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U.S. Government Shutdown: Will Performance of Private Contracts Be Excused?

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With Congress unable to reach an agreement on a continuing resolution, the federal government shut down all "non-essential" services on October 1, 2013. The shutdown will remain in effect until Congress passes appropriations legislation for fiscal year 2014. As the shutdown continues, performance under contracts between private parties may become difficult, if not completely unachievable. In rare cases, parties have options to excuse such performance under various contract excuse doctrines. This alert provides guidance on what private contracting parties affected by the shutdown should consider.[1]

As the government shutdown continues, its impact is spilling over into the private sector. The energy, agriculture, steel, industrial, restaurant, retail, travel and tourism, and hospitality industries have been or are expected to be getting hit hard, potentially throwing into jeopardy obligations under contracts between private parties. The breadth of the impact will only increase dramatically if the government defaults on its debts. Those private parties that have been impacted by the shutdown (or, potentially, a default) ought to consider the various excuse doctrines.[2]

Availability of Excuse Doctrines

Excuse doctrines—which include mutual mistake, impossibility or impracticability of performance, frustration of purpose, and force majeure—permit a party to avoid its contractual obligations when a basic assumption of the parties in entering into the contract changes substantially. None of the excuse doctrines, however, permit a party to alter the agreed-to risk allocation under a contract. For an event to excuse performance, it must be one that changes the risk allocation that underlay the agreement; otherwise,

[1] This alert does not address government contracts, which are governed by government procurement regulations. For more information on government contracts, *see* Pillsbury Client Alert: In the Event of a Government Shutdown: Preparation Pointers for Federal Contractors, dated October 2, 2013.

[2] David M. Lindley and John E. Davis, Excuse Doctrines, Commercial Contracts: Strategies for Drafting and Negotiating, §§ 9.01-9.06 (Vladimir Rossman, *et al.* eds., Aspen Publishers 2d ed. 2012) (providing an overview of excuse doctrines generally).

courts will be reluctant to forgive non-performance. For example, in cases where parties agree to a fixed-dollar contract price, a foreign seller assumes the risk of currency devaluation. If a currency is devalued, the seller cannot seek to excuse performance—this is true even where the contract becomes hugely unprofitable.[3]

The *Force Majeure* Clause

Force majeure is one of the most likely excuse doctrines that parties will turn to in the face of the shutdown because *force majeure* events may include acts of government. A *force majeure* clause is a common contractual provision that excuses a party from performing its contractual obligations due to unforeseen events beyond its control. *Force majeure* events typically include natural disasters and other "Acts of God," war, terrorist attacks, riots, strikes, and acts of government. A party could only be excused where it did not cause the event in question and could not have avoided the event.

A party seeking to avoid obligations will likely face challenges. The history of government acts to which *force majeure* has been applied has been limited and is highly dependent on the specific language in the provision.[4] If an event is determined to be foreseeable, then the application of the doctrine will also likely fail. While government shutdowns are extremely rare—the last shutdown occurred in 1996—a party opposing excused performance might argue that evidence of prior shutdowns and the long-standing disagreements between the political parties made the event foreseeable. The inquiry into whether the shutdown was "reasonably foreseeable" will depend on the specifics of the contract, as well as the current political environment.[5]

Ultimately, the wording of the *force majeure* clause will make the difference in the outcome of any potential litigation—contracting parties are free to specify which events they consider as "unforeseen" or beyond the reasonable control of the parties. Courts typically interpret these clauses narrowly and will only excuse a party's nonperformance if the event is specifically identified.[6] Performance must have been impossible, rather than just expensive. The lesson going forward: Parties may want to consider including "government shutdown" in future contracts as one of the events in a contracts' *force majeure* clause.

Help from the Uniform Commercial Code?

For those contracts that lack a *force majeure* provision, sellers may still be able to turn to the Uniform Commercial Code. Section 2-615 permits a seller to delay, cancel or only partially perform on a contract where it is commercially impractical to do so.[7] Like *force majeure* events, the party must show that the unforeseen event upon which the excuse is predicated is due to factors beyond the party's control. Courts

[3] U.S. case law generally rejects the application of excuse doctrines based on currency fluctuations. Contracting parties are presumed to be aware of the possibility of exchange rate fluctuations and changes in market condition.

[4] *See, e.g.*, *Duane Reade v. Bear Stearns Commercial Mortg., Inc.*, 2009 N.Y. Slip Op. 4348, at *9, 63 A.D.3d 433, 434 (1st Dept. 2009) (party permitted to invoke contract's *force majeure* clause where a binding temporary restraining order issued by the New York Supreme Court qualified as a "governmental prohibition" under the clause).

[5] Even in the wake of the September 11, 2011 terrorist attacks, courts were reluctant to excuse performance based on the economic effects of unexpected events—even when there was no history of an event of this magnitude. *See, e.g.*, *OWBR LLC*, 266 F. Supp. 2d at 1224 ("To excuse a party's performance under a *force majeure ad infinitum* . . . would render contracts meaningless in the present age, where terrorism could conceivably threaten our nation for the foreseeable future"). But courts are split as to whether or not the most recent financial collapse was foreseeable.

[6] *See, e.g.*, *Macalloy Corp. v. Mettalurg, Inc.*, 728 N.Y.S.2d 14, 14–15 (government decision to enforce environmental regulations not within *force majeure* clause's "plant shutdown" language; plaintiff's decision to close the plant was voluntary and made for financial reasons caused by the enforcement of the regulations—regulations plaintiff knew about before executing the contract).

[7] Section 2-615 applies in the context of sale of goods, which is governed by Article 2 of the Uniform Commercial Code.

will not excuse performance when the governmental act was foreseeable and fundamental to the risk allocation. As discussed above, this too will be challenging—particularly with respect to foreseeability. In one case under the U.C.C., a court concluded that the Arab oil embargo was foreseeable and thus not excused under section 2-615.[8] The court noted that the record was "replete with evidence as to the volatility of the Middle East situation, the arbitrary power of host governments to control the foreign oil market, and repeated interruptions and interference with the normal commercial trade in crude oil."[9] Because the parties were aware of this possibility, they should have protected themselves in the contract.

Tough Road Ahead

While there has not yet been any litigation surrounding the current federal government shutdown, it is clear that parties will find it difficult to successfully assert one or more excuse doctrines as a means to avoid contractual obligations. Ultimately, the outcome of any litigation surrounding the consequences of the shutdown will be determined on a contract-specific basis. One needs to carefully analyze the specific contract involved to understand the risk allocation of the agreement. Only then can you begin to identify whether the parties' situation is more like the rare case where excuse doctrines have been found to apply—or whether any non-performance would constitute a plain breach.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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[8] *Eastern Air Lines, Inc. v. Gulf Oil Corp.*, 415 F. Supp. 429, 442 (S.D. Fla. 1975).

[9] *Id.* at 441 (citation omitted).

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