clause is a standard clause analog of the frustration doctrine, which customizes the elements of that default rule.”).

entering the merger agreement — to acquire a profitable or synergistic target — has been frustrated. But the MAC clause liberalizes the Frustration doctrine by employing the term “material,” thereby establishing a standard lower than what the common law ordinarily demands.²⁶⁰

My reading of the MAC clause suggested that the case law applied too high of a standard for analyzing whether a target had suffered a MAC. The Frustration doctrine already provides an escape for an acquirer if the target experiences a catastrophe during the executory period. In other words, the courts’ prior interpretation effectively meant that the MAC clause did nothing more than merely restate the common law. Such a reading violates the fundamental interpretive rule that contracts should be read so as not to render any term superfluous.²⁶¹

It would be unreasonable to conclude that sophisticated parties to merger agreements, who expend considerable resources drafting and negotiating MAC clauses, intend them to do nothing more than restate the Frustration doctrine. Instead, I argued in that article that the MAC clause is a standard clause analog of the Frustration doctrine that alters, not simply restates, that doctrine.

Most importantly, the MAC clause should be understood as relaxing the second element of the Frustration doctrine. Rather than requiring an acquirer to demonstrate total or near-total destruction of the value of the target,²⁶² which is nearly impossible in practice, the MAC clause should be read as lowering this bar to a more achievable level. A “material” diminishment of the value of the target should suffice under a typical MAC clause (although it would not under the Frustration doctrine).²⁶³

²⁶⁰ See *id.* at 829 (“[T]he MAC clause should be easier to satisfy than . . . the frustration doctrine.”).

²⁶¹ *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715, 741 (Del. Ch. 2008) (“[A] contract should be read so as not to render any term meaningless.”).

²⁶² See *supra* Part II.A.2.b.

²⁶³ Schwartz, “*Standard Clause Analysis*,” *supra* note 6, at 807, 829 (providing that “[b]y using a frustration clause . . . parties can lower this bar to an achievable level by providing for excuse when the value of the counterperformance has ‘materially’ (or ‘considerably’ or ‘significantly’) diminished” and discussing that the current standard imposes too heavy of a burden on a party seeking to be excused under a MAC clause, claiming that “[w]hatever ‘material’ may mean, it is something less than ‘catastrophic.’”).

3. The Akorn Decision

My claim that the MAC clause should be read as a standard clause analog to the Frustration doctrine was subsequently adopted in the landmark opinion in *Akorn v. Fresenius*, the only Delaware case to allow a corporate acquirer to back out of a deal based on a MAC clause.²⁶⁴ In that case, Fresenius, a pharmaceutical company headquartered in Germany, entered into a merger agreement to acquire Akorn, also a pharmaceutical company, for roughly \$5 billion.²⁶⁵ Shortly after signing the deal, Akorn suffered a “dramatic, unexpected, and company-specific downturn.”²⁶⁶

First, Fresenius learned from whistleblowers that Akorn had serious issues with “data integrity,” including the submission of false information to the Food and Drug Administration (“FDA”), and that Akorn did not meaningfully address those issues until they were raised by Fresenius post-signing.²⁶⁷ Second, “immediately after the signing of the Merger Agreement, Akorn’s performance dropped off a cliff.”²⁶⁸ Its revenue declined twenty-five percent from the prior year, and the downturn showed “no signs of abating.”²⁶⁹ Because Akorn experienced a “sustained decline in business performance that is durationally significant and which would be material to a reasonable buyer,” the court held that Akorn suffered a MAC.²⁷⁰

In coming to its conclusion, the *Akorn* opinion, which was issued by the Delaware Chancery Court in 2018 and affirmed by the Delaware Supreme Court that same year, expressly followed the line of reasoning I presented in A “*Standard Clause Analysis*” of the *Frustration Doctrine and the Material Adverse Change Clause*, explaining as follows (quotations are to my article):

[T]he black-letter doctrine of frustration of purpose already operates to discharge a contracting party’s obligations when his principal purpose is substantially frustrated without his fault by

²⁶⁴ Tom Hals, *Delaware Judge Says Fresenius Can Walk Away from \$4.8 Billion Akorn Deal*, REUTERS (Oct. 2, 2018), <https://www.reuters.com/article/us-akorn-m-a-fresenius-ruling/delaware-judge-says-fresenius-can-walk-away-from-4-8-billion-akorn-deal-idUSKCN1MB2PY> [<https://perma.cc/Z2S6-AE3T>] (referring to *Akorn* as a “landmark case”).

²⁶⁵ *Akorn, Inc. v. Fresenius Kabi AG*, No. CV 2018-0300-JTL, 2018 WL 4719347, at *19 (Del. Ch. Oct. 1, 2018), *aff’d*, 198 A.3d 724 (Del. 2018).

²⁶⁶ *Id.* at *22.

²⁶⁷ *Id.* at *6-12.

²⁶⁸ *Id.* at *55.

²⁶⁹ *Id.* at *35, *55.

²⁷⁰ *Id.* at *57.

the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made. This common law doctrine “provides an escape for an acquirer if the target experiences a catastrophe during the executory period.” “It is not reasonable to conclude that sophisticated parties to merger agreements, who expend considerable resources drafting and negotiating MAC clauses, intend them to do nothing more than restate the default rule.” In lieu of the default rule that performance may be excused only where a contract’s principal purpose is completely or nearly completely frustrated, a contract could “lower this bar to an achievable level by providing for excuse when the value of counterperformance has ‘materially’ (or ‘considerably’ or ‘significantly’) diminished.” That is what the parties did in this case.²⁷¹

B. COVID-19 as MAC

1. Example and Analysis

As a way to analyze the question of the validity of a MAC claim based on COVID-19, let us return to the hypothetical acquisition of Massage Inc., discussed in Part II.B.1.d above. Importantly, the *Akorn* case makes clear that the acquirer stands a better chance of exiting the deal using an acquisition agreement’s MAC clause than it would under the common-law Frustration doctrine.

Unlike the Frustration doctrine, which requires a showing that the target business has become practically worthless, the MAC clause would be triggered if Massage Inc.’s business becomes fundamentally weaker going forward — which may well be the case. Under Delaware precedents, a significant and sustained fall-off in Massage Inc.’s business would permit the acquirer to walk away.²⁷² If the effects of the pandemic are not merely a “blip” but instead significantly affect the long-term business prospects of Massage Inc., that could qualify as a material adverse change.²⁷³

On the other hand, recall that most MAC clauses include exceptions, known as “carveouts.” These specify certain types of causes that, even

²⁷¹ *Id.* (quoting Schwartz, “Standard Clause Analysis,” *supra* note 6, at 807).

²⁷² *E.g.*, *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715, 738 (Del. Ch. 2008) (defining a material adverse change as one that is “consequential to the [target’s] long term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months”).

²⁷³ *In re IBP, Inc. S’holders Litig.*, 789 A.2d 14, 67 (Del. Ch. 2001).

if they materially and adversely affect the target, do not permit the acquirer to walk away from the deal.²⁷⁴ Presuming that the Massage Inc. MAC clause is of the typical variety, it would almost certainly include a carveout for changes in general economic or industry-wide business conditions, and it may include a carveout for “Acts of God,” but it would probably not include a carveout for pandemics.²⁷⁵ For present purposes, let us assume that it lacks a carveout for Acts of God.²⁷⁶

Under this scenario, it would appear that the acquirer could not rely on the MAC clause to avoid closing the deal with Massage Inc. That is, because the downturn in Massage Inc.’s business was (let us assume) caused by a general falloff in the massage-therapy industry, the acquirer would be held to the deal. Although Massage Inc. did indeed suffer a material adverse change during the executory period, it does not count as a MAC because it was caused by a carved-out factor.

Recall, however, that MAC clauses often include exceptions to the general economic and industry-wide carveouts if the target company is “disproportionately” affected compared to its peers in the industry.²⁷⁷ So, the issue would ultimately turn on whether the adverse change in Massage Inc.’s business, caused by the pandemic, was proportional to the general downturn in the massage-therapy industry. For example, if Massage Inc.’s value dropped by thirty percent, on par with other competitors, then the acquirer would be held to the deal. On the other hand, if Massage Inc.’s value dropped by eighty percent while its industry peers only saw losses in value of twenty percent, then the acquirer could walk away.

2. Emerging Case Law

The precedent set by *Akorn* was put to use in 2020 by numerous companies who wanted to use the MAC clause to avoid going through with acquisitions of targets hobbled by the pandemic.²⁷⁸ Several of these

²⁷⁴ See *supra* Part III.A.1.

²⁷⁵ See *supra* Part III.A.1.

²⁷⁶ Only about half of MAC clauses include a carveout for “Acts of God.” NIXON PEABODY, *supra* note 243, at 10 (reporting that fifty-seven percent of 2020’s MAC clauses included a carveout for “Acts of God”).

²⁷⁷ See *supra* Part III.A.1.

²⁷⁸ Gail Weinstein, Philip Richter & Steven Epstein, *First COVID-19 M&A Decision*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 23, 2020), <https://corpgov.law.harvard.edu/2020/12/23/first-covid-19-ma-decision> [<https://perma.cc/6DXJ-BAUR>] (“A number of cases are currently pending in various courts relating to whether, under an acquisition agreement signed prior to the COVID-19 pandemic, the effects of the

cases involve hundreds of millions, or even billions, of dollars at stake.²⁷⁹ By the end of the year, only one case reached a final decision on its merits.

In one instance, luxury goods conglomerate LVMH announced in September 2020 that it was terminating its \$16 billion deal, signed in late 2019, to purchase jeweler Tiffany & Co. on the ground that the COVID-19 pandemic had caused its target to suffer a MAC.²⁸⁰ Tiffany then sued LVMH to force it to close, and LVMH counterclaimed for a declaratory judgment.²⁸¹ In its counterclaim, LVMH alleged that the pandemic had “devastated Tiffany’s business,” leading the company to “incur[] a substantial net loss in the first half of 2020,” a worse showing than during the global financial crisis of 2008–09.²⁸² With a nod to prior case law, LVMH claimed that COVID-19’s negative effects on Tiffany’s business were “durationally significant,” because ninety percent of Tiffany’s revenues came from brick-and-mortar stores and the pandemic had shifted much retail consumption online permanently.²⁸³ That lawsuit was also settled, with LVMH ultimately agreeing to go through with the deal, albeit for \$430 million less than the original price.²⁸⁴

For another example, Simon Property Group sued in June 2020 to terminate its \$3.6 billion deal, which had been signed in February 2020, to purchase fellow mall owner Taubman Centers.²⁸⁵ Simon claimed that Taubman had experienced a MAC because COVID-19 had “a uniquely devastating and disproportionate effect on Taubman,” which operates “indoor malls in densely populated areas” — precisely the sort that

pandemic and the target company’s responses to it constituted a ‘material adverse effect.’”).

²⁷⁹ See *id.* (“In *AB Stable VIII LLC v. Maps Hotels and Resorts One LLC* (Nov. 30, 2020), the Delaware Court of Chancery has reached the first decision, on the merits, that we know of on these issues.”).

²⁸⁰ Matthew Dalton & Suzanne Kapner, *LVMH Pulls Out of Tiffany Takeover*, WALL ST. J. (Sept. 9, 2020), <https://www.wsj.com/articles/lvmh-pulls-out-of-tiffany-takeover-11599649473> [<https://perma.cc/AAH7-5ANQ>].

²⁸¹ Matthew Dalton, Noemie Bisserbe & Suzanne Kapner, *LVMH Says Tiffany’s Handling of Pandemic Invalidates Merger*, WALL ST. J. (Sept. 10, 2020), <https://www.wsj.com/articles/lvmh-says-tiffanys-handling-of-pandemic-invalidates-deal-11599744782> [<https://perma.cc/5AA2-YSCH>].

²⁸² *Tiffany & Co. v. LVMH*, No. 2020-0768-JRS, slip op. at 6 (Del. Ch. Sept. 16, 2020).

²⁸³ *Id.* at 7.

²⁸⁴ Cara Lombardo & Dana Cimilluca, *Tiffany Agrees to New Deal Terms with LVMH*, WALL ST. J. (Oct. 29, 2020), <https://www.wsj.com/articles/tiffany-lvmh-near-agreement-on-new-deal-terms-11603899275> [<https://perma.cc/63YZ-GGA8>].

²⁸⁵ *Simon Prop. Grp. v. Taubman Ctrs., Inc.*, No. 2020-181675-CB, slip op. at 1-2 (Mich. Cir. Ct. June 10, 2020).

many consumers avoid due to the pandemic.²⁸⁶ This lawsuit was settled after Taubman agreed to an \$800 million reduction in the price.²⁸⁷

For better or worse, all of these cases settled before a court had to rule on whether the MAC clause had been triggered. This begs the question of how a MAC claim premised on the COVID-19 pandemic might fare? One answer is suggested by the terms of the settlements: LVMH only achieved a 2.6 percent reduction in price, while Simon negotiated a price reduction of nearly twenty percent.²⁸⁸ This suggests that Simon's MAC claim was much stronger than that of LVMH, but this sort of induction may not be fully reliable.

Fortunately (for present purposes), one COVID-19 MAC case did generate a judicial opinion, although it did not directly address whether the downturn in the target's business reached the level of a "material adverse change." *AB Stable VIII LLC v. Maps Hotels and Resorts One LLC* involved the acquisition of a company that owned fifteen major luxury hotels across the United States, including the Westin St. Francis in San Francisco, the Four Seasons Jackson Hole, and the Fairmont Chicago, for a total price of \$5.8 billion.²⁸⁹

The contract was signed in September 2019 and was set to close in April 2020.²⁹⁰ In between, of course, the COVID-19 pandemic ravaged the hotel industry. Government travel restrictions and cancellations by both business and leisure travelers left most hotels nearly vacant, causing them to lose money at an alarming rate.²⁹¹ The fifteen hotels at issue in *AB Stable* were not immune.

²⁸⁶ *Id.* at 2-3.

²⁸⁷ Cara Lombardo, *Simon Property, Taubman Agree to Revise Merger Deal*, WALL ST. J. (Nov. 15, 2020), <https://www.wsj.com/articles/simon-property-taubman-agree-to-revise-merger-deal-11605479910> [<https://perma.cc/EP5C-USJM>].

²⁸⁸ Carol Ryan, *LVMH Saves Face but Little Money*, WALL ST. J. (Oct. 29, 2020), <https://www.wsj.com/articles/lvmh-saves-face-but-little-money-11603973014> [<https://perma.cc/FRG6-5HL6>] (describing the 2.6 percent price adjustment as "minor"); Lombardo, *supra* note 287.

²⁸⁹ *AB Stable VIII LLC v. Maps Hotels & Resorts One LLC*, No. CV 2020-0310-JTL, 2020 WL 7024929, at *1, *9, *11, *16 (Del. Ch. Nov. 30, 2020).

²⁹⁰ *See id.* at *35.

²⁹¹ Craig Karmin & Esther Fung, *Marriott, Hotel Owners Furlough Thousands of Workers, Cut Staff*, WALL ST. J. (Mar. 22, 2020), <https://www.wsj.com/articles/marriott-to-furlough-thousands-of-corporate-jobs-in-u-s-and-abroad-in-response-to-travel-collapse-11584834631> [<https://perma.cc/RH5K-XAC8>] ("The hospitality industry has been upended by the collapse in global travel as governments [have] imposed travel restrictions in response to the pandemic. Companies have halted business trips, conference organizers have called off events and vacationers have put plans on hold. Hotels are suffering the brunt of this sudden evaporation of travel, which is wiping out in a matter of weeks all the profits many companies had piled up over the past few

In March 2020, just weeks before closing, the fifteen hotels saw their “financial performance deteriorate[] at an accelerating rate.”²⁹² On March 24, the target completely closed two of its hotels, while the remaining ones were effectively closed but officially open.²⁹³ In March and early April, the target’s “business performance continued to plummet.”²⁹⁴ Things were so bad that the company’s auditors discussed whether the company was likely to remain a “going concern,” suggesting that the group might soon cease operations permanently.²⁹⁵

In light of this turn of events, the buyer refused to close and sought to get out of the deal on multiple contractual bases, including that the target had experienced a MAC due to COVID-19’s adverse effects on its business.²⁹⁶ The target, for its part, brought suit against the buyer in the Delaware Court of Chancery, seeking a decree of specific performance to compel the acquirer to complete the contract and close on the transaction.²⁹⁷

The parties amassed factual evidence, expert opinions, and arguments on whether COVID-19’s effects on the target’s hotel business qualified as “material” and “adverse” — but the court ultimately declined to rule on that issue.²⁹⁸ Rather, the court “assume[d] for purposes of analysis that [the target] suffered an effect due to the COVID-19 pandemic that was sufficiently material and adverse to satisfy the requirements of Delaware case law.”²⁹⁹ It took this tack because it concluded that the effect of the pandemic, even if material and adverse, was attributable to a cause that was carved out in the MAC clause’s exceptions portion.³⁰⁰

The MAC clause agreed to by the parties included a carveout for MACs caused by “natural disasters or calamities.”³⁰¹ In other words, a

years.”); Craig Karmin, Katherine Sayre & Costas Paris, *Coronavirus Sends Travel Business and Millions It Employs into All-Out Crisis*, WALL ST. J. (Mar. 17, 2020), <https://www.wsj.com/articles/the-travel-business-and-the-millions-it-employs-confront-all-out-crisis-11584484867> [<https://perma.cc/DU8Y-7JH3>] (“[H]otel owners in most every major urban market in the U.S. are now experiencing occupancy levels around 20% or less, a rate that will make it challenging to meet payroll, let alone pay other expenses and meet debt obligations . . .”).

²⁹² *AB Stable VIII LLC*, 2020 WL 7024929, at *39.

²⁹³ *Id.* at *40.

²⁹⁴ *Id.*

²⁹⁵ *See id.* at *39.

²⁹⁶ *Id.* at *48, *55.

²⁹⁷ *Id.* at *45.

²⁹⁸ *Id.* at *55.

²⁹⁹ *Id.*

³⁰⁰ *Id.*

³⁰¹ *Id.*

material adverse effect on the target caused by “natural disasters or calamities” would not “count” as a MAC excusing the buyer from the contract. Although the MAC clause made no specific reference to “pandemics,” the court held that the COVID-19 pandemic qualified as a “calamity.”³⁰² This holding accords with my argument above that the COVID-19 pandemic should be viewed as the equivalent of an earthquake or avalanche.³⁰³

The court looked first at the dictionary definition of “calamity”: “A state of extreme distress or misfortune, produced by some adverse circumstance or event. Any great misfortune or cause of loss or misery, often caused by natural forces (e.g., hurricane, flood, or the like). See Act of God; Disaster.”³⁰⁴ Based on this definition, the court found that

[t]he COVID-19 pandemic fits within the plain meaning of the term ‘calamity.’ Millions have endured economic disruptions, become sick, or died from the pandemic. COVID-19 has caused human suffering and loss on a global scale, in the hospitality industry, and for [the target’s] business.³⁰⁵

Beyond the dictionary, the court considered arguments relating to the structure of the contract’s MAC clause as well as expert reports on trends in other MAC clauses.³⁰⁶ None of these arguments persuaded the court.³⁰⁷ In the end, the court found that the target’s business was harmed by a carved-out calamity — the COVID-19 pandemic. The court also stated, though with somewhat less conviction, that the pandemic “arguably” qualifies as a “natural disaster.”³⁰⁸

Finally, one would expect the court to turn to the exceptions to the carveouts, such as the typical “disproportionate effect” exception.³⁰⁹ It turned out that the MAC clause in *AB Stable* was an unusual variant that completely lacked any exceptions to the carveouts.³¹⁰ The effect was to

³⁰² *Id.* at *57-65.

³⁰³ See *supra* text accompanying notes 113–119.

³⁰⁴ *AB Stable VIII LLC*, 2020 WL 7024929, at *57 (citing *Calamity*, BLACK’S LAW DICTIONARY (6th ed. 1990)).

³⁰⁵ *Id.*

³⁰⁶ *Id.* at *59-64.

³⁰⁷ *Id.* at *64-65.

³⁰⁸ *Id.* at *58.

³⁰⁹ See *supra* Part III.A.1.

³¹⁰ See *AB Stable VIII LLC*, 2020 WL 7024929, at *56, *61.

make it much tougher to prove a MAC; it was a “seller-friendly” MAC clause.³¹¹

To sum up, the *AB Stable* case did not address the basic question of whether the pandemic’s effects on the target reached the standard of being a “material adverse change,” and so we must wait for further developments in the case law before we have a firm understanding of when the effects on a target caused by COVID-19 will qualify as a material adverse change.³¹² On the other hand, *AB Stable* did clarify that a carveout for “natural disasters or calamities” should be read to include the COVID-19 pandemic, a result in accord with my analysis above.³¹³ It also represents a big win for targets and a loss for acquirers, as most MAC clauses include carveouts for natural disasters, calamities, or Acts of God.

CONCLUSION

This Article explored the application of the Frustration doctrine and the MAC clause to contracts capsized by COVID-19. As we have seen, both Frustration and the MAC clause impose very high bars to relief, and claims to either are routinely rejected in ordinary times. But these are not ordinary times. Contracts upset by once-in-a-lifetime events, like World War II or the COVID-19 pandemic, are exactly the ones that should be covered by the Frustration doctrine or the MAC clause.

We should therefore expect that, in the context of this pandemic, courts will be more receptive to claims of Frustration or that a MAC has occurred. This does not mean that all, or even most, such cases will win, but rather that a few, like *UMNV v. Caffé Nero*, will succeed. Given the exacting standard that courts apply to both Frustration and the MAC clause, a couple of successful cases would qualify as a notable development. This new body of case law, moreover, will form the foundation of our understanding of Frustration and the MAC clause for many years to come.

³¹¹ *Id.* at *61. It bears noting that the court did ultimately allow the buyer to back out of the contract. The court based its ruling on the alternative ground that the target’s closing of hotels and scaling down of operations violated its contractual obligation to operate in the “ordinary course of business” between signing and closing. *Id.* at *79.

³¹² One Canadian case, *Fairstone Financial Holdings Inc. v. Duo Bank of Canada*, [2020] O.N.S.C. 7397, expressly held that the impact of COVID-19 on the target did indeed rise to the level of a “material adverse change.” Like *AB Stable*, however, the *Fairstone* court went on to hold that the acquirer was still required to close the transaction because COVID-19 fell within a carveout. *Id.* at para. 152.

³¹³ See *supra* text accompanying notes 113–119.