AN ECONOMIC PERSPECTIVE ON CONTRACTUAL EXCUSE: LESSONS FROM COVID-19

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ABSTRACT

This Article shows that, contrary to the recommendation of much recent legal scholarship, courts rarely found that business restrictions during the COVID-19 pandemic excused contract performance. In cases where courts did excuse performance, it was pursuant to a contractual force majeure clause—not under one of the default excuse doctrines of impossibility, impracticability or frustration. This is in line with the longstanding judicial practice of severely narrowing default excuses. By reviewing the economic purposes served by executory contracts, this Article explains why the no-excuse default outcome is likely economically efficient: the no-excuse default enhances both the risk reduction and investment-increasing value of executory contracts while minimizing the transaction and strategic costs of bargaining around the default.

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INTRODUCTION

The coronavirus disease ("COVID-19") began to spread across the United States in early 2020. Soon after that, states and localities across the country began issuing orders, closing businesses to prevent or control the spread of the virus.[1] These lockdown orders varied in timing and severity. Generally, lockdowns targeted businesses deemed "nonessential" under orders issued by state governors. However, many businesses were deemed nonessential: including not only restaurants, (some) retail establishments, and those involved in hosting mass gatherings (such as sporting events, concerts, weddings and funerals), but also factories and other manufacturing facilities. From their earliest imposition in March 2020, lockdown orders in cities like New York evolved from complete restrictions on business operation (shutdown orders) to partial restrictions. For example, they allowed restaurants to fill only take-out orders at first, but later allowed in-person dining at greatly reduced capacity.

By late 2021, COVID-19 lockdowns were largely a thing of the past. Yet, the severe costs of the lockdowns remained. Deprived entirely, or substantially, of operational revenue during the lockdowns, businesses faced severe economic hardship in finding the funds to pay their workers, suppliers, and landlords. Businesses laid off employees, cancelled supply contracts, and stopped paying rent. Such actions predictably led to lawsuits for breach of contract. In response, businesses coalesced around a frequent defense: COVID-19 restrictions were unanticipated events that legally excused the breach of contractual promises.

Legal scholars have been more than sympathetic to this COVID-19-era defense to legal enforcement of contracts. They have argued that both COVID-19 lockdowns and the pandemic itself should have excused contractual performance under one or more default excuse doctrines—impossibility, impracticability and frustration. According to Givati, Kaplan and Listokin, the COVID-19 pandemic "rendered many contracts obsolete," with government-imposed business lockdowns converting contracts from commercial leases and wedding events into "one-sided albatrosses."[2] Similarly, Schwartz argued that the "COVID-19 pandemic is an Act of God so radically different than the ordinary challenges" of a service contract that the legal doctrine of impossibility would excuse the provider from performing (his example is that of a babysitter).[3] More broadly, Hoffman and Hwang[4] argued that caselaw supports the

1. For a comprehensive catalogue of such orders, see Raifman J., Nocka K., Jones D., Bor J., Lipson S., Jay J., and Chan P. (2020). "COVID-19 US state policy database." Available at: https://perma.cc/8E55-BFES.
2. Yehonatan Givati, Yotam Kaplan & Yair Listokin, *Excuse 2.0*, 109 CORNELL L. REV. 629, 630 (2024).
3. Andrew A. Schwartz, *Contracts and COVID-19*, 73 STAN. L. REV. ONLINE 48, 52 (2020).
4. David A. Hoffman & Cathy Hwang, *The Social Cost of Contract*, 121 COLUM. L. REV. 979, 984 (2021).

excuse of contracts whose performance might result in the spread of communicable disease; the authors even more ambitiously suggest that such cases support a general principle that courts should refuse to enforce and rewrite (under the remedy of reformation) contracts whose performance would generate a negative externality.

These academic recommendations have proven to be radically at odds with what courts actually did. With very few exceptions, courts did not excuse, but rather enforced, contractual obligations in spite of COVID-19 lockdowns and business restrictions. In instances where the court did excuse contractual obligations, it was because the court interpreted a force majeure clause in the parties' contract as including COVID-19 lockdown orders as among excusing events and the particular performance obligation as among those excused. Courts virtually never found that a default excuse such as impossibility, impracticability, or frustration excused a commercial tenant's obligation to pay rent. Judges did not think that COVID-19 lockdowns "made contracts obsolete." To the contrary, judges determined the relative rights and obligations of parties hit by COVID-19 lockdowns by applying and interpreting relevant contract language.

There are several explanations for the radical disjunction between the crushing impact of COVID-19 lockdowns on contracts theorized by legal academics and consistent judicial contract enforcement despite such lockdowns. The first is that far too much scholarship on default contract excuse doctrines focuses simply on trying to justify or critique the standard Restatement (Second) of Contracts statements about default excuses of impossibility, impracticability and frustration. An actual reading of judicial opinions involving these default excuses, however, would reveal that the Restatement (Second) versions of excuse of doctrine are simply not what courts do. Contract performance is only very rarely excused under one of these default excuse doctrines. Under New York law—which is the substantive contract law that parties most often choose to apply to their contracts—the default contract excuse outcome is a simple one: no excuse. While there is variation across states—with some state courts (most notably, perhaps, Florida) exhibiting enormous confusion about the default excuses of impossibility, impracticability and frustration—the vast majority of courts across the country follow the New York approach by very rarely granting excuse.

For decades prior to COVID-19 lockdowns, contracts scholars have struggled to explain the supposedly confused law of default contract excuse. But the law of default excuse is not confused. The twentieth was a turbulent century, with periodic global pandemics, two great world wars, at least one major depression and several bouts of unanticipated inflation, global market volatility, and, at its end, the new threat of global terrorism. In virtually every period of war, terrorism, disease or market volatility, contract parties have invoked default excuse doctrines in an attempt to persuade courts to relieve them of their contractual obligations to perform. Rarely, if ever, however, did courts oblige. The practical outcome is virtually always no excuse.

There is a second reason for the disjunction between legal scholarship on COVID-19 and contractual excuse and the general failure of courts to apply default excuses to

find that COVID-19 lockdowns excused contractual performance. Any normative model of if and when courts should excuse contract performance must be grounded in an explanation of why parties benefit from judicial enforcement of executory contracts. While the best early comprehensive economic explanations of contract law, such as that provided in Cooter and Ulen's *Law and Economics*,[5] do begin with an economic theory of why parties use executory contracts, most contracts scholarship on excuse does not provide such an explanation.

This Article provides such an explanation. I begin by considering the alternative to an executory contract. The classic executory contract commits the parties to performance at a fixed price at a fixed future date. The alternative to such ex ante contracting is to wait and execute the exchange on a future spot market. By comparing executory contracting to such future spot market exchange, the advantages of executory contracting come into clear relief. The main advantage of executory contracting stressed in this article is the elimination of the risk of fluctuating future spot market price and market availability. For risk-averse parties, such risk reduction motivates higher relationship-specific investments that increase transaction value. At the same time, however, executory contracts replace future market risk with future idiosyncratic performance risk, the risk that a counterparty will be unwilling to perform for reasons peculiar to it. Certain contract enforcement incentivizes parties to take costly actions to reduce such idiosyncratic risk and thereby increases relationship specific investment.

This model of the benefits of certain executory contracts immediately reveals the danger in broad applications of contractual excuse. By increasing uncertainty, broad default excuse would severely reduce all of the benefits of executory contracting. Perhaps even more importantly, default excuses (impossibility, impracticability and frustration) are just that – defaults that the parties may bargain around. Some of the most well-known academic work on contract excuse seems to completely ignore the significance of this fact by focusing solely on devising default excuse tests that would lead courts to the ex post efficient result, ignoring whether parties can actually bargain around those defaults.

For example, under the economic approach taken by Posner and Rosenfield,[6] whether the contract should be excused under a default excuse would depend upon the identity of the superior risk bearer. So, if the promisor is the superior risk bearer, then performance should not be excused, while performance should be excused where

5. ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 228-36 (1988).

6. Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977).

the promisee is the superior risk bearer.[7] More recently, Eisenberg[8] set out an alternative non-economic test for when courts should excuse performance. Under Eisenberg's approach, breach should be excused whenever an event occurs whose non-occurrence was a tacit shared assumption of the parties, with one such shared assumption being that if an unexpected event occurs that causes a loss from performance, the promisor cannot be expected to bear that loss, which is "significantly greater than the risk of loss that the parties would reasonably have expected that the seller had undertaken."

Posner and Rosenfield's test requires courts to identify the superior risk bearer, and this requires the court to consider a large number of factors, such as not only each party's knowledge of the risk but also their skill and ability in controlling the risk, and ability to diversify the risk away.[9] No judicial opinion has ever applied this Posner-Rosenfield test. Unlike Posner and Rosenfield's test, Eisenberg's is seemingly intended to track more closely what courts actually do. As I discuss below, in some jurisdictions (for example, Florida), one observes courts applying very complex and confused tests for excuse. Eisenberg's test too is exceedingly complex. Under Eisenberg's approach, a court has to determine the parties' implicit, unwritten understanding about the range of unexpected losses that the parties reasonably expected the promisor to bear. However, as Goldberg[10] has trenchantly explained, Eisenberg's test neither explains nor economically justifies results in the canonical excuse cases. The same is true of the Posner and Rosenfield approach.

Still, both the Posner-Rosenfield and the Eisenberg approaches can be defended as attempts to rationalize the complexity of the Restatement (Second) tests for excuse on grounds of impossibility, impracticability and frustration. In the first section of this paper, I describe the classic cases that gave rise to these default excuses. As I explain, the most important thing about these default excuse doctrines is that courts have always been reluctant to apply them to excuse performance. Focusing on the law of New York, I show that New York courts have narrowed the default excuses to the point where contract performance is virtually never excused because of impossibility, impracticability, or frustration. When courts excuse contract performance under the

7. As Posner and Rosenfield clarify, a party may be the superior risk bearer either because it can prevent the risk from materializing at reasonable cost or is the superior insurer against loss from risk when it materializes. Posner & Rosenfield, *supra* note 6, J. LEGAL STUD. 88-92.

8. Melvin A. Eisenberg, *Impossibility, Impracticability and Frustration*, 1 J. LEGAL ANALYSIS 207, 211 (2009).

9. Uri Benoliel, *The Impossibility Doctrine in Commercial Contracts: An Empirical Analysis*, 85(2) BROOKLYN L. REV. 393, 405–07 (2020) (listing eight non-exclusive factors that a court might need to consider in determining the superior risk bearer under the Posner and Rosenfield analysis).

10. Victor P. Goldberg, *Excuse Doctrine: The Eisenberg Uncertainty Principle*, *in* RETHINKING CONTRACT LAW AND CONTRACT DESIGN 137, 144 (2015).

law of New York, it is because the parties' contract included a force majeure clause which the court interpreted as applying to the facts of a particular case. And, in New York and most other jurisdictions, such force majeure clauses are interpreted narrowly, both with regard to what sort of events excuse performance and which performance obligations are excused. In practice, in New York and most other U.S. jurisdictions, the occurrence of an allegedly unforeseeable event that radically changes either the cost or the value of performance does not excuse non-performance unless the parties have expressly so provided in their contract. Whatever may be the Restatement (Second) black letter doctrine, the law as applied by the courts is no excuse.

In the next part of the paper, I explain the economic logic supporting the no excuse default: broad default excuse erodes the value of executory contracts and yet is likely difficult to bargain around. I explicitly explain the economic advantages of executory contracts—present day contracts promising future performance—relative to future spot market transactions. Preeminent among the advantages of an executory contract is risk reduction. Assuming it is enforced, a contract promising a specified performance at a fixed price at a fixed point in time eliminates uncertainty about future price and market availability. This elimination of uncertainty directly benefits risk-averse contacting parties, and by reducing risk, the contract increases value increasing investment by such parties.

But nothing is free. A perfectly enforced executory contract eliminates future market price and availability risk, but it creates a new sort of risk, the risk of non-performance due to the realization of a risk that is idiosyncratic to a particular contracting party. When such a risk is realized—the seller's cost goes up, the buyer's value goes down—performance of the contract may no longer be mutually beneficial. The law of contract damages recognizes this, and instead of penalizing contract breach, the law permits breach provided that the breaching party compensate the victim of breach for the actual harm done to it by breach. Liability for breach of contract puts the risk of a change in circumstances, a seller cost increase or a decrease in buyer value, on the party best able to forecast and take precautions against such a change. Contracts can and are renegotiated in light of unanticipated changes in cost or value, but legal enforcement ensures that it is the party who would lose from performance who must pay for such renegotiation.

These fundamental principles underlying the law and economics of contracts explain and justify both narrow default excuse and strict interpretation of force majeure provisions. Under broad default excuse, a potentially large number of events excuse performance, and many of these may be correlated with market fluctuations. The larger the number of excusing events and the greater their correlation with market fluctuation, the smaller are both the risk reduction and investment increasing benefits from an executory contract—the closer the executory contract collapses into a gamble of a future spot market transaction. Second, and relatedly, as default excuse broadens, (i) the incentives for contracting parties to make value-enhancing investments decrease

and (ii) contracting parties are less likely to take precautions that reduce the likelihood or harm from idiosyncratic breach.

The fact that default excuse doctrines are defaults that the parties may bargain around further justifies narrow default excuses. Narrow default excuse forces a party to pay for contractual terms excusing its performance, in the process providing information to the potential victim of non-performance that allows the victim to better tailor its own contract-specific investments to the likelihood that those investments will pay off. Narrow or no excuse is predictable and easy to contract around—the parties know that performance will only be excused under circumstances that they themselves have specified ex ante in their contract. By contrast, broad excuse – such as found in the Posner-Rosenfield and Eisenberg tests discussed earlier—cuts the value of contractual performance promises in an uncertain way that is difficult to price or contract around. Were courts to employ a broad principle, such as that suggested by Posner (i.e., performance would be excused whenever a court believed that an ex post cost-benefit test shows that reasonable parties would have wanted such excuse), no language would be clear enough to prevent excuse.

As a corollary, a contractual force majeure clause should be understood as supplanting rather than supplementing default excuses. A broad force majeure clause that often excuses many performance obligations degrades the value of performance promises and so lowers the value of such promises. This is a real ex ante cost that limits the scope of force majeure provisions. Were courts to supplement force majeure clauses with broad default excuse, they would lower the value of performance promises even further but in an uncertain way that is difficult to price. And such default supplementation of a force majeure clause would reduce the value of incurring the cost of drafting such a clause in the first place. A force majeure clause is thus correctly understood as supplanting, not supplementing default excuse doctrines.

After setting out these economic guidelines, I turn to the cases. In the typical COVID-era excuse case, a commercial tenant argued that business lockdowns imposed by state and local governments to slow the spread of COVID-19 ("COVID") triggered one or more of the default excuses, thereby relieving the tenant of its obligation to pay rent. In resolving these cases, courts by and large conformed to the summarized economic guidelines. They did not find such an obligation excused by any of the default excuses (impossibility, impracticability or frustration). Over the universe of COVID-19 excuse cases that I have found and read, when a court found a contractual obligation excused, it was invariably because the parties included a force majeure clause, and the court interpreted COVID-19 lockdown orders as an event covered by the clause and the performance obligation at issue in the case relieved under that clause.

In reaching this no-excuse result, the courts in the COVID-19 excuse cases did what they have consistently done for over a century. Throughout the 20th century, all sorts of traumatic and allegedly unforeseen events have upset the cost and value of contract performance. These events have ranged from disease epidemics and

pandemics in the early part of the century through economic depressions, inflations, and wars in mid-century to the terrorism risks of late century. With very few exceptions, however, the courts have not acceded to the argument that the occurrence of such events should excuse contract performance. They have followed the guidelines set out here and granted excuse only if the parties' contract clearly indicated that the parties had agreed and paid for such excuse ex ante.

Against this practical background, academic enthusiasm for broad contractual excuse defaults is at the very least puzzling. I critique such work, with my critique paralleling the rationale offered by the authors. Givati, Kaplan and Listokin believe that private contracts were simply inadequate in addressing compensation for the massive harm inflicted by pandemic-inspired lockdowns. But this belief rests upon two misperceptions: first, that private insurance against the cost of pandemic lockdowns was unavailable in the market; the second, that the parties themselves could and would not bargain ex post to share the risk of COVID-19 lockdowns.

Much more generally, Hoffman and Hwang viewed the COVID-19 excuse cases as an opportunity to potentially persuade courts that they should relieve contractual performance and rewrite (reform) contracts whenever performance would cause external harm to non-parties to the contract. I argue that given the absence of any objective standard for when such external harm exists and is not priced in markets, for courts to adopt such an approach would undermine private contracting and substitute coercive judicial ordering for voluntary private contracting.

I conclude by explaining the relatively rare judicial decisions finding that a COVID-19 restriction excused contractual performance. Most of such cases were decided via judicial interpretation of a poorly drafted contractual force majeure clause. Typically, such poor drafting took the form of ambiguities and inconsistencies that, among other things, blurred the distinction between events that excused performance and which particular performance obligations were excused by the occurrence of those events. The lesson here is the obvious one: poorly drafted contract clauses can lead to results that may differ dramatically from what the actual contracting parties intended. Additionally, a small number of judicial decisions did apply default excuses to find that COVID-19 lockdowns and other restrictions excused contract performance. These decisions reflected both confused formulations in some states of the default excuses, along with a judicial misunderstanding of how default excuse may erode the value of executory contracts. It is the goal of this article to correct such misunderstandings.

I. COMMON LAW CONTRACTUAL EXCUSES AND ITS ECONOMIC JUSTIFICATION

A. Impossibility, Frustration, and Impracticability

Traditionally, common law courts have excused contractual non-performance due to the occurrence of an unforeseen event only where the event has made performance impossible or where its occurrence has completely frustrated the purpose

of the contract. Since their inception, courts have interpreted these excuses very narrowly. Performance is excused for impossibility only if a person or thing necessary for performance has unforeseeably become unable to perform or been destroyed. Thus in *Taylor v. Caldwell*,[11] where impossibility is generally understood to have been first set out as an excuse, the defendant rented the Surrey Gardens Music Hall for four days to the plaintiff, who planned to use the venue for a series of musical events dubbed "grand concerts." When the Hall was destroyed by a fire that occurred without defendant's fault, the plaintiff sued seeking compensation for what he said were his substantial expenses in advertising, promoting and preparing for the concerts.[12] The court held that the defendant's failure to perform was excused. It analogized the situation before it to personal contracts in which performance promised by a particular person was excused by that person's death or disability. Interpreting the contract, the court concluded that "looking at the whole contract, we find that the parties contracted on the basis of the continued existence of the Music Hall at the time when the concerts were to be given; that being essential to their performance."

Similarly, in *Howell v. Coupland*,[13] the court interpreted a promise to buy 200 tons of potatoes grown on land owned by the defendant as a promise to buy only those potatoes, so that the destruction of that particular crop by disease excused the buyer's performance. As these two opinions indicate, whether or not an event destroying or disabling a person or thing excuses performance depends entirely upon whether the court interprets the contractual performance as requiring the existence of that person or thing. When the court finds that the person or thing's existence was not required, performance is not excused. Thus, in *Seitz v. Mark-O-Lite Sign Contractors, Inc.*,[14] finding that a promise to restore and replace a neon marquee did not have to be done by a particular sheet metal worker employee of the defendant, the court held that the worker's unavailability due to hospitalization did not excuse the defendant's failure to perform.

The impossibility defense is narrow. The parties must have intended that performance would be done in a particular way, by a particular person or at a particular place, and performance must have become impossible due to an unforeseen event outside the control of the promisor that destroys or disables the person or place. Mere inability to perform does not excuse the promisor's failure to perform. This is illustrated by *Canadian Industrial Alcohol v. Dunbar Molasses*,[15] where a middleman promised to deliver 1.5 million gallons of molasses from a particular refiner of

11. Taylor v. Caldwell (1863) 122 Eng. Rep. 309; 3 B & S 826.
12. I take this adumbration from MARVIN A. CHIRELSTEIN, CONCEPTS AND CASE ANALYSIS IN THE LAW OF CONTRACTS 182 (7th ed. 2013).
13. Howell v. Coupland (1876) 1 Q.B. 258.
14. George Seitz v. Mark O-Lite Sign Contractors, Inc., 210 A.2d 319, 510 (N.J. Super.L. 1986).
15. Canadian Industrial Alcohol Co. v. Dunbar Molasses Co., 179 N.E. 383, 384 (N.Y. Ct. App. 1932).

molasses, and the refiner's failure to produce enough molasses did not excuse the middleman's failure to deliver the promised quantity. The court stressed that performance would have been excused if the refinery had been destroyed, of if output was cut because of the failure of the sugar crop, or by war. According to the court, simple breach of the refiner's contract to supply the requisite amount would have excused the middleman from performing only if the buyer "had bargained…for molasses to be supplied in accordance with a particular contract between the defendant (middleman) and the refiner, and if thereafter such contract had been broken without fault on the defendant's part."

Frustration is essentially the flip side of impossibility, but frustration is even narrower than impossibility. Standard frustration doctrine holds that if an unforeseen event outside the control of the promisor completely destroys the value of the contract to the promisor by defeating the contract's shared purpose, then even though the promisor is still fully capable of performing, its performance may be excused. Such was the result in the classic frustration case of *Krell v. Henry*, where the illness of King Edward VII caused the postponement of the King's coronation procession. As, according to the court, both parties understood fully that Henry had leased rooms from Krell only in order to view the procession on those particular dates, the value of the contract to Henry was completely lost, and his performance—paying the balance due on the lease—was excused.[16]

Courts have never been enthusiastic about the *Krell v. Henry* frustration excuse[17] and have severely limited it. The supervening event must not only be unforeseeable, but it must also create an "extreme hardship" to the promisor by totally or nearly totally destroying a shared purpose of the contract and the value the promisor will obtain by performing. The narrowness of this test is illustrated by *Lloyd v. Murphy*.[18] When the U.S. government imposed a ban on the sale of new cars as part of World War II rationing, a Los Angeles car dealer sought to escape its five-year lease of property "for the sole purpose of conducting thereon the business of displaying and selling new automobiles..." But the court refused to excuse the car dealer's performance on grounds of frustration, reasoning that because the lessor had waived use restrictions and allowed the dealer to sub-lease or use the property for "any legitimate purpose," the contract still had value to the dealer. The court found that the dealer had failed to show that the value of the lease had been "destroyed," proving instead only that the wartime regulation had only limited or restricted the lessee's business, making the business less profitable, but not "entirely prohibit[ing]" his business.

Article 2-615 of the Uniform Commercial Code (UCC) purported to expand upon the impossibility excuse by allowing excuse not just in cases where performance has

16. Krell v. Henry (1903) 2 K.B. 740.

17. *See*, *e.g.*, Maritime National Fish Ltd. v. Ocean Trawlers Ltd., AC 524, 528-29 (1935).

18. Lloyd et al. v. Murphy, 25 Cal.2d 48, 153 P.2d 47, 49-53 (1944).

become impossible, but impracticable, meaning much more costly than anticipated. Like frustration, courts have interpreted UCC 2-615 extremely narrowly. Following the text of UCC 2-615, for excuse due to impracticability, courts require the party seeking to be excused to show that its cost has increased due to the occurrence of an unforeseen event, the risk of which was not allocated to it either by explicit contractual language, custom, or the court. It is rare that a cost increase is so large that a court will find that it makes performance impracticable,[19] and even large cost increases must be completely unforeseeable and unforeseen by both parties for courts to grant excuse for impracticability.[20] The UCC drafters clearly intended impracticability to expand the potential to excuse non-performance, but the courts have not effectuated that intent.[21]

The narrowness of excuse for impossibility, frustration, and impracticability can be clearly seen in the approach taken by New York courts. New York contract law is especially significant because, as shown by Eisenberg and Miller,[22] businesses often choose New York law to govern their contracts. In a study of almost 3000 contracts included in corporate federal securities filings in 2002, Eisenberg and Miller found that (excluding mergers) New York law was chosen as the governing law in about 50% of the contracts that included a choice of law clause.

The leading New York case on excuse is *Kel Kim Corp. v. Central Markets Inc.*[23] In 1980, Kel Kim leased a vacant supermarket for use as a roller-skating rink and promised the lessor that it would obtain and maintain in "full force" a liability insurance policy of at least $1 million. Due to the mid-1980's crisis in the property and liability insurance market, the lessee could not get a policy for anything more than $500,000, putting it in breach. The New York Court of Appeals said that breach would be excused for impossibility only "when the destruction of the subject matter of the

19. *See* Transatlantic Financing Corp. v. United States, 363 F.2d 312, 319 (D.C. Cir. 1966) (where closure of the Suez Canal increased the carrier's cost of performing a contract priced at $305,842.92 by $43,972, or about 14%, but the court found that such a cost increase was not large enough to constitute impracticability).

20. *Id*. at 318. The court said that commercial parties could well foresee that Egyptian closure of the canal might follow after the Israeli invasion of Egypt and a combined British/French invasion of the Canal Zone triggered by Egyptian nationalization. *Transatlantic Financing Corporation*, 363 F.2d at 318-19. Likewise, in *Eastern Airlines Inc. v. Gulf Oil Corp*., 415 F.Supp. 429, 441 (1975), the court held that while the particular form of oil price deregulation adopted by the U.S. in the aftermath of the Arab oil embargo of 1973 might have been unforeseen, some increase in global oil prices was clearly foreseeable. *Eastern Airlines Inc*., 415 F.Supp. at 441.

21. *See* George Wallach, *The Excuse Defense in the Law of Contracts: Judicial Frustration of the U.C.C. Attempt to Liberalize the Law of Commercial Impracticability*, 55 NOTRE DAME L. REV. 203, 207 (1979).

22. Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts*, 30 CARDOZO L. REV. 1475 (2008).

23. Kel Kim Corp. v. Central Markets, Inc., 524 N.Y.S.2d 384 (N.Y. Ct. App. 1987).

contract or the means of performance makes performance objectively impossible" and the impossibility was caused by "an unanticipated event that could not have been foreseen or guarded against in the contract." Applying this rule, Kel Kim's non-performance was not excused.

In interpreting the impossibility excuse to require the "destruction" of the "subject matter of the contract or means or performance" by an unforeseeable event that could not have been "guarded against in the contract" the *Kel Kim* test has proven to be virtually impossible to meet. A Westlaw search reveals 195 New York cases citing or discussing *Kel Kim* since that opinion's release in 1987, and of these there is only one granting excuse. In that case, *Kolodin v. Valenti*, non-performance was excused because it would have violated a court order prohibiting contact between parties to a family law dispute. A number of courts have applied *Kel Kim* to hold that regardless of the cause, financial hardship caused by performance, even including bankruptcy, does not constitute impossibility excusing performance.[24] Even where an event has made performance impossible, and where the occurrence of the event was clearly out of the direct control of the promisor, the New York courts will not excuse performance unless the event could not have been foreseen and "guarded against" in the contract. Thus, in *World of Boxing LLC v. King*,[25] where a boxer was disqualified from competing in a bout because he failed a pre-fight drug test, the boxer's promoter/manager's failure to produce the fighter as promised was not excused. The court reasoned that because the boxer had a history of failed drug tests, the promoter "should have foreseen the possibility of [the boxer] testing positive and guarded against it in the contract."

New York courts have similarly severely limited the frustration defense. As one court recently summarized the test for frustration in New York, "the frustrated purpose must be so completely the basis of the contract that, as both parties understood, the transaction would have made little sense."[26] A Westlaw search reveals no opinions since the 1987 *Kel Kim* opinion in which contractual non- performance was excused on the ground of frustration under New York law.

Both impossibility and frustration are default rules, and parties very often bargain out of these default rules by including an explicit force majeure clause in their contract. Such clauses detail the circumstances under which performance is not contractually required. Under *Kel Kim*, performance is excused under such a clause "only if the force majeure clause specifically includes the event that actually prevents a party's performance," and non-performance is not excused either by a general catch-all clause such as "other similar causes beyond the control of such party." Applying the ejusdem generis interpretive rule that "general words are not be to be given expansive meaning;

24. For illustrative applications of this rule, see, e.g., Bersin Props, LLC v. Nomura Credit & Capital, Inc., 74 Misc.3d 120, 159 N.Y.S.3d 828 (2022); Bank of New York v. Tri Polyta Fin. B.V., No. 01CIV.9104(LTS)(DFE), 2003 WL 1960587, at *4, 5 (S.D.N.Y. Apr. 25, 2003).

25. World of Boxing LLC v. King, 56 F.Supp.3d 507, 513 (S.D.N.Y. 2014).

26. In re Condado Plaza Acquisition LLC, 2020 WL 594112, at *13 (U.S. Bkrtcy. S.D.N.Y. 2020).

they are confined to things of the same kind or nature as the particular matters mentioned," the *Kel Kim* court interpreted a clause excusing non-performance caused by "labor disputes, inability to procure materials, failure of utility service, restrictive governmental laws or regulations, riots, insurrections, war, adverse weather, Acts of God" as covering only events that "pertain to a party's ability to conduct day to day operations on the premises." In denying excuse, the court found that the *Kel Kim* defendant's failure to procure liability insurance in the promised amount was "materially different" than the events that excused non-performance under the contract's force majeure language.

As a corollary of this interpretive approach, when a contract specifies that non-performance is *not* excused by certain events, the New York courts give such language full effect. Thus when the debtor in *Chase Manhattan Bank v. Traffic Stream (BVI) Infrastructure Limited* attempted to argue that its default on note payments was excused by a policy change by the Chinese Communist Party delaying it revenues from a toll road project,[27] the court simply pointed to language of the contract stating that an event of default was an event of default even if the "reason for such Event of Default" was an "order, rule or regulation of any administrative or government body." The court in *Williamsburg Climbing Gym Co. LLC v. Ronit Realty LLC*,[28] dealt with similar dispatch in rejecting a commercial tenant's argument that its obligation to pay rent was excused by COVID-19 lockdowns (discussed further below), pointing simply to contract language stating that only obligations "other than the payment of Fixed Rent or additional Rent by tenant," could be excused by "governmental law or regulations [which] prevent or substantially interfere with the required performance."

B. Narrow Common Law Excuses and Their Economic Logic

In analyzing the choice between broad versus narrow common law excuse, the first thing to remember is that these are default rules that the parties may bargain around through their own force majeure clause. As with all contract default rules, the optimal default depends both on how often the default is efficient given the parties' preferences, but also on the transaction costs (understood broadly, to include the cost of strategic behavior) that must be incurred when the default is not efficient and the parties bargain around it. In order to understand the impact of common law doctrines excusing performance, however, we must first clearly understand the value of contractual performance; that is, we must first explain something that the economics of contract law has generally taken for granted and failed to explain:[29] why parties

27. Chase Manhattan Bank v. Traffic Stream (BVI) Infrastructure Ltd., 86 F.Supp.2d 244 at 250 (S.D.N.Y. 2000).

28. Williamsburg Climbing Gym Co. LLC v. Ronit Realty LLC, 2022 WL 43753, at *2-4 (E.D.N.Y. Jan. 5, 2022).

29. An important exception to this neglect is the work of Victor Goldberg, which analyzes

enter into a contract in the first place.

1. Economic Value of Executory Contracts

The value of contracting, and contractual enforcement, cannot be understood without clarifying the alternative to contracting. The typical executory contract litigated in excuse cases involves the exchange of two present promises—the seller's promise to provide the specified good or service to the buyer at a specified future date and the buyer's quid pro quo promise to pay a fixed price on or before (and perhaps in installments) that date. For both the buyer and the seller, the alternative to entering into an executory contract at the present time is to gamble on the availability of exchange on the same terms at the same future time. This is to say that the alternative to an executory contract today is a future spot market exchange.

Spot market exchange is an obvious alternative for many goods and services that are provided on thick markets, but it is an alternative that is virtually always available. For example, while most businesses that rent their places of business do so pursuant to a lease agreement, in many states such leases are not required, and a business can instead occupy and use a space while paying rent. As this example shows, unlike spot market transacting, an executory contract is a future commitment. For both buyers and sellers, the present-day executory contract for future performance brings both benefits and costs relative to waiting to execute a future spot market transaction.

a. Risk Reduction

Relative to an executory contract with a fixed price and quantity, waiting for a future spot market transaction generally involves two types of risk: price and market. The former denotes the risk of an uncertain and fluctuating future price, while the latter denotes the risk that at the future time (the "performance date"), it may be impossible to find a buyer or seller willing to undertake the transaction at a price that generates a net gain. Thus, unavailability of a future market at the performance date does not require that there be literally no buyers or sellers of the good or service at any price at that time, but rather that, viewed from the present, there is a risk that it will be impossible to find a buyer or seller willing to accept a price that yields a positive net gain at that time.

Both price and market risk can be illustrated by the facts of *Taylor v. Caldwell* and

and critiques judicial decisions ostensibly fashioning contract default rules by first attempting to understand the economic logic behind the actual contracts being interpreted. *See*, *e.g.*, VICTOR P. GOLDBERG, *Impossibility and Related Excuses*, *in* FRAMING CONTRACT LAW: AN ECONOMIC PERSPECTIVE 333 (2006).

Krell v. Henry.[30] In *Taylor v. Caldwell*, the concert's promoter could have waited until the day before the first concert and then attempted to pay for a concert venue for the next day's performance. In *Krell v. Henry*, the plaintiff could have waited to rent rooms until the day of the coronation.

Such market and price risk may intuitively seem reckless to take. But the risk in *Taylor* would seem much less reckless, I would contend, in a world where concert venues were in oversupply and rental fees for such venues were expected to fall. Similarly, on the facts of *Krell* it might seem prudent to wait to plan an expensive party to view the coronation parade until one has first contracted to rent rooms for such a party. But if we posit a world where suitable rooms for viewing the parade were abundant (meaning little market risk) and the parade was not expected to generate much public interest (meaning little price risk), then waiting to rent rooms for viewing until even the day of the parade might not seem unreasonable. After all, by waiting, the lessee delays investing in the party until she has better information about whether the parade will actually happen, and such delay may enable the lessee to obtain a lower price.

Of course, in both *Taylor* and *Krell*, the lessees decided not to gamble on a future spot market transaction, and both the lessees and lessors in those cases perceived they would be better off with an executory contract. An executory contract that is either performed or perfectly enforced with probability 1 (what I shall refer to as a certain executory contract) eliminates all price and market availability risk. Risk elimination per se is valuable to risk-averse contracting parties.

To see how a risk averse party benefits from risk elimination, consider a numerical example. Suppose that the risk foreseen by the parties is price risk, with both parties thinking that either a high future spot price of, say $100, or a low future spot price of, say, $50 are equally likely (probability 0.5) at the future performance time. The expected (or average) future price is $75.

For a risk-averse buyer, the prospect of possibly having to pay $100 at the future contracting time itself causes disutility. The risk-averse buyer would be willing to pay more in a present-day futures contract than the expected future spot market price to be free of the risk of having to pay $100. Such a risk-averse buyer might, for example, be willing to contract now to pay $80, more than the present expected value of the future price, to be off the risk that the future spot market price may be $100.

For a risk-averse seller, waiting to transact on the future spot market at equally probable prices of either $50 or $100 is worse than receiving the expected value of the future price, $75. Such a seller would be willing to receive some amount less than $75 in a present day certain executory contract rather than face the risk of future spot market contracting. With a risk-averse buyer willing to pay more than $75 and the risk-

30. Taylor v. Caldwell (1863) 122 Eng. Rep. 309; 3 B & S 826; Krell v. Henry (1903) 2 K.B. 740.

averse seller willing to accept something less than $75, there is obviously room for a mutually beneficial certain executory contract.

As we can see directly, the certain executory contract generates a risk reducing gain from trade even if only one party is risk-averse. If the seller is risk-neutral and values the future spot market price at its expected value of $75, then such a seller is better off with a certain contract price of anything more than $75 than she would be under future spot market contracting. And a risk-averse seller can pay more than the expected future spot market price and still be better off than waiting for a future spot market exchange. Here again, the risk-shifting function of the executory contract creates room for mutually beneficial exchange.

This framework views the arrangement in *Krell* the same way as does Chirelstein, as involving an executory contract inherently shifting risk. Had the coronation occurred as scheduled, and if the weather had been good, "demand for a vantage point overlooking the big parade might have increased stupendously as coronation day approached, so that Henry could have found himself holding a very hot ticket indeed."[31] In other words, if the coronation had happened, demand and the spot market price at the performance time may have soared, and Henry, whose lease was apparently transferable, could have sold his viewing rights at a profit.

Relative to the spot market price under such circumstances, of course, Krell would have incurred the opportunity cost of having contracted beforehand. But Krell could not have succeeded in arguing to the court that he had no obligation to perform as promised because spot market demand was so high that the contract price was lower than the market price. That is an inherent risk of executory contracting. In *Krell*, Henry was essentially arguing that he had no obligation to perform because the spot market demand and his own value was lower than anticipated due to the cancellation of the coronation. But demand crashed because the parade was cancelled—the event was perfectly correlated with market demand—and so cancellation of the coronation is precisely the sort of event that on my analysis should not excuse a buyer from performing.

b. Uncertain Enforcement

As I show more formally in Appendix 1, as the risk elimination benefit from an executory contract becomes smaller, the lower the probability that the contract is actually performed or enforced so that the parties receive what was promised. To see why this is so intuitive, suppose that the buyer perceives that if the future price turns out to be the high $100, then there is only a 50% chance that the buyer will actually get what she expects—the goods at a price equal to the contractually agreed price of $75. The other half of the time, the seller will break his promise and sell at the more

31. MARVIN A. CHIRELSTEIN, CONCEPTS AND CASE ANALYSIS IN THE LAW OF CONTRACTS 187 (7th ed. 2013).

profitable future spot market price of $100.

Under such circumstances, the buyer is once again exposed to the risk of having to pay a future spot market price of $100. True, the risk is lower, only 25% rather than 50%, but the risk-averse buyer will certainly attach less value to a promise to pay $75 in the future that will only be kept 25% of the time than attaches to a promise that will certainly be kept. The risk-averse buyer will pay less for an executory contract that is of uncertain future performance than it would pay for such a contract that will always be performed. That is, the maximum price that a buyer will pay for the executory contract falls, the lower the probability that the executory contract will be enforced in the high price future state of the world.

Observe that uncertainty in enforcement has converted a certain contract, calling for payment of $75 at the future performance date, into a state contingent contract. When the future spot market price is low, $50, the buyer pays the contract price of $75, but when the future price is high, the buyer has bought a lottery, a 50% chance of getting the $75 price and a 50% chance of having to pay the market price of $100. The expected price under this contract is $81.25 (0.75*$75 + 0.25*$100), higher than $75. And because the contract carries risk, a risk-averse buyer will act as if the price is even higher. By creating a 50% chance that the seller is not bound when the future spot market price is $100, uncertainty in enforcement has effectively rewritten the contract by forcing the buyer to pay a higher price.

The same logic can be applied to the opposite situation, in which there is only a 50% chance that the courts enforce the $75 contract against the buyer when the future spot market price is the low value of $50. When there is a 50% chance that the contract will not be enforced in this situation, the expected future price falls to $68.75 (0.75*$75 + 0.25*$50). Because the contract now carries risk, a risk-averse seller will act as if the price is even lower.

If the non-enforcement risk is evenly balanced, with a 50% chance that the contract will not be enforced against the buyer when the future spot market price is below the contract price and a 50% chance that the contract will not be enforced against the seller when the future spot market price is above the contract price, the expected contract price will be identical to the futures contract price of $75. However, with the risk of non-enforcement, what was intended to be a risk-eliminating executory contract has become a risky contract, one with less risk, in the sense of lower price variance, than spot market contracting, but one with risk nonetheless.[32]

32. The variance of the spot market price is given by .550-752+.5100-752=625. The variance of the futures contract with a 50% chance of non-enforcement and reversion to the spot price under both realizations of the spot price is given by .250+.2550-752+.250+.25100-752=312.5. The variance under the $75 futures contract that is always enforced is, of course, 0.

c. Investment and Joint Value

Executory contracts do more than just reduce risk. By reducing risk, they also increase risk-averse parties' level of value-increasing and cost-reducing investments. The intuition behind this result again has to do with risk aversion. The net value of an investment that increases contract value to a buyer depends upon the price the buyer pays, with a higher price reducing the net value (and vice versa of course for a seller). The futures contract that is certain to be enforced generates a certain return on such an investment, lower to be sure than the return that would be realized if the spot price is low, but higher than if the spot price is high. The return to the investment under spot market contracting depends upon the realized future spot price, and therefore the return is discounted by a risk-averse buyer, who invests less. As I show in Appendix 2, an executory contract with price equal to the expected future spot market price will certainly increase the level of investment by a risk-averse buyer (or seller for that matter) relative to the level of investment such buyer would make under the spot contracting alternative.

d. Idiosyncratic Performance Risks

An executory contract eliminates future price and market availability risk, but it creates a new potential risk: idiosyncratic performance risk. Under such a contract, the buyer (seller) is no longer subject to the risk of future market changes, but it is subject to the risk of seller (buyer) non-performance, which is to say the buyer (seller) faces the risk of falling back on a future spot market exchange that it thought it had contracted out of.

As a general matter, a buyer has an incentive to breach an executory contract studied here when either its value has fallen and/or a low future market price is realized. Conversely, a seller has an incentive to breach when its costs have increased and/or a high future market price is realized. The first sort of risk—a decrease in buyer value or increase in seller cost—is idiosyncratic in that it does not necessarily reflect a change in market conditions. The second sort of risk—the realization of a low or high market price—is of course a change in market conditions. Inasmuch as such a future market condition is the primary risk eliminated by having an executory contract in the first place, it makes sense that if costlessly and perfectly administered, the default damage measure supplied by contract law—the difference between market and contract price, plus the cost of transacting on the market—eliminates any incentive to breach simply because of the realization of adverse market conditions.

What I am calling idiosyncratic performance risk comprises changes in buyer value or seller cost that are uncorrelated with market moves. The perfect executory contract—meaning one in which the legal remedy for breach of contract gives the victim of breach precisely the value it expected under the contract—does not eliminate the incentive for contract breach that arises due to idiosyncratic risk. Indeed, a basic

result in the early law and economics literature is that breach will occur even with such perfect enforcement, and that when it occurs, such breach is economically efficient—because seller cost as realized has ended up being above realized buyer value.

However, because perfect contract enforcement forces the breaching party to internalize the cost of breach to the victim of breach, it also creates an incentive for both parties to take efficient precautions to lower the probability of breach due to idiosyncratic, controllable risk. As between the two, the seller is in the best position to know and control its costs, and the buyer is in the best position to know and control its value. Sellers control their cost in a variety of ways, not only through choices about inputs (the cost and quality of the labor employed, for example), but also—since labor and raw material costs may fluctuate with the market—by entering into executory contracts of their own to fix the price of acquiring labor and various raw materials.

The same is true on the buyer's side, where buyer decisions determine the value at risk of loss in the event of seller breach. Such buyer decisions are illustrated in *Taylor* and *Krell*. The only damages sought by the plaintiff in *Taylor* were for the expenses it had incurred in promoting and preparing for the concerts, expenses clearly designed to increase the value to it of the venue. There was no attempt by Henry, the lessee in *Krell,* to recover such expenses, but as argued by Goldberg, the fact that the 75 pound price Henry paid to rent the rooms was about one and half times per capita income at the time, and much higher than the rates in many other coronation cases, suggests that Henry bought the viewing space not for his own use but to sell to others.[33] To be sure, we don't know whether Henry made investments to increase the value of the rooms he let, but in another case arising out of the cancelled coronation parade, *Chandler v. Webster*,[34] the facts indicate that the lessee was a commercial renter who intended to make value-increasing investments by erecting a viewing stand and to then sell tickets for the viewing.[35]

The executory contract between the buyer and seller thus generates benefits of relationship specific investment by each. Because the seller's cost is under the control of the seller, and the buyer's value is under the control of the buyer, a perfectly enforced executory contract puts the risk of breach due an idiosyncratic cost increase or value decrease on the party best able to take steps to lower the probability of and magnitude of loss from breach. This is consistent with the reason for contracting out performance rather than undertaking performance internally, with, that is, the efficiency gain from executory contracting. This indeed is the fundamental insight underlying the field of economics known as transaction cost economics.[36] In concrete

33. Victor P. Goldberg, *After Frustration: Three Cheers for* Chandler v. Webster, 68 WASH. & LEE L. REV. 1133, 1141 (2011).

34. Chandler v. Webster (1904) 1 K.B. 493.

35. Goldberg, *supra* note 33, at 1142.

36. *See* Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J. L. & ECON. 233, 238-61 (1979).

terms, if we imagine both the buyer and seller to be firms engaged in production and sale, the buying firm only purchases from another firm rather than producing the good or service itself if costs are lower contracting without than with its own production. Similarly, the selling firm sells only because the buyer is more efficient in using the good or service sold to produce further value than is the seller.[37]

A buyer in an executory contract is a buyer, and not a seller, because the seller is the more efficient producer, more knowledgeable and skilled and lower cost in producing. Similarly, the buyer realizes greater value from the good or service, whether in consumption or production, than does the seller. Either party could make relationship-specific investments without an executory contract, gambling that they will find a buyer or seller after investing. But as already argued, for risk-averse parties, the level of such investment, and hence total contract value, will always be lower than with a certain executory contract. The value of such contracting would be severely eroded by legal failure to enforce contracts due to idiosyncratic increases in seller cost or decreases in buyer value. Because it shifts idiosyncratic performance risk to the party least able to evaluate and control such risk, such enforcement failure is in fact inconsistent with the fundamental reason why parties enter into such executory contracts.

2. Economic Value Losses From Broad Default Excuse

The foregoing analysis of the efficiency gains from executory contracting has an important implication for excuse doctrine. Broad default excuse for non-performance would harm both the risk-shifting and value enhancing functions of executory contracts and reduce the incentive for precautions to reduce the probability of or magnitude of loss from breach due to idiosyncratic risk realization.

Consider first the risk reduction benefit from a certain executory contract. As already shown, as the probability of contract enforcement falls, the executory contract reduces less and less risk (price and market availability variance increase). As applied to excuse doctrine, this general fact implies that the higher the correlation between the excusing event and the spot market price or spot market availability, the larger is the impact of excuse in undoing the risk-shifting function of contract. Most simply, if the buyer's performance was excused anytime market price was low, the value of the contract to the seller relative to spot market contracting would be zero. If the seller's performance was excused anytime the spot price was high, then the contract would have zero value to the buyer. Moreover, the price under the executory contract would

37. It may well also be true that the buyer contracts with a particular seller because the buyer has chosen that seller as offering the best available price-quality option, and the seller may have chosen a particular buyer because of its perception of buyer quality, such as the buyer's reputation for paying in a timely manner. This is another justification for executory contracting, and when true it has implications for the legal remedy for breach, arguing in favor of specific performance.

have just as high a variance as the spot market price. If, conversely, the excusing event is uncorrelated with the market price, then the contract may have lower variance than future spot market contracting.

As shown earlier, the elimination of risk from fluctuating future spot market price and availability is not the only source of mutual economic gain from executory contracts. Another gain comes from increasing relationship specific investment in efficient contracting out. As argued above, such contracting necessarily involves the risk that the particular buyer or seller in the executory contract may not perform as promised. As just argued, a legal default rule that liberally excuses failure to perform due to idiosyncratic increases in seller cost or decreases in buyer value would shift idiosyncratic performance risk to the party least able to evaluate and control such risk.

In addition to increasing risk and reducing relationship-specific investment, broad excuse also reduces the incentive to incur costs to reduce the probability of or magnitude of loss from breach due to idiosyncratic risk realization. We can see this in an example capturing the stylized facts of a typical frustration case. Suppose a farmer takes out a loan to finance her operations (from planting through harvesting) for a season. The season may be wet or droughty and the farmer must choose the fraction of her field to plant with drought-resistant seed versus normal seed. The normal seed produces very little if drought occurs, but it generates a high yield in wet conditions, while the drought-resistant seed is costly in that while it does generate a moderate crop even under drought, it generates very little under wet conditions. The drought resistant seed thus represents a form of costly precautions to lower the magnitude of the farmer's loss when drought occurs. Whatever her seed choice, the farmer's contract with her lender requires her to pay back the loan with interest at the end of the season.

On the facts of this example, the farmer might argue that when drought eventuates and her value from the contract drops, her obligation to pay back the loan should be excused on grounds of frustration. The economic question is how excusing the farmer's obligation to pay back the loan affects her decision regarding the fraction of her crops to plant with the drought resistant seed. As I show formally in Appendix 3, there are two cases to consider. If the farmer is risk neutral, then with no excuse, she does not diversify her crop. If the probability of drought is high enough and the relative cost of planting drought resistant seed is sufficiently low, she plants all drought resistant crop; if the probability of drought and cost of planting drought resistant seed is higher, she plants all normal seed.

A risk-averse farmer, by contrast, always diversifies. To lessen the loss from drought, a risk-averse farmer will always plant some positive fraction of her fields with drought-resistant seed. However, if her obligation to pay back the loan is excused whenever a sufficiently severe drought occurs, the farmer will plant a smaller fraction of her fields with drought resistant seed. In this way, excuse cuts the incentive for the farmer to take precautions to lower the magnitude of loss when the adverse state of the world occurs.

As this example suggests, the decreased incentive to take precautions against

breach caused by contractual excuse may have very real consequences for social welfare. When farmers fail to diversify by planting drought resistant varieties, agricultural production under conditions of drought is lower than when farmers diversify. This effect is far from theoretical. Like contractual excuse, federal crop insurance effectively insulates farmers against loss from crop failure due to adverse weather, and it has been shown[38] that such insurance reduces farmers' incentives to adapt to drought and extreme heat, both of which are forecast to become more frequent (in some regions) with climate change.

3. Risk Shifting Under Narrow Excuse: The Role of Insurance

It may be argued that a default rule of narrow excuse entails shifting the risk of performance or value—destroying events onto risk-averse parties who cannot take steps to lessen the probability that that event occurs. There are two responses to this criticism: the first is that it is rare that the probability of occurrence of such an event is completely beyond the control of the affected contracting party. Even though the court said the fire in *Taylor* occurred without fault, the facts indicate that the fire was caused by a plumber who failed to attend to a flame.[39] Inasmuch as the decision to hire that plumber was under the owner's control, it is not quite true that fire occurred without any fault—the owner could have hired a more careful plumber or supervised him more closely.

The second response to the concern about risk shifting under narrow default is more general. Both for harmful events that can be controlled to some extent as well as for those that are more clearly exogenous (in that the probability of their occurrence does not depend on any decision made by the party harmed by their occurrence), such a party can typically shift the risk by buying insurance. In *Taylor*, fire insurance had been widely available in England since the 17th century, and the Surrey Music Hall was covered by fire insurance.[40] Fire liability insurance—insurance against legal liability due damage caused by fire for which the insured is legally responsible—is widely available today.[41]

In *Krell*, while there is no indication that the lessee there bought insurance against cancellation, insurance against cancellation of the coronation parade was in fact widely available. As Goldberg[42] pithily puts it, the likelihood that a sixty-year-old, grossly overweight, heavy smoker, who had been the target of at least one assassination

38. Francis Annan & Wolfram Schlenker, *Federal Crop Insurance and the Disincentive to Adapt to Extreme Heat*, 105 AM. ECON. REV.: PAPERS & PROCEEDINGS 262, 266 (2015).

39. Goldberg, *supra* note 33, at 1137 (referencing G. H. TREITEL, FRUSTRATION AND FORCE MAJEURE 44-45 (2004)).

40. *Id.* at 113.

41. *Fire Legal Liability Insurance*, GEN. LIABILITY, https://perma.cc/NPC6-2HTS.

42. Goldberg, *supra* note 33, at 1140.

attempt might be unavailable for the coronation "was not trivial." As the *New York Times* reported immediately after the cancellation, "Hotel proprietors, restaurant men, owners of grand stands, managers of places of amusement have all insured themselves against loss in the event of the failure of the coronation to take place." According to the *Times*, "thousands of insurance policies were issued during the past year to tradesmen and others who depended for their livelihood for some time to come on the ability of the King to pass through the coronation ceremonies," and upon cancellation, the "loss of the British insurance companies, particularly those of London, which accepted risks on the coronation, will, it is estimated, run into the millions."[43]

Today, whether the event is a wedding or a concert or parade viewing, the expenses lost when an event is cancelled due to things such as weather or the failure of a vender to show up can be insured against in an event cancellation insurance policy, and such a policy can be purchased by both the event venue's owner and an event promoter.[44] And for venue owners, fire insurance is universally available, although—because of the endogeneity of the risk to actions taken by the owner—often with restrictions on how the property is used[45] and with contractual requirements that the owner take certain fire prevention and detection measures.

Given that both parties can insure against non-performance due to the occurrence of risks such as fire or illness, there would seem to be no risk-shifting justification for excuse in *Taylor* or *Krell*. In *Taylor*, the court's failure to enforce the contract left the promoter to contract at the last minute on the spot market to find an alternative venue, having already incurred what the promoter claimed were expenses of 58 pounds in advertising and planning the concerts—a considerable sum given that per capita annual income in England at the time (1861) was less than 30 pounds.[46] The result transformed the lessor's fixed price commitment to provide the hall into a contingent

43. *Id.* (quoting *The Coronation Gamble: Odds Given at 100 to 3, Many Thousands Being Underwritten on This Basis*, N.Y. TIMES (June 22, 1902)).

44. Event cancellation insurance can be purchased by both the venue and the concert or tour promoter. *See*, *e.g.*, *Cancellation Insurance for Entertainment and Concerts*, SHOWDOWN EVENT CANCELLATION INS., https://perma.cc/7LXR-CMB3. For a general discussion of event cancellation insurance, *see What to Know About Special Event and Cancellation Insurance*, ALTUS PARTNERS (Oct. 29, 2020), https://perma.cc/PT8S-KA57. For a list of wedding insurance providers, with reviews, *see* Ashley Valentine, *Best Wedding Insurance of 2024*, FORBES (Feb. 4, 2025), https://perma.cc/N5PX-54XG.

45. This has long been true. In the United States, according to Nicholas B. Wainwright, *The Philadelphia Contributorship for the Insurance of Houses from Loss by Fire* (1952), the Philadelphia Contributorship insurance mutual, created by Benjamin Franklin in 1752, adjusted fire insurance premia according to the type of building construction, *id.* at 27, required that insured structures be built so as to facilitate firefighting, *id.* at 42, and charged a higher premium or refused to insure if the structures were used in certain hazardous trades (with the Philadelphia Contributorship refusing coverage of dwellings where gunpowder was stored and charging higher rates for apothecary shops, *id.* at 42-43).

46. Goldberg, *supra* note 33, at 1138.

commitment to supply the hall, with no obligation in the event that the hall was destroyed by fire. Had the contract simply been enforced against the breaching lessor, the result would shift the risk of loss from fire to the music hall owner. But the music hall owner was in the best position to take steps to prevent and insure against fire, not the promoter.

The King's illness in *Krell* was obviously beyond Henry's control, but shifting the concededly exogenous risk of the King's illness to Henry, the lessee, would not ultimately have put the risk on a risk-averse party. Assuming Henry behaved prudently, he would be bought insurance, putting the risk on a risk neutral insurance company. The insurer would of course charge Henry a premium, but premium would be a cost of contracting for tickets ahead of time that Henry could have passed along (in whole) or part to his customers.

Thus, given the availability of insurance against cancellation of the parade, for the court to have insisted on performance in *Krell* would have shifted risk to a party with every incentive to become informed about the probability that the event would occur as planned and to insure against its potential cancellation. And in *Taylor*, the rule of no excuse would have shifted the risk of loss to the party both best able to take steps to reduce the probability of occurrence of the harmful event, fire, and easily able to insure against the event's occurrence.

It is true that in *Taylor*, the magnitude of the loss from the particular realization of the risk—the promoter's expenses, what in contract law are called respectively its reliance expenditures—were under the control of the promoter and likely known only by the promoter and not known by the lessor. Moreover, the perform-no-matter-what (no excuse) rule would seem to create no incentive for the promoter to moderate its reliance in light of the chance that the venue might be destroyed. There thus seem to be two reliance-based problems with no excuse in cases such as *Taylor*—an incentive for overreliance by the lessee/promoter, and, correspondingly, an inability on the part of the lessor/owner to tailor its precautions against breach to the expected lost reliance expenses in the event of breach.

Well-established contract doctrine deals with both problems. For two doctrinal reasons, the owner or lessor does not have to worry about potential liability for excessive reliance by the promoter. First, the promoter would have an obligation to mitigate its damages. Thus the promoter in *Taylor* would have been obliged to look for an alternative venue for the concert, and only if such a venue was not available would the owner in *Taylor* be liable for reliance costs incurred by the promoter. (And note that the prospect that an alternative venue was not available is precisely the reason for the promoter to contract ahead of time, thus justifying contract enforcement for full damages.)

Second, under long established principles of contract damages, a venue owner would only be liable for the promoter's reasonable reliance expenditures. The optimal level of lessor-owner precautions against the risk of fire is determined not by the promoter's actual reliance expenses, but by the reliance expenses that a reasonable

promoter would incur taking into account the probability that the venue might not be available. This approach eliminates the incentive for the promoter to disregard the probability of breach and over-rely.

These two doctrines in turn largely dispose of the concern that the lessor/owner will be unable to tailor its precautions to the expected reliance costs of breach. Under the twin doctrines of mitigation and liability only for reasonable reliance, the owner can forecast that it will be liable only for average or typical reliance expenses and fully liable for such expenses only if the promoter is not able to find a substitute venue.

Even granting that the lessor/owner will face some uncertainty over the magnitude of promoter reliance expenditures for which it might be liable in a particular case, it is important to see that the level of precautions against fire taken by the owner in *Taylor* and other venue owners is not likely primarily determined by the potential liability in a particular instance. In general, fires cause a loss which extends beyond any current lost revenue source to include future revenues lost pending the completion of fire repairs. A building owner's incentive to take precautions against fire is thus in general determined by the present value of such future lost revenue, rather than by the loss of a particular lessee's sunk investments. Thus, even though the no excuse rule makes the lessor/owner fully liable for a particular promoter/lessee's sunk reliance investment, such liability is not likely to overwhelm the whole stream of future losses from venue destruction that determine the owner/lessor's level of precautions.

4. Bargaining Around Default Excuse

It is important to remember that default excuses are defaults that the parties may bargain around. As in the economic analysis of contract default rules more generally, in order to identify relative efficiency advantages of competing approaches to default excuse doctrine, the transaction costs of bargaining around alternative approaches to default excuses must be included in the analysis.

On this dimension, narrow or no default excuse is clearly superior. To see why, consider the two extreme cases of no excuse and purely discretionary judicially created excuse. Such purely discretionary excuse might, for example, excuse performance whenever the court feels that such excuse is in the interest of "justice." With no default excuse, the parties know that contractual performance will only be excused when and if it is excused under a force majeure clause that they have agreed upon. Uncertainty regarding which events excuse which performance obligations can be substantially lessened through careful drafting.

To be sure, because there is uncertainty over how courts will interpret contractual language, the parties will face some uncertainty over how their force majeure clause will work in practice, especially if they have included the standard catch-all clause excusing performance for "other events beyond the party's control." But even admitting some residual uncertainty over the operation of the force majeure clause,

the parties should be able to roughly estimate how often performance will be excused and to price such excuse into the contract, lowering the price paid for performance.

In bargaining for a broad force majeure clause, a party faces a clear tradeoff. The larger the set of excusing events and performance obligations that will be excused by the occurrence of one of the events, the lower is the value of promised performance to the other party. Other things equal, therefore, the broader is excuse, the lower the contract price received by the party bargaining to be excused.

Broad default excuse, by contrast, lessens the benefit of bargaining for a force majeure clause. The benefit of such a clause under broad default excuse lies primarily in increasing the probability that particular events and performance obligations will be excused. But the broader default excuse is, the greater is the probability that the court would grant excuse regardless of what the force majeure clause says, and the lower this marginal benefit becomes. In this way, broad default excuse substitutes the court's ex post judgment of whether the parties would have excused performance for the parties' own ex ante determination and contractual specification of excuse. Inasmuch as the parties have better information about their own preferences than the court can discern ex post, this substitution generates errors—excuse under circumstances that the parties would not have found to be in their ex ante mutual interest.

Perhaps more seriously, broad default excuse would have a decided tendency to function as a mandatory term. This is because broad default excuse is difficult to bargain around. Complex formulations of tests for default excuse, such as those set out by Posner and Rosenfield[47] and Eisenberg[48], and as articulated in some jurisdictions, are expressly designed to replicate what the parties would have preferred ex ante. A default excuse rule specifying that performance will be excused whenever reasonable contracting parties would have preferred excuse, with factors to be considered including the foreseeability of the risk and the impact of its eventuation on the cost or value of performance (somewhat tracking both the Restatement (Second) and academic formulations) invite the court to look first to the circumstances that were realized, not to what the parties themselves said in their contract about whether those circumstances should excuse performance.

It is true that the parties could specify that "performance only of the following (listed) obligations are to be excused and only under the following (listed) circumstances, and under these or any other circumstances, no other performance obligation under this contract is to be excused." The problem with this is that, under a regime of broad default excuse, a court will interpret whatever the parties say in light of the default test for excuse. A party seeking excuse will argue that no contract is complete, and that the parties' reasonable interpretation was that this clause would still allow excuse under circumstances specified by the default rule. While some judges

47. *See* Posner & Rosenfield, *supra* note 6 and accompanying text.

48. *See* Eisenberg, *supra* note 8 and accompanying text.

may reject this argument and strictly adhere to the parties' express stipulation of when performance is excused, others will inevitably interpret the contract in light of the default excuse principles. Whatever the parties may say, performance under their executory contract will inevitably be more uncertain under the regime of broad default excuse than under a regime of narrow or no excuse.

Finally, the parties' incentives in bargaining around broad default excuse do not make sense. With narrow or no default excuse, the parties have a strong incentive to spend time and money thinking about possible future events that will affect the value or cost of performance and to draft a force majeure clause specifying the impact of such events on contractual obligations. The more lenient a force majeure clause is in relieving a party of the obligation to perform, the lower the value of performance to the other party and hence the maximum price that the party will pay. With broad default excuse, there is no need to bargain for leniency, as the courts already provide it through an uncertain and complex default. But broad and uncertain default not only potentially excuses performance when the parties would not have chosen to do so, but because it is uncertain, it also generates the risk that—finding the counterparty's performance excused—a party is left to find substitute performance on the future spot market. To avoid this risk is one of the primary reasons that parties enter into contracts in the first place.

5. Narrow Excuse and the Interpretation of Force Majeure Clauses

When the contract includes a force majeure clause, the correct approach for courts to take involves two steps. The first thing the court must do is to interpret the force majeure clause to determine whether the event that has occurred is among those that the contract defines as force majeure events. When the court finds that the event is among those whose occurrence excuses performance under the force majeure clause, the court must then ask whether the particular performance obligation at issue is excused. Thus, in interpreting the contract, courts must carefully distinguish between the question of whether the occurrence of a particular *event* excuses performance, and precisely which *performance obligations* are excused by the occurrence of the event. Only if both (a) the event is among those that excuse performance, and (b) the non-performance is among those excused under the language of the contract, then is non-performance excused under the language of the contract.

If neither or only one of these conditions hold, then the question arises as to whether non-performance may be excused under one of the default excuse doctrines. Because all of these doctrines—impossibility, impracticability, or frustration—are defaults, they apply only if the parties have not bargained around them. But when it comes to a force majeure clause, we must be more precise. The question is whether a force majeure clause substitutes for or instead merely supplements default excuse. On the argument in the preceding section, the better default is no or narrow excuse, and under this default, a force majeure clause displaces default excuse. Thus, if the parties'

contract, then both the events that excuse performance and the performance obligations excused should be determined solely by interpreting the force majeure clause.

One important consequence of this approach is that if an event is included among those that excuse performance under a force majeure clause, then the court should find that the event was foreseeable (or "not wholly unforeseeable" under the better approach taken by New York courts). Because every default excuse applies only if the court finds that the event was "wholly unforeseeable," the fact that a potentially excusing event falls within the categories of those that the parties' foresaw and included in the contract's force majeure clause immediately implies that no default excuse applies.

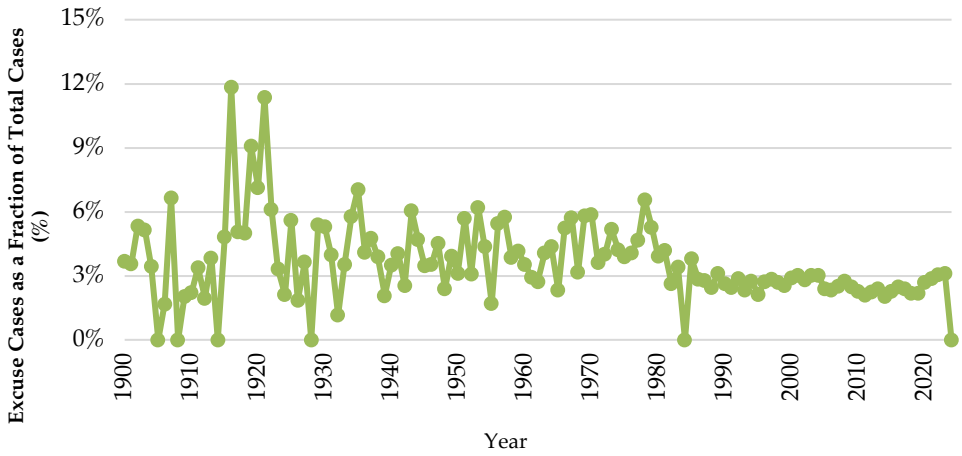
II. NARROW EXCUSE IN THE COURTS

A. Before COVID-19

The twentieth century was a turbulent century, with sharp and painful economic contractions, periods of high and unexpected inflation, and, especially toward the end of the century, heightened risks of terrorism. These shocks often had major impacts on the cost or value of private contract performance, leading to contract breach and an argument that such breach was excused, either by a default excuse doctrine or by a contract's force majeure clause.

Figure 1 below summarizes this history. As Figure 1 below shows, excuse arguments were most often made (relative to all breach of contract cases in federal court) during the turbulent and chaotic years surrounding World War I and the 1918

Figure 1: Contractual Excuse Frequency in Breach of Contract Cases



global flu pandemic. As the figure shows, for roughly the last forty years, as a fraction of all breach of contract cases in the federal courts, excuse cases have remained at a relatively low and constant level. COVID era excuse cases brought a slight uptick, but only slight.

There is another consistency of even longer duration that one cannot see from Figure 1. Over the entire period depicted in the figure, barring government orders prohibiting contract performance, courts did not excuse contract performance under default excuse doctrines, but instead narrowed such excuses to the very limited contours that they have today.

Some of the most well-known default excuse cases emerged from contract disruptions caused by orders of federal government authorities during wartime. Most dramatically, during World War II, the federal government condemned private property and essentially shut down entire sectors of the private economy. But courts routinely rejected the argument that such actions excused contract performance under the default excuse of frustration, clarifying that for contract performance to be excused by frustration, the core purpose of the contract had to be completely destroyed by the government action.[49] Similarly, in cases arising out of the Korean War,[50] the Suez Canal Crisis of 1956,[51] and the 1991 Gulf War,[52] the courts ruled that materials shortages, price increases, and supply disruptions that increased the cost of performance were among the risks contractually assumed by promisors and did not excuse performance under any of the default excuse doctrines. Nor did the terrorist attacks of 9/11 excuse contract performance. On various grounds, courts rejected default excuses[53] and also found that a generalized threat of terrorism was not an excusing event under a force majeure clause.[54]

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49. *See* Leonard v. Autocar Sales and Service, 64 N.E.2d 477, 481 (Ill. 1945); *Lloyd v. Murphy*, 153 P.2d 47 (1944). In another case, *Baetjer v. New England Alcohol Co.*, the court interpreted a force majeure clause narrowly, as providing only temporary relief from foreseeable war-related disruptions. Baetjer v. New England Alcohol Co., 66 N.E.2d 798, 801-04 (Mass. 1946).

50. *See*, *e.g.*, Peerless Cas. Co. v. Weymouth Gardens, 215 F.2d 362, 364 (1st Cir. 1954).

51. Transatlantic Financing Corp, 363 F.2d; Am. Trading & Prod. Corp. v. Shell Int'l Mar. Ltd., 453 F.2d 939, 941-42 (2d Cir. 1972).

52. Conn. Nat. Bank v. Trans World Airlines, Inc., 762 F.Supp. 76, 81 (S.D.N.Y. 1991); 7200 Scottsdale Rd. Gen. Partners v. Kuhn Machinery, Inc. 909 P.2d 408 (Ariz. Ct. App. 1997); Power Eng'g & Mfg. Ltd. v. Krug Int'l, 501 N.W.2d 490, 493 (Iowa 1993).

53. *See*, *e.g.*, in *Sub-Zero Freezer Co., Inc. v. Cunard Line Ltd.*, the court found that the possibility of terrorism was foreseeable, so default excuses did not apply. Sub-Zero Freezer Co., Inc. v. Cunard Line Ltd., No 01-C-0664, 2002 WL 32357103, at *5 (W.D. Wis. Mar. 12, 2002).

54. *See* OWBR LLC v. Clear Channel Commc'ns, Inc., 266 F.Supp.2d 1214, 1224 (D. Haw. 2003), where the court ruled that even under a force majeure clause defining "terrorism" as an excusing event, and even though hundreds of conference attendees had cancelled due to fear of traveling months after 911, the promisor was obligated to pay for now-unneeded conference hotel rooms unless it could show a "specific terrorist threat." *OWBR*

Unsurprisingly, with the virtual complete disappearance of credit markets for some period of time during the Great Recession and Great Financial Crisis of 2007-2009, that event generated a substantial number of cases in which a party claimed that such market changes excused its non-performance. On the theory developed earlier in this article, however, market swings are among the core risks that executory contracts protect against. Consistent with this analysis, with very few exceptions, the courts held that market unavailability during the financial collapse of 2007-2009 did not excuse contract breach. They rejected default excuses such as frustration or impossibility.[55] Courts also correctly understood that even though the 2007-2009 financial crisis was beyond the control of any promisor, a standard force majeure catch-all clause excusing performance when an event that is "beyond the reasonable control" of the promisor occur did not apply to excuse performance.[56]

LLC, 266 F.Supp.2d at 1225. As the court reasoned, "to excuse a party's performance under a force majeure clause ad infinitum when an act of terrorism affects the American populace would render contracts meaningless in the present age, where terrorism could conceivably threaten our nation for the foreseeable future." *OWBR LLC*, 266 F.Supp.2d at 1224.

55. The reasoning varied, but a number of courts said that regardless of whether the depth of the financial crisis and subsequent recession were foreseeable, a failure to obtain financing and financial distress in general was foreseeable and did not excuse performance. Great Lakes Gas Transmission Ltd. P'ship v. Essar Steel Minn., LLC, 871 F.Supp.2d 843, 843-44 (D. Minn. 2012); Bank of Am. NA v. Shelbourne Dev. Grp. Inc., 732 F.Supp.2d 809 (N.D. Ill. 2011); Flathead-Michigan I, LLC v. Penninsula Dev., LLC, 2011 WL 940048 (E.D. Mich. 2011); Ner Tamid Congregation of N. Town v. Krivoruchko, 638 F.Supp.2d 913, 925 (N.D. Ill. 2009); Urban Archaeology Ltd. v. 207 E. 57th St. LLC, 891 N.Y.S.2d 63, 64 (N.Y. App. Div. 2009). One court explained explicitly that "the potential inability to obtain commercial financing is generally considered a foreseeable risk that can be readily guarded against by inclusion in the contract of financing contingency provisions." YPI 180 N. LaSalle Owner, LLC v. 180 N. LaSalle II, LLC, 403 Ill.App.3d 1, 933 N.E.2d 860, 866 (Ill.App. 1 Dist. 2010). Another stated that "fluctuating market conditions do not create the level of impossibility" warranting recission. Ashraf v. Swire Pacific Holdings, Inc., 752 F.Supp.2d 1266, 1270 (S.D. Fla. 2009).

56. In re Old Carco LLC, 452 B.R. 100, 119-26 (Bkrcty. S.D.N.Y. 2011) (relying upon United States v. Panhandle E. Corp., 693 F.Supp. 88, 96 (D. Del. 1988) for the general presumption that a force majeure clause's catch-all "events beyond the reasonable control of the promisor" clause does not include market fluctuations). Alternatively, courts reasoned that decisions taken by the promisor caused it performance difficulties which the financial crisis merely exacerbated. *See* Route 6 Outparcels LLC. v. Ruby Tuesday, Inc., 910 N.Y.S.2d 408 (N.Y. 2010); Elavon Inc. Wachovia Bank, Nat'l Ass'n, 841 F.Supp.2d 1298, 1308 (N.D. Ga. 2011). There is indeed only one opinion suggesting that market unavailability during the financial crisis might constitute impossibility. In *Hoosier Energy Rural Electric v. John Hancock Life Insurance*, Judge Easterbrook suggested that market unavailability might excuse as impossible a credit default swap party's failure to obtain insurance against its promise to pay on a long-term lease. Hoosier Energy Rural Electric v. John Hancock Life Ins., 582 F.3d 728 (7th Cir. 2009). While possibly explicable by its bizarre procedural context—with the lessee contending that it would soon have the promised insurance, and the lessor arguing that this was impossible (thereby arguing for

B. COVID-19 Cases

During and in the aftermath of the business lockdowns ordered by state and local governments in the COVID-19 pandemic lasting roughly from March 2020 until late 2021, there were many cases brought by landlords against commercial tenants who had failed to pay rent after lockdowns were imposed in which the tenant argued that is obligation to pay rent was excused by the imposition of such lockdowns. With very few exceptions, the courts ruled as a matter of law that the defenses of frustration, impossibility and impracticability did not apply to excuse such tenants from paying rent. If nonpayment of rent was excused, it was only because it was excused under the express language of a contractual force majeure clause. Some courts went as far as to say that the obligation to pay rent due to regulatory actions such as the lockdowns could be excused only through an express contractual force majeure provision, and that in the absence of such a provision, one would not be implied through excuse doctrine.

1. The Failure of Default Excuses

As New York City had among the most draconian business lockdown orders in response to COVID, many landlord-tenant COVID-19 cases arose in that jurisdiction. In one such case, *Gap Inc. v. Ponte Gadea New York LLC*,[57] Gap, a multibillion-dollar multinational company and the largest specialty apparel company in the United States—selling clothing brands including Old Navy, Gap, Banana Republic, and Athleta—entered in 2005 into long term contracts with a landlord to lease two properties in New York City in which it operated a Banana Republic and Gap retail clothing stores. On March 7, 2020, the Governor of the state of New York declared that the COVID-19 pandemic constituted a state of emergency within the state. Ten days later, Gap closed all its stores in the United States. Three days after that, the Governor of New York ordered all non-essential businesses to reduce their workforces by 100%. In April, Gap announced that it had suspended all rent payments to owners of properties it rented for store locations. On June 22, 2020, the state of New York allowed retail establishments to reopen, but only at 50% capacity and with mandatory masking and social distancing requirements. Gap did not reopen the two locations at issue, but beginning in early June 2020, it sold clothes through curbside pickup at its Banana Republic location and at its Gap store after late August. It also continued to use both stores for online order fulfilment.

In addition to arguing that its performance was excused under the language of its

excuse)—this decision is incorrect. Protecting against future market unavailability is, as we have seen, one of the primary reasons why a party enters into an executory contract. Future market unavailability cannot then excuse performance.

57. Gap Inc. v. Ponte Gadea New York LLC, 524 F.Supp.3d 224, 228-30 (S.D.N.Y. 2021).

contract (an issue discussed shortly), Gap argued that its nonperformance was excused by frustration and/or impossibility. The court found as a matter of law that the two requirements for excuse for frustration were not met. First, the court ruled that the fact that the lease itself had defined a force majeure event to include "governmental preemption of priorities or other controls in connection with a national or other public emergency," showed that pandemic restrictions did not constitute a "wholly unforeseeable" event to which frustration might apply.[58] Second, the court said that Gap failed to show a complete loss of value due to the pandemic restrictions. Gap, the court found, had operated the stores at issue for some periods of time and offered curbside pickup at those stores during the pandemic and had opened others of its retail locations in Manhattan to in-person shopping during that period.

Also, as a matter of law, the court found the excuse of impossibility inapplicable. Again, the court pointed to the language of the force majeure clause as itself showing that pandemic era restrictions were not wholly unforeseeable. And the fact that Gap had not been evicted from its locations and operated the locations for curbside pickup, while other stores were open for in-person shopping, showed that even if performance had been financially burdensome, it was not impossible.[59]

Courts in virtually all U.S. jurisdictions have agreed with the court in *Gap, Inc. v. Ponte Gadea New York LLC* that under neither impossibility nor frustration did temporary reduction of business income due to COVID-19 lockdowns excuse a commercial tenant's failure to pay rent. Both in New York[60] and in other jurisdictions,[61]

58. *Id.* at 234.

59. *Id*. at 237-38.

60. Gap, Inc. v. 170 Broadway Retail Owner, LLC, 195 A.D.3d 575, 577 (2021) (finding no frustration because the "tenant was not 'completely deprived of the benefit of its bargain'" and that there was no impossibility because the period of closure by executive order had ended by the time the action was filed); Delshah 60 Ninth, LLC v. Free People of PA LLC, 2022 WL 4228213 (S.D.N.Y. 2022) (holding that although the pandemic and the New York Governor's executive orders made Free People's business "indisputably" less profitable, that does not constitute either frustration or impossibility); Hugo Boss Retail Inc. v. A/R Retail, LLC, 145 N.Y.S.3d 329, at *9 (N.Y. 2021) (following numerous other New York courts, including that in *Ponte Gadea*, by finding that there was no frustration because the several month shutdown followed by "an evolving set of capacity restrictions" reduced but did not eliminate tenant's ability to generate revenue from its retail operation).

61. *See*, *e.g.*, 40 West Hubbard, LLC v. RCSH Operations, Inc., No. 20 C 4904, 2022 WL 477336, at *7 (N.D. Ill. Oct. 3, 2022), where the tenant restaurant closed a Chicago location even though the state's COVID-19 lockdown orders had allowed takeout orders and eventually allowed serving indoor customers at 50% of capacity, and the court found that because the restaurant failed to show that the "value of the leased Premises was totally or nearly totally lost," the excuse of frustration did not apply; GPM Se. LLC v. Riiser Fuels LLC, 647 F.Supp.3d 674, 703 (E.D.Wis. 2022) (where sale of business was less profitable because COVID-19 restrictions did not constitute frustration); Highlands Broadway OPCO v. Barre Boss LLC, 528 P.3d 517, 521 (Colo. App. 2023); In re CEC Entertainment Inc., 625 B.R. 344 (Bkrtcy.S.D.Tex. 2020) (where the lease wasn't restricted to a particular

the courts have reasoned that the temporary COVID-19 lockdowns and business operating restrictions did not completely destroy lease value, as required for frustration. And generally,[62] the courts have understood that as a commercial tenant's obligation is simply to pay rent to the landlord, and COVID-19 lockdowns and restrictions did not prevent or increase the cost or such performance, impossibility and impracticability were inapplicable.[63]

2. No Excuse Under "Casualty" Excuse Provisions

In *Ponte Gadea*, Gap's contract with Ponte Gadea contained a force majeure clause defining a force majeure event to include both a "fire or other casualty" and a "governmental preemption of priorities or other controls in connection with a national or other public emergency." However, the express language of the contract granted Gap a "rent abatement" only in the event of a casualty and only until the date that the "[l]andlord substantially completes the restoration work." The court found that this language did not grant a rent abatement for the lockdown orders, saying:

> The text and structure of Article 16, which refers in several instances to a ''fire or other casualty'' causing ''damage'' occurring ''in'' or ''to'' the ''Premises,''

purpose and allowed subletting, requirements for frustration under North Carolina law not met by lockdown shutdown and restrictions on operation of Chuck-E-Cheese venues).

62. There are a surprising number of opinions in which the courts misunderstood and misapplied the impossibility and impracticability excuses. *See*, *e.g.*, Glenhill Associates LLC v. JPO Concepts, Inc., 2023 WL 456029 (N.Y.C. S. Ct. 2023) (irrelevantly discussing whether COVID-19 lockdowns made it impossible for the tenant to operate its restaurant for a period of time); Verbal v. TIVA Healthcare, Inc., 628 F. Supp. 3d 1222 (S.D. Fla. 2022) (where the court completely conflated the defendant healthcare service company's contractual obligation to give notice before cancelling class members' work assignments, with the impact of COVID-19 restrictions on the value of the contract to defendant). *Glenhill Associates LLC* illustrates error arising from the court confusing the tenant's contractual right—to operate its business—with its obligation to pay rent. In fairness to the opinion in *TIVA Healthcare*, 628 F. Supp. 3d, the court was applying what is to my knowledge a uniquely vague and unworkable definition of impossibility set out by its appellate court in *Cook v. Deltona Corp.*, 753 F.2d 1552, 1558 (11th Cir. 1985), under which performance is excused for impossibility if the court finds that the "supervening event so radically altered the world in which the parties were expected to fulfill their promises that it is unwise to hold them to the bargain."

63. *See*, *e.g.*, *Highlands Broadway OPCO*, 528 P.3d at 521, where the court rejected a fitness business tenant's impossibility excuse both because COVID-19 restrictions were foreseeable when the parties made the lease and because the executive order did not make it illegal for the tenant to pay rent "which is the only contractual duty that landlord alleged tenant breached"; and the court followed decisions such as *Ponte Gadea* and from a number of other states—including Connecticut, Delaware, Michigan and Pennsylvania––in holding that neither impossibility nor frustration applied.

> and describes in detail the restoration obligations of the parties in the event such damage occurs, leave no doubt that ''casualty'' refers to singular incidents, like fire, which have a physical impact in or to the premises—and does not encompass a pandemic, occurring over a period of time, outside the property, or the government lockdowns resulting from it. [64]

As the court in *Gap, Inc. v. Ponte Gadea New York LLC* noted, its interpretation of "casualty" in a force majeure clause to require physical damage to or destruction of the physical property has long been well established. It has been followed by the majority of courts confronting and rejecting arguments that COVID-19 lockdowns constituted a "casualty."[65]

This interpretation of "casualty" in force majeure clauses is consistent with its interpretation in business property insurance policies. The typical commercial property insurance policy provides coverage for "direct physical loss of or damage to the Covered Property" that is "caused by or resulting from a 'cause of loss' covered by the policy."[66] Traditionally, such insurance has protected businesses against loss from damage to property due to risks such as fire, wind, or theft. Businesses who buy such insurance can also choose to add coverage for lost business income and extra expense caused by "physical loss of or damage to" property. If a business has suffered such a financial loss as a consequence of "physical loss or damage to property," then and only then can it potentially recover for financial losses as a consequence of such loss or damage.

Every court interpreting such policies in the context of claims for income lost due to COVID-19 lockdowns has held that there is no coverage unless the insured can show lost income due to COVID-19 lockdowns was caused by "physical loss of or damage to" the business premises. Some business claimants tried to argue that the possible or actual presence of the COVID-19 virus on its business property caused a "physical loss . . . or damage." This argument was universally rejected as courts have said that

64. *Gap Inc.*, 524 F.Supp.3d at 232.

65. *See*, *e.g*, Arista Development LLC v. Clearmind Holdings, LLC, 207 A.D.3d 1127, 1127-28 (N.Y. App. Div. 2022), where the policy abated rent if the space was rendered "unusable" as a result of damage caused by "fire or other casualty" and the court quoted *Ponte Gadea* for the proposition that casualty "refers to singular incidents, like fire, which have a physical impact in or to the premises[,] and does not encompass a pandemic, occurring over a period of time, outside the property, or the government lockdown resulting from it;" *A/R Retail LLC v. Hugo Boss Retail, Inc.*, 149 N.Y.S.3d 808, 816 (N.Y. 2021) (holding that pandemic and subsequent closures and restrictions did not constitute a "casualty event" because they caused no physical damage to the property and the premises were not "completely or partially destroyed").

66. Such policy language has been interpreted in countless recent cases. *See*, *e.g.*, Santo's Italian Café LLC v. Acuity Ins. Co., 15 F.4th 398 (6th Cir. 2021); Big Onion Tavern Grp. LLC v. Soc'y Ins., No. 20-cv-02005 (N.D. Ill. 2020); and Verveine Corp. v. Strathmore Ins. Co., 184 N.E.3d 1266, 1273 (Mass. 2022).

"physical loss of or damage to property" requires tangible loss or damage, and that even the actual presence of the virus on the insured's property did not qualify as such loss or damage.[67] Courts likewise rejected a number of other attempts to argue that somehow COVID-19 lockdown orders constituted a "physical loss."[68] All in all, of merits rulings by trial courts in both state and federal courts in cases where plaintiffs have alleged that COVID-19 constituted a physical loss potentially triggering business interruption coverage, over ninety percent have gone for the defendant.[69]

Cases brought seeking payments from insurers under commercial property and liability insurance policies have fared no better. After reaching a peak of eighty-one COVID-19 insurance coverage cases filed during the week of May 4, 2020, such filings steadily fell to around ten the first week of January 2021, before rising again, as lockdowns returned in some jurisdictions, to a peak of around sixty during the week March 8, 2021. Since June 2021, COVID-19 insurance coverage cases have virtually disappeared.[70]

The reality of the casualty insurance market confirms the soundness of the courts' uniform interpretation that COVID-19 business restrictions did not constitute a casualty under casualty business interruption insurance. As of roughly April 2020, cumulative premia paid for property casualty had allowed insurers to fund a reserve of about $800 billion—money that was set aside to pay all kinds of insured losses from things such a fires, theft and tornadoes. Small business losses from COVID-19

67. *See*, *e.g.*, Karmel Davis & Assoc. v. Hartford Fin. Serv. Grp., 515 F. Supp. 3d 1351, 1357 (N.D. Ga. 2021). Another argument that parties seeking excuse made in an attempt to trigger the application of a casualty excuse provision was that COVID-19 restrictions constituted a "casualty" because such restrictions prevented them from using the premises. With only a few exceptions, that courts also held that "direct physical loss or damage" triggering coverage obligations in business property insurance cases did not encompass damage from "lost access or use" caused by COVID-19 closure orders. Food for Thought Caterers Corp. v. Sentinel Ins. Co., Ltd., 524 F. Supp. 3d 242, 251 (S.D.N.Y. 2021); 10012 Holdings, Inc. v. Stentinel Ins. Co., Ltd., 21 F.4th 216, 219 (2d. Cir. 2021).

68. For example, in *Team 44 Rest. LLC v. Am. Ins. Co.*, the court considered a policy that promised that in the event of physical loss, coverage would be provided for the actual loss of business income "caused by action of civil authority that prohibits access to the described premises." Team 44 Rest. LLC v. Am. Ins. Co., 562 F.Supp.3d 61, 65 (D. Az. 2021). This provision, the court said, would be rendered "redundant" if the policy already provided coverage for "any instance in which governmental orders deprive the insured of access or use of the building." *Team 44*, 562 F.Supp.3d at 67. *See also* another rejected argument in *Indep. Rest. Grp. v. Certain Underwriters at Lloyd's, London*, which was that the business had suffered direct physical loss or damage to the property because it added plexiglass barriers and made other physical changes to make their premises safe for patrons during the COVID-19 outbreaks. Indep. Rest. Grp. v. Certain Underwriters at Lloyd's, London, No. cv 20-2365, 2021 W.L. 131339 (E.D. Pa. 2021).

69. *See Covid Coverage Litigation Tracker*, INS. LAW CTR. (Feb. 5, 2025), https://perma.cc/5Z5U-P392 (showing the state court merits dismissal rate was 191 of 237 (81%) while the rate for federal court was 715 of 741 (96%)).

70. *Id.*

lockdowns were running at between $255 and $431 billion *per month*.[71] In Massachusetts alone, the American Property Casualty Insurance Association estimated that making insurers pay for all lost business income due to the COVID-19 lockdowns would cost between $2 billion and $8 billion per month, versus total monthly premium payments for commercial policies of $110 million.[72] Nationwide, making commercial property insurers liable for business income lost due to COVID-19 lockdowns could well have threatened the solvency of many insurance companies, likely leading to a contraction of the industry, and a combination of large premium increases and outright refusal to write casualty insurance in the future for the most exposed businesses.

3. Excuse Under A Force Majeure Clause

When confronted with the argument that a contractual force majeure clause excused a commercial tenant's obligation to pay rent due to COVID-motivated business shutdown orders and restrictions, the courts looked to and interpreted the language of the particular force majeure clause. When reasonably clear, the language of such a clause determined the legal result.

The most clearly drafted force majeure clauses seen in the litigated COVID-19 cases clearly distinguish between *events* whose occurrence (or non-occurrence) excuses performance and the particular *performance obligations* excused. As for excusing events, the courts universally found COVID-19 lockdowns and operating restrictions to be events included under force majeure clauses whose list of excusing events included "government regulations,"[73] "order or regulations of or by any governmental authority,"[74] "action or decree of any lawful authority power or authority,"[75] and "governmental laws or regulations."[76]

Inclusion of COVID-19 lockdowns and restrictions among the excusing events under a force majeure clause did not mean that a commercial tenant's non-payment of

71. *NAIC Statement on Congressional Action Relating to COVID-19*, NAT'L ASS'N OF INS. COMM'RS (Mar. 25, 2020), https://perma.cc/YK27-TBKV; *APCIA Releases Update to Business Interruption Analysis*, AM. PROP. CASUALTY INS. ASS'N (Apr. 28, 2020), https://perma.cc/PN5V-9YVX.

72. *See* Verveine Corp. v. Strathmore Ins. Co. & Com. Ins. Agency, Amici Curae Brief for American Property Casualty Insurance Association, National Association of Mutual Insurance Companies, and Massachusetts Insurance Federation, Mass. Supreme Judicial Court, No. SJC-13172.

73. Nelkin v. Wedding Barn at Lakota's Farm, LLC, 72 Misc.3d 1086, 152 N.Y.S.3d 216 (N.Y. 2020).

74. *A/R Retail LLC*, 149 N.Y.S.3d at 825 (N.Y. 2021).

75. Delshah 60 Ninth, *supra* note 60, at *4.

76. *See*, *e.g.*, Vota Inc. v. Urban Edge Caguas, L.P., No. CV 20-1634 (ADC), 2021 WL 4507979 (D.P.R. Sept. 30, 2021); In re CEC Entertainment Inc., *supra* note 61.

rent was excused under such a clause. While some litigated force majeure clauses that did include COVID-19 lockdowns and restrictions among excusing events also specifically excused the "payment of Rent or other monies due"[77] from a commercial tenant, others clearly stated that the tenant's obligation to pay rent was not excused.[78] In *A/R Retail LLC v. Hugo Boss Retail, Inc.*, for example, the lease stated that both landlord and tenant were excused "for the period of delay in performance" due to force majeure, "except [the] [t]enant's obligation to pay any sums of money due under the terms of this Agreement."[79]

By the same token, if a force majeure clause did state that government orders and regulations relieved a tenant, or a landlord, of its obligations under the contract, then the court gave effect to such language. In *Nelkin v. Wedding Barn at Lakota's Farm, LLC*, the contract for a wedding venue stated that "the performance of this agreement is subject to termination without liability and refund of all refundable deposits upon the occurrence of any circumstances beyond the control of either party," with such circumstances specifically including "government regulations." Under this language, the court said, the plaintiff's wedding party was free to cancel, but because the contract specifically stated that the $3,875 fee paid by the wedding party was non-refundable, that fee stayed with the defendant wedding venue.

When force majeure clauses or the causal connection between a business cancellation and COVID-19 lockdowns or restrictions was less clear, courts generally could not decide as a matter of law whether the COVID-19 lockdowns and restrictions excused a commercial tenant's performance obligation. In *Rudolph v. United Airlines Holdings, Inc.*,[80] United argued that it did not owe the plaintiff a refund for the ticket price because it cancelled the plaintiff's flights due to government travel warnings and stay at home orders that constituted force majeure events under the contractual catch-all category of events "not reasonably foreseen, anticipated or predicted by United." Plaintiff argued that he was due a refund, and not just a credit, because United's cancellations were a schedule change made for business reasons and with at most a

77. This was the language of the clause at issue in Morgan St. Partners, LLC v. Chicago Climbing Gym Co. LLC, 2022 W.L. 602893 (U.S. N.D. Ill. 2022).

78. *See*, *e.g.*, 1600 Walnut Corp. v. Cole Haan Co. Store, 530 S.Supp.3d 555 (E.D. Pa.2021); 1163 West Peachtree St. Apartments Inv. LLC v. Einstein & Noah Corp., 2021 WL 2176928 (N.D. Ga. 2021); *Highlands Broadway OPCO*, 528 P.3d at 521; Simon Prop. Grp., L.P. v. Brighton Collectibles, LLC, C.A. No. N21C-01-258 MMJ CCLD, 2021 WL 6058522, at *6-7 (Del. Super. Ct. Dec. 21, 2021) ("Notwithstanding the foregoing, the provisions of this Section 24.5 shall at no time operate to excuse Tenant from the obligation to open for business on the Commencement Date, except in the event of an industry wide strike, adverse weather, acts of God or inability to timely procure labor and/or materials as a result of any such events, nor any obligations for payment of Minimum Annual Rent, Percentage Rent, additional rent or any other payments required by the terms of this Lease when the same are due, and all such amounts shall be paid when due.").

79. *A/R Retail LLC*, 149 N.Y.S.3d at 824.

80. Rudolph v. United Airlines Holding, Inc., 519 F.Supp.3d 438, 450 (N.D. Ill. 2021).

very indirect causal relationship to any government COVID-19 orders. The court held that aside from United's cancellation of the plaintiff's flight to Costa Rica—whose closed border "falls comfortably within the definition of a force majeure event"—this causal issue required discovery. Similarly, the court found that it could not determine as a matter of law whether COVID-19 orders restricting on-premises consumption of food at the plaintiff's restaurant constituted "total untenantability" entitling the tenant to a full rent abatement versus "partial untenantability" for which the contract did not grant such an abatement.

There are very few decisions finding as a matter of law that COVID-19 lockdowns and restrictions actually excused a commercial tenant's obligation to pay rent under a force majeure clause. Most of those reflect poorly drafted force majeure clauses that failed to distinguish clearly between events whose occurrence may excuse performance and the particular performance excused. The force majeure clause in *In re Hitz* excused both Landlord and Tenant "from performing [their] obligations or undertakings provided in this Lease . . . but only so long as the performance of any of its obligations are prevented or delayed, retarded or hindered by . . . laws, government action or inaction, orders of government . . . [l]ack of money shall not be grounds for Force Majeure."[81]

The problem with this language is that it does not clearly distinguish between excusing *events* and the performance *obligations* that are excused. Instead, they are included and conflated with one another in the same clause. More precisely, in saying that "lack of money shall not be grounds for Force Majeure," this clause seems to equate a tenant's "lack of money" with exogenous events that may constitute excuse. Case law has universally held that financial distress, including bankruptcy, does not excuse a promisor's obligations to pay sums due under a contract. By explicitly stating that "lack of money" was not "grounds for Force Majeure," the clause invited the tenant's argument that the actual cause of its "inability to generate revenue and pay rent" were the Illinois Governor's COVID-19 business restriction orders.[82]

Judicial decisions that simply misinterpret a well-drafted force majeure clause are rare. The most prominent such decision, *JN Contemporary Art LLC v. Phillips Auctioneers*,[83] adopted a bizarre interpretation of "natural disaster" that was rejected by the Second Circuit. The plaintiff in *Philips Auctioneers* consigned a valuable painting to Philips for auction and took out a loan that it expected to pay off from the proceeds of the auction, but after the issuance of the March 2020 COVID-19 lockdown orders in

81. In re Hitz Restaurant Group, 616 B.R. 374, 376-77 (Bkrtcy. N.D. Ill. 2020).

82. Even worse was the contract in *In re Cinemax USA Real Estate Holdings, Inc.*, whose catch-all clause defined excusing events to include "other conditions similar to those enumerated in this Section beyond the reasonable control of the party obligated to perform (other than failure to timely pay monies required to be paid under this Lease)," thus completely conflating the performance obligation to pay rent with an excusing event. In re Cinemax USA Real Estate Holdings, Inc., 627 B.R. 693, 699 (Bkrtcy. S.D. Fla. 2021)

83. JN Contemporary Art LLC v. Phillips Auctioneers, 507 F.Supp.3d 490, 501 (S.D.N.Y. 2020).

New York, the auction house terminated its agreement to auction the painting. The parties' agreement contained a force majeure clause making the auction house's obligations "null and void" in the event that the "auction is postponed for circumstances beyond our or your reasonable control, including, without limitation, as a result of natural disaster, fire, flood, general strike, war, armed conflict, terrorist attack or nuclear or chemical contamination." According to the trial court,[84] because "it cannot seriously be disputed that the COVID-19 pandemic is a natural disaster" that "fall[s] squarely" within the language discharging all obligations "without limitation" in the event of "natural disaster," the auction house's performance was excused under the force majeure clause.

The trial court's interpretation completely ignores the fact that the event adduced by the auction house to excuse its performance was not the pandemic itself, but rather the "severe restrictions upon all non-essential business activities" imposed by New York State and New York City governments.[85] No other opinion that I have found interpreted government business restrictions and lockdowns imposed due to COVID-19 as a "natural disaster."[86]

It is true that in *JN Contemporary Art LLC v. Phillips Auctioneers LLC*,[87] the Second Circuit upheld the district court's decision that the auction house's performance was excused under the contract's force majeure clause. However, it did so "without resolving the question of whether COVID-19 is a natural disaster within the meaning of the force majeure clause."

Unlike the trial court, which failed to even cite *Kel Kim*, the leading New York case on excuse and the interpretation of force majeure clauses, the Second Circuit at least acknowledged New York law as controlling and as requiring courts to "construe force majeure clauses narrowly" with excuse under such a clause "only if the force majeure clause specifically includes the event that actually prevents a party's performance." However, the Second Circuit then effectively ignored the New York cases. It reasoned that the "pandemic, coupled with the state government's orders restricting the activities of nonessential businesses, constituted an occurrence beyond the parties' reasonable control." This was so, according to that court, because "the pandemic and government shutdown orders" were an event "of a type that cause large-scale societal disruptions," the same type of event as those listed in the clause: "natural disaster, terrorist attack, and nuclear or chemical contamination."

While not as obviously wrong as the district court, the Second Circuit was still incorrect. It added a general category of excused events—those causing "large scale societal disruptions"—that the contract did not include, and then ignored the basic

84. *Id.*

85. JN Contemporary Art LLC v. Phillips Auctioneers LLC, 472 F.Supp.3d 88, 91 (S.D.N.Y. 2020).

86. *Id.*

87. JN Contemporary Art LLC v. Phillips Auctioneers LLC, 29 F.4th 118, 124 (2d Cir. 2022).

interpretive principle followed by New York courts since *Kel Kim* of ejusdem generis, under which the general description of excusing events in a force majeure clause is to be read to include only events of the same type as those listed. The listed events expressly include "natural disaster, fire, flood, general strike, war, armed conflict, terrorist attack or nuclear or chemical contamination" all of which are exogenous events likely making performance impossible. Perhaps most importantly, unlike many force majeure clauses, such as several discussed above, this force majeure clause expressly does not include among excusing events government orders or regulations that impose temporary, revenue lessening restrictions on operations. Under a correct interpretation, the COVID-19 lockdown orders would not have excused the auction house's breach in *JN Contemporary Art LLC*. By adding to the excusing events covered by the parties' force majeure clause, the result eviscerates the risk-limiting purpose of the force majeure clause.

4. Evaluation of COVID-19 Cases

The vast majority of litigated COVID-19 excuse cases surveyed above involved a commercial tenant saying that COVID-19 lockdown orders excused its obligation to pay rent on grounds of either impossibility or frustration. As most courts understood, COVID-19 lockdown orders did not make performance by a commercial tenant of its promise to pay rent either impracticable or impossible. Because such a tenant's obligation to the landlord was to pay rent, and the lockdown orders did not prevent rent payments from being made, impossibility was inapposite. COVID-19 lockdown orders did reduce the value of leases to tenants, but as such orders completely prevented restaurants and stores from operating only for a very short time, gradually allowing the resumption of full or close to full operations by later in 2020 or early 2021, there was not the complete destruction of contract value required for frustration to apply to excuse the tenant's obligation to pay rent.

Thus with very few exceptions, the courts applied the correct default excuse doctrine, frustration, and found that COVID-19 lockdowns did not constitute an event that legally frustrated performance. But the results in most COVID-19 excuse cases surveyed above turned not on the application of the default excuse doctrines of frustration, and impossibility but rather on the court's interpretation of a force majeure clause. As with the default excuse doctrines, for the most part courts interpreted force majeure clauses correctly. Without exception among the surveyed opinions, they held that clauses cutting rent payment obligations in the event of a "casualty" did not apply to either the COVID-19 pandemic or COVID-19 lockdowns, because (as the court put it in *Gap, Inc. v. 170 Broadway Retail Owner, LLC*) "casualty" in such clauses is understood to "refer to singular accidents causing physical damage to the property." Courts thus gave "casualty" in force majeure clauses the same universally understood meaning it has in commercial property insurance policies.

Conversely, other force majeure clauses clearly covered COVID-19 lockdowns

because, for example, they defined as force majeure events to include "order or regulations of government authority."[88] However, many of the contracts with such broad definitions of force majeure events specifically stated that the tenant's obligation to pay rent was not excused. Courts uniformly gave effect to such language and held that tenants were required to pay rent notwithstanding COVID-19 lockdown orders.

Courts also generally correctly understood the relationship between the default excuses of impossibility and frustration and express force majeure clauses. Most obviously, courts ruled that if COVID-19 restrictions were an excusing event under a force majeure clause but performance of the tenant's rent payment obligation was expressly not excused, then default excuses could not apply to relieve the tenant of that obligation.[89] Courts also ruled that where a force majeure clause expressly included among excusing events things such as government regulations and restrictions, COVID-19 lockdowns and orders were among the class of events that the parties had not only foreseen but actually contracted about, precluding application of any default excuse doctrine.[90] And some courts relied on more general, established common law rules saying that when the parties spell out the events that excuse performance in a force majeure clause, default excuses simply do not apply.[91] These results are all supported by the analysis developed earlier—the value of a force majeure clause would be severely eroded by a judicial approach under which such a clause merely supplements, rather than displaces, the set of events excusing performance under default excuse doctrines.

In the relatively small number of cases where there was no force majeure clause, with some exceptions,[92] courts typically[93] found that COVID-19 regulatory restrictions were unforeseeable and that default excuses therefore potentially applied. The conclusion that COVID-19 business restrictions were unforeseeable rests upon a misconception of foreseeability.

Of course, before COVID-19 appeared, few if any people could have foreseen the precise manner in which the COVID-19 virus escaped and spread throughout the world, and COVID-19 business restrictions were not an event that contracting parties could have foreseen and specifically included among the events excusing contract

88. *A/R Retail LLC*, 149 N.Y.S.3d at 825; *but see* Linda A. Sharp, Annotation, *COVID-19 Related Litigation: Effect of Pandemic on Contractual Obligations*, 73 A.L.R. 7th Art. 2 (2022) (for a discussion of cases where the force majeure clause similarly did not excuse the rent payment obligation).

89. *1600 Walnut Corp.*, 530 F.Supp.3d at 558.

90. *See*, *e.g.*, *Gap Inc.*, 524 F.Supp.3d at 226; *Hugo Boss Retail Inc.*, 145 N.Y.S.3d at *9.

91. *See Morgan St. Partners*, 2022 W.L. 602893.

92. *See*, *e.g.*, 1877 Webster Ave., Inc. v. Tremont Center, LLC, 148 N.Y.S.3d 332 (N.Y. Sup. Ct. 2021) (where the court ruled that the foreseeability of COVID-19 restrictions raised genuine issues of fact).

93. For an example of such a summary finding of unforseseeability, see Brodnik v. Cottage Rentals LLC, 209 N.E.3d 1200, 1200 (Ind. Ct. App. 2023).

performance. But the pandemic itself was not the event that parties seeking legal relief advanced as the event excusing contractual performance. The events that promisors in the COVID-19 cases said excused their performance were the government orders shutting down and then restricting business operations. Contagious disease outbreaks are only one of many event types that can provoke government orders shutting down or limiting business operations.

As illustrated by the pre-COVID-19 excuse cases that discussed below, wars, terrorist attacks and other events predictably lead to government orders and interventions that temporarily restrict business operations and affect contract value. The predictability of such government interventions is why so many of the litigated COVID-19 excuse cases display contracts with force majeure clauses that specifically include government "orders" and "regulations" as excusing events. Such government orders and regulations are highly foreseeable, and indeed are often included in contracts as excusing events, so that at least under the *Kel Kim* approach taken in New York, they cannot constitute grounds for excuse under any of the default excuse doctrines.

III. EVALUATING ARGUMENTS IN FAVOR OF BROAD DEFAULT EXCUSE

A. Judicial Activism in Excusing and Rewriting Contracts is Doctrinally and Economically Unsound

To some academic commentators, this outcome has seemed too harsh. Using the example of a babysitter who refuses to perform because of the risk of spreading (or contracting, Schwartz is not clear on this) COVID, Schwartz has argued that because the "COVID-19 pandemic is an Act of God and so radically different from the ordinary risks and challenges of babysitting, and because it makes the babysitter's performance so much more difficult and dangerous than expected, the law will excuse babysitter nonperformance pursuant to the doctrine of Impossibility."[94] Hoffman and Hwang argue that courts often either refuse to enforce or rewrite (via the remedy of reformation) private contracts that generate "negative externalities," and that "particularly in the case of disease," courts have declined to enforce "contracts as written."[95] Rather than positing an imperiled babysitter threatened by the children in her care, the COVID-19 risk posited by Hoffman and Hwang arises from group gatherings such as a church service, funerals and choir practice that government authorities in some states early identified during the COVID-19 pandemic as "superspreader" events causing clusters of COVID-19 cases.

Even in New York, if the government issued an order prohibiting performance by the babysitter, or prohibiting a church from holding a church service, then such

94. Schwartz, *supra* note 3, at 52.

95. Hoffman & Hwang, *supra* note 4, at 984.

performance would be excused under the impossibility doctrine.[96] But what Schwartz and Hoffman and Hwang contend is that courts would (Schwartz) or could and should (Hoffman and Hwang) have excused the babysitter from performing on grounds of impossibility even if there had been no such government order. They argue that the possibility of communicating or becoming infected by a contagious disease itself would have excused performance. As a statement about what courts do, this is simply wrong. It is true that a court might find that the risk of the COVID-19 pandemic was, to paraphrase Schwartz, far outside the normal risks of babysitting. But this just means that the first requirement for a default excuse to apply—a "wholly unforeseeable risk"—would be met. As the earlier discussion explained, that is not the only requirement. It is hornbook law, followed strictly in virtually every U.S. jurisdiction, that only if a person or thing necessary for performance has died or been destroyed will courts excuse performance on grounds of impossibility. Schwartz misstates the law when he concludes, summarily, that because the risk of contracting or communicating COVID-19 while babysitting makes that job "so much more difficult and dangerous than expected," the babysitter's performance would be legally impossible.

A better argument for the babysitter would be that the risk of contracting COVID-19 made her performance impracticable. The babysitter might argue that in order to do her job, she would have to incur inordinately high expenses in taking precautions against disease. But to succeed on an impracticability defense, babysitter would have to prove such expenses, and she would also need to prove that such expenses were so high is to destroy virtually all value to her from performance. There are very, very few cases in which impracticability has actually succeeded, and in New York, there are literally none. In light of what is now known about the extremely small risk that children and young adults without substantial comorbidities will suffer serious illness due to contracting COVID-19, and the very low cost of standard precautions against contracting COVID, it seems highly unlikely that babysitter could succeed on an impracticability defense.

Hoffman and Hwang believe that excuse in COVID-19 cases may support a much broader and more radical approach to contractual excuse. They say argue that while admittedly in "disfavored and odd cases that result from extraordinary facts," the courts have shown that they will excuse performance of contracts whose performance might result in the spread of communicable disease and even rewrite (grant reformation of) such contracts.[97] Hoffman and Hwang suggest that such cases may support a general principle under which reformation is granted for any contract whose performance would generate externalities.

While Hoffman and Hwang quite correctly say that cases in which courts have excused contract performance that might result in the spread of communicable disease

96. Schwartz, *supra* note 3, at 52, 58.

97. Hoffman & Hwang, *supra* note 4, at 998.

are "disfavored and odd," this is a bit of an understatement. The authors say that these "disfavored and odd" cases help to comprise an "anticanon of other-regarding contract cases" that "suggest how public health might matter to contract enforcement and how we might expect courts, in the wake of the current pandemic, to interpret contracts that have the potential to endanger public health."[98]

As we have seen, however, the COVID-19 cases certainly do not add to this "anticanon." Courts did not respond to the COVID-19 pandemic by excusing performance obligations and rewriting private contracts. As for older excuse cases that might constitute this "anticanon," my research suggests that the "anticanon" of opinions excusing contract performance on grounds of risks to public health consists of a few incorrect decisions. *Hanford v. Connecticut Fair Association, Inc,*[99] perhaps the main case referred to by Hoffman and Hwang, was a suit by a promoter and manager of a baby show against a State Fair Association that had breached its contract to provide a room for the show during the state fair in Hartford. The State Fair cancelled the show, it said, because an outbreak of infantile paralysis—polio—during August and September of 1916 had made any large gathering of children highly dangerous to the health of the children and to the community. The majority of the Connecticut Supreme Court refused to enforce the contract on grounds of public policy, saying that the show "would be 'highly' dangerous to the public health," and the court would no more enforce the performance of such a contract than it "would require one to be performed which was immoral."[100] Following a more traditional approach, the dissent argued that the state legislature had delegated the regulation of public health to a "complete system of state, county and municipal health officers" and that the "determination of the preliminary question whether the public health is endangered should be left to the responsible medical experts appointed for that purpose," and not by a jury.

Citations to *Hanford v. Connecticut Fair Association, Inc.* in subsequent Connecticut cases are few and far between,[101] and it certainly was not understood to support judicial refusal to enforce contracts whose enforcement might cause harm to non-

98. *Id.*

99. Hanford et al. v. Connecticut Fair Ass'n, Inc., 103 A. 838, 838 (Conn. 1918).

100. *Id.* at 839.

101. In subsequent Connecticut cases, terminated at-will employees have relied upon *Hanford* in attempting to persuade courts to expand upon public policy limits implied into at-will employment contracts. Courts have uniformly and consistently rejected this attempt. *See, e.g.*, Zweig v. Marvelwood Sch., 252 A.3d 367 (Conn. Ct. App. 2021). The *Zweig* court limited *Hanford* to its facts and relied upon the well-established proposition that while courts recognize public policy exceptions to contract enforcement, the public policies justifying non-enforcement are limited to those that the state legislature has already recognized and set forth. Courts, such opinions unequivocally state, do have the authority to themselves declare when "public health" or some other public policy prevents contract enforcement.

parties. Looking outside Connecticut, there have been infectious disease outbreaks throughout American history, and, unsurprisingly, there is a long history of litigation in which one party has argued that a business closure during such an outbreak excuses contract performance. With very few exceptions, however, courts have held that closures ordered due to such a disease outbreak do not excuse contractual performance. During the late-nineteenth and early-twentieth centuries, schools closed during periodic outbreaks of contagious diseases such as smallpox and did not pay teachers for periods when their services were not needed due to such closures. However, aside from one opinion in which the court misunderstood the impossibility defense, the courts ruled that however "wise" it may have been to close a school during such an outbreak, nothing made performance of a school district's obligation to pay a teacher impossible.[102] The same result was generally reached in cases involving the so-called "Spanish influenza" of 1918.[103]

All these cases involve a situation where a government authority, such as a local public health board, ordered schools closed. While such opinions may exist, I have found no case other than *Hanford* in which a court held that performance was excused by a contagious disease outbreak, as opposed to government closure orders issued to control such an outbreak. The reason Hoffman and Hwang stress *Hanford* is because it is an instance where the court excused performance not because a government order affected the cost or value of performance, but because the court made its own determination that performance could cause harm—in that case, the spread of polio––to people who were not parties to the contract. Hoffman and Hwang believe that such externalities from contract performance justify courts in entirely excusing performance

102. *See*, *e.g.*, Dewey v. Union Sch. Dist. of the City of Alpena, 5 N.W. 646 (Mich. 1880); McKay v. Barnett, 60 P. 1100 (Utah 1900); Libby v. Inhabitants of Douglas, 55 N.E. 808 (Mass. 1900); Smith v. Sch. Dist. No. 64 of Marion Cnty., 131 P. 557, 558-59 (Kan. 1913); Bd. of Educ. of City of Hugo, Choctaw Cnty. v. Couch, 162 P. 485, 485 (Okla. 1917). In the sole exception, *Sch. Dist. No. 16 of Sherman Cnty. v. Howard*, while it was true that under established excuse doctrine, the Board of Health's order the school closing the school due to a smallpox outbreak excused the school from operating, the issue in the case was whether the school was obligated to pay the teacher during the period of closing, and there was no evidence that the closure order affected the school's ability to perform this obligation. Sch. Dist. No. 16 of Sherman Cnty. v. Howard, 98 N.W. 666 (Neb. 1904). The court in that case, as in a few other COVID-19 cases discussed earlier, got the wrong result because it did not clearly identify the school's performance obligation, conflating its *value* from performance with its *ability* to perform.

103. Phelps v. Sch. Dist. No 100, Wayne Cnty., 134 N.E. 312 (Ill. 1922) (discussing cases from a number of jurisdictions). The decision in *Sandry v. Brooklyn Sch. Dist. No. 78 of Williams Cnty.* is arguably an outlier in that the school's obligation to pay bus drivers was excused. However, the contract there did include a clause allowing the school to cancel its contract with bus drivers "in case of discontinuance of the school," which at least in the view of the concurrence permitted cancellation (despite the fact that the school was not "discontinued" but merely closed during the pandemic). Sandry v. Brooklyn Sch. Dist. No. 78 of Williams Cnty., 182 N.W. 689 (N.D. 1921).

and rewriting private contracts and that courts should grant excuse regardless of whether the state legislature or any executive officer of the state has recognized the existence of such external harm by restricting private activities.

A moment's reflection is enough to establish the infeasibility of a blanket rule declaring excusable any contract involving a large gathering of people for a future event that might lead to an increase in the probability of transmission of communicable disease. Upper respiratory tract viruses are ubiquitous, and some are present in the population at virtually every time of the year. Plausibly, mass gatherings increase the transmission of viruses, and so a rule excusing the performance of a contract involving a mass gathering on the ground that it might increase the likelihood of communicable disease spread would essentially create a free option for patrons and providers too to cancel such events at their discretion and without cost. Such a rule would create unknowable and non-shiftable risk. Given that some communicable disease is virtually always present, either a host or provider could cancel because a better offer came along and rely upon the disease to excuse the payment of damages for breach. Executory contracts for such events would have little value.

Granting this, a court inclined to excuse performance of the mass gathering event contract might try to limit excuse to certain types of events occurring during periods when severe disease is widespread. Such a rule seems better than the blanket excuse-for-disease rule, but it is not. The problem with the widespread severe communicable disease rule is that depends on a judicially defined threshold for when a communicable disease is "widespread and severe." With no guidance from the state legislature or state agencies, it is unclear how any court could define "widespread and severe disease" in a way that would actually provide a knowable default rule for contracting parties. Virtually every communicable upper respiratory tract disease can cause severe illness and even death for some chronically ill or very old people. For this reason, any attempt to define "widespread and severe disease" by reference to the number or fraction of infected individuals becoming severely ill or suffering death just kicks the can down the road, moving the definitional problem from defining "severe disease" to setting a severe illness or mortality number or frequency threshold. Such a judicially determined threshold would create just as much uncertainty and have just as severe a destabilizing impact on executory contracts as does the judicially determined "severe disease" trigger for excuse.

More generally, a legal system in which judges declare unenforceable and then rewrite contracts whose performance would, in their view, generate negative externalities, confers far too much discretion on judges. Legal enforcement of private contracts effectuates the intent of private parties and enlarges their sphere of action. Vesting judges with the power to simply refuse to enforce contracts that they think might harm others if performed would allow such judges to pick and choose which contracts to enforce. The fear that a baby might catch polio in the midst of an outbreak was the ostensible reason for contract cancellation in *Hanford.* But the event in that case was a "better baby" contest, and although such contests were promoted by the

Progressive era eugenics movement,[104] not everyone participated in such contests, and the judge in *Hanford* may well have found the event itself socially undesirable and found the polio outbreak a convenient justification for contract recission.

It seems that what academic commentators such as Schwartz and Hoffman & Hwang are concerned about is that contract enforcement will somehow force people to perform contracts that endanger themselves and others. But further reflection shows that this concern is due to confusing contract enforcement with contract performance. As explained long ago by Goetz and Scott,[105] enforcing a contract does not mean that it will be performed.

This standard approach to the remedy for contract breach itself creates incentives that likely both deter a party from insisting on performance that would be dangerous under conditions of pandemic and, the obverse problem, from invoking the pandemic in bad faith to excuse breach.

To see this, consider a wedding reception cancelled by its provider due to an ongoing pandemic. When a provider relies upon a disease outbreak to excuse performance but actually has some other reason to breach (implying bad faith), the ability of a patron to cover by arranging substitute performance is not itself strong evidence that the provider's claim about the severe risk posed by the event is not shared widely in the relevant community. The damage remedy—the difference in price between promised performance and the realized spot market price—would itself deter providers from making the bad faith argument that their breach is justified by an ongoing disease outbreak.

As for the opposite problem, a provider insisting on performance that would be dangerous to non-parties, when performance really does raise such as risk, one would expect to see a public health order restricting performance. Under existing doctrine, such an order would excuse the provider's non-performance. If there were such a widely perceived dangerous outbreak but there were no public health order restricting performance, then it is likely that the patron could not cover by arranging substitute performance and as a matter of current doctrine, the patron might well have a right to specific performance. As is well known, however, this does not mean that the provider will perform. Instead, it just means that the patron will be in a powerful position to bargain with the provider over the amount that the patron will accept in exchange for performance. The end situation is then one in which providers, enjoined to perform contracts they feel are dangerous to the community but which no public health authority has restricted, must pay patrons to acquiesce in such non-performance.

If one believes that public health authorities are in the best position to know

104. *See* Steven Selden, *Transforming Better Babies into Fitter Families: Archival Resources and the History of the American Eugenics Movement, 1908-1930*, 149(2) PROC. AM. PHILOS. SOC. 199 (2005).

105. Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 979–81 (1983).

whether the risks from such events are real, then the fact that they have deemed the risks too small to restrict the event from occurring means that performance should occur. There then seems no unfairness in requiring payments from those who disbelieve the authorities to those who believe them. If, on the other hand, the community is right and the public health authorities are wrong—there is a real risk, but one that public health authorities have been unwilling to address, perhaps for political reasons—then requiring providers to pay patrons for refusing to perform may have the salutary effect of mobilizing political pressure on public health authorities to restrict dangerous contract performance.

Standard remedies for contract breach serve a similar function when the provider insists on performance, but the patron does not wish to go through with the event. Such a case would naturally arise because the patron's concern with the event increasing the probability of disease spread to guests and then later to non-attendees has caused a big drop in the value of promised performance to the patron. In such a case, forcing the patron to pay for the provider's lost profit modestly ensures that the patron's value from performance really has dropped—that is, that the patron is not using the disease outbreak for as an excuse for breach that is occurring for some other value-decreasing reason. In other words, the standard damage measure ensures that the increased risk of disease really is significant and unusual, and it is not a mere pretext employed by a patron seeking to escape the contract for some other reason.

All the cases discussed thus far are ones in which either the patron or provider insists on performance. It is also possible that parties agree that the risks from contagious disease are too great and that performance is not in their mutual interest. This situation is not one that the academic commentators have worried about, because since neither party wishes to perform the externality-generating contract, neither will tender performance,[106] and in the default case of simultaneous performances, failure to tender performance means that neither party would be entitled to recover its sunk cost damages. Thus, in the case where neither party wishes to perform, each party would be left bearing its own sunk costs. This does not seem unreasonable: each party controls its own sunk costs, and default contract rules tell each party that it should choose its sunk costs taking into account the probability that it may not wish to perform.

B. Parties Renegotiate Contracts to Obviate Concerns About Unfair Risk Distribution and the Unavailability of Insurance

Judicial unwillingness to find that COVID-19 restrictions on business operations excused commercial lessees from the rent payment obligations meant that such lessees bore the risk of COVID-induced business operation restrictions. A potential criticism

106. A party might threaten to tender performance if the other does not pay some part of its sunk cost, but such a threat is not credible under the assumptions made here.

of this judicial unwillingness to grant excuse is that it puts the risk of COVID-19 restrictions on the wrong side of such transactions—on parties least able to appreciate and take steps to reduce their losses from COVID-19 restrictions or insure against such losses.

Such a critique would be badly misplaced. As argued above, both the probability and magnitude of loss from COVID-19 business restrictions was largely under the control of the business lessees subject to such restrictions. As for the relative ability of such lessees to bear or shift the risk of loss, the evidence shows that the risk was in fact shared by both commercial tenants and their landlords. The initial impact of COVID-19 business restrictions on commercial lessees was crushing, with more than 60 major retailers filing for bankruptcy in 2020 and the percentage of retailers current on their rent payments falling from 91% before COVID-19 restrictions were imposed in March 2020, to 54% in the first month of restrictions.[107] According to Yelp, by September 2020, 98,000 businesses had closed permanently.

However, almost as soon as COVID-19 restrictions were imposed, commercial lessees began demanding that their landlords renegotiate their leases to defer and then cut their rental payments.[108] With national retail and restaurant chains taking the lead, the rent on tens of thousands of such leases were renegotiated lower with thousands more such leases terminated.[109] As many as 50% of retailers may have received rent reductions during 2020.[110] Landlords have their own expenses, including taxes, insurance, building maintenance, and debt or mortgage payments, and especially in the midst of the lockdown-induced recession of 2020-2021, landlords had every incentive to renegotiate leases to keep existing tenants, rather than risking leaving a building empty with no new tenant in sight.[111] To keep valuable tenants, landlords agreed to accept rents equal to a percentage of monthly sales rather than a fixed monthly dollar rent and even in 2021, the percentage of such rent agreements was increasing.

By 2024, with store openings exceeding store closings for two straight years, landlords are apparently moving back to fixed monthly rent payments and no longer

107. Aisha Al-Muslim, *Retail Tenants Leverage Pandemic Stress for Rent Cuts*, WALL ST. J. (Jan. 11, 2021), https://perma.cc/8BTZ-5L7C.

108. Esther Fung & Heather Haddon, *Starbucks, Others Press for Rent Cuts*, WALL ST. J. (May 20, 2020), https://perma.cc/D2WC-YKJB.

109. *See* Al-Muslim, *supra* note 107, reporting that by the end of 2020, one real estate advisory firm alone had renegotiated lower rents on 9550 leases, reducing rental payments by $1.7 billion, and obtained terminations of another 950 leases.

110. *See Landlords and Retail Tenants Compromise to Emerge Stronger Post-COVID-19, says NRF and PJ Solomon*, NAT'L RETAIL FED'N (Sept. 24, 2020), https://perma.cc/8P59-X4RC.

111. For an account in the midst of the recession, *see* Stacy Cowley, *Unable to Pay Rent, Small Businesses Hope for a Deal with Their Landlord*, N.Y. TIMES (Sept. 17, 2020), https://perma.cc/TK9V-WMGH.

willing to discount rent and take a share of sales.[112] The key point for present purpose is that despite the fact that courts did not excuse commercial tenants' rent payment obligations, commercial landlord and tenants shared the cost of the 2020-2021 COVID-19 lockdowns. Rather than insisting on contract performance (contractually specified rent payments), landlords renegotiated leases by suspending and even cutting rent payment obligations. Both landlords and tenants benefited from such renegotiation. Especially given that a not uncommon fact pattern in litigated cases during COVID-19 lockdowns involved a contract between a local commercial landlord and a multibillion-dollar retail lessee, it would seem difficult to argue that such risk sharing between landlord and commercial tenant was either unfair or inefficient.

Finally, it is important to note that pandemic insurance is not something that courts had to create ex post by using default excuses to shift the cost of lockdowns. As discussed above, business losses from cancellation of events such as concerts and sporting events have long been insurable. Apparently in the wake of the SARS epidemic of 2003, viral pandemics became a standard exclusion in business interruption insurance policies.[113] However, companies can insure against the specific risk of closure due to pandemics by buying all-risk policies or by buying specialized coverage either as a stand-alone policy or by including specific provisions (endorsements) in an all-risk policy. Since at least 2008-2009, standard business pandemic insurance has been available on the market. Payment under pandemic insurance—with payment triggered by a World Health Organization Alert level of three or higher—was apparently not often purchased, but some businesses did buy pandemic insurance and received very large payouts when the COVID-19 pandemic hit. Both the British Open golf tournament and the Wimbledon Tennis Tournament had pandemic insurance policies in place before the COVID-19 lockdowns. The Wimbledon tennis tournament paid annual premiums totaling about $32 million on a pandemic insurance policy that it took out after the SARS epidemic in 2003, an investment that proved its worth when the policy paid Wimbledon about $141 million to cover its losses from the cancellation of its tournament in 2020.[114]

The fact that pandemic insurance has been available on the market for some years seems to contradict Givati, Kaplan and Listokin's (hereinafter, Givati et al.) assertion that "[p]rivate insurers who attempt to bear the risk of global pandemics would rapidly become insolvent when the risk materializes."[115] To understand the failure of this prediction, we must understand the two-part justification for it.

The first reason that Givati et al. believe that private insurers cannot profitably

112. *See World of Boxing*, 56 F.Supp.3d at 513.

113. David Heppen & Veronika Cooper, *Business Interruption Insurance Compendium*, SOC. OF ACTUARIES 1, 6 (2021).

114. *See* Heather A. Turner, *Wimbledon's Pandemic Insurance Coverage Results In $141M Payout*, PROPERTYCASUALTY360 (Apr. 10, 2020), https://perma.cc/4JWN-V9MH.

115. Givati, Kaplan & Listokin, *supra* note 2, at 633.

offer pandemic insurance is that pandemics are so rare and unpredictable that coverage for their costs cannot be priced. As they say: "Global pandemics such as COVID, for example, are extremely rare and hard to predict events. This makes the private insurance pricing problem still harder, further explaining the absence of such insurance."[116] However, global pandemics are not "extremely rare and hard to predict." The SARS and MERs pandemics, involving the same type of virus, occurred within two decades of COVID-19. Predictions of an imminent coronavirus pandemic had been made by knowledgeable scientists. While it is true that the precise mechanism of occurrence and timing of such a pandemic was not precisely known, such limited knowledge is of course the reason why people buy insurance—if one knows precisely when, where and how a risk will eventuate, it is no longer a risk.

The second reason given by Givati et al. for the unavailability of private pandemic insurance is seemingly on firmer economic ground. This argument is that like "[s]ystematic macroeconomic risk," pandemic risk is uninsurable because "harm is both economically significant and highly correlated across individuals."[117] It is true that if the *risk from pandemics* was what was being insured, then clearly since pandemics affect the entire globe, that risk would be highly correlated across insureds. Under such positive correlation, insurers do not diversity risk, but rather aggregate it. Rather than behaving in a risk neutral fashion, insurers will themselves seek insurance, and the premia for such reinsurance increase prices for insurance and some insurers will refuse to write policies at all.

However, pandemic insurance must be purchased and paid for separately and apart from general commercial casualty and loss insurance. Givati et al.'s argument regarding the size and correlation of pandemic losses at most explains why pandemic insurance does not come bundled with general casualty insurance. Casualty insurance is priced on the assumption that if one business suffered a casualty, say due to a fire, it is unlikely that other insured businesses also suffered such a loss. This is unlikely to be true of loss from pandemics, and for this reason insurance against pandemic loss must be purchased and paid for separately and apart from general commercial casualty and loss insurance.

A more important problem with Givati et al.'s argument is its assumption of correlated losses from pandemics. If this assumption were empirically sound, then pandemic insurance would indeed be a very risky and likely losing proposition for insurers. Importantly, however, pandemic insurance is insurance not against a pandemic per se, but against business losses caused by government restrictions imposed because of the pandemic. Even within a given jurisdiction, the lost business revenues suffered by insured businesses due to restrictions such as those imposed in response to COVID-19 are not perfectly correlated and may even be negatively correlated. Businesses deemed essential—and not subject to COVID-19 lockdowns—

116. *Id.* at 652.

117. *Id.* at 633.

prospered tremendously during periods of COVID-19 lockdowns.[118] Only some non-essential businesses suffered losses from lockdowns. Even within the category of non-essential businesses, losses varied tremendously, with businesses most nimble in adapting online ordering, pickup and delivery and other adaptations suffering the least. Thus, even within the category of non-essential businesses, losses from COVID-19 lockdowns were likely correlated, but far from perfectly.

In addition to such intra-jurisdiction lack of correlation in business loss from COVID-19 business restriction, there was little correlation across jurisdictions in such losses. COVID-19 business restrictions varied tremendously across U.S. states and across countries. The severely restrictive measures in New York state had their virtual mirror opposite in the relatively loose and very short-lived restrictions imposed in states such as Georgia, Florida and South Dakota. An insurer writing a pandemic business loss policy in both South Dakota and New York would have little payout in South Dakota. So too would an insurer writing such a policy in both Sweden and Italy have had only low payouts in Sweden.

These features explain how pandemic insurance can be profitable. Across a range of potential insured businesses, losses from pandemics are not perfectly correlated, and the larger and more jurisdictionally diverse the pool of insureds, the more an insurer can take advantage of diversification and the law of large numbers. To be sure, coverage for the loss due to pandemics is far different than coverage for casualty losses. The probability and magnitude of loss from fire, covered by casualty insurance, is determined by factors that are quite different than the factors that determine the probability and magnitude of loss from pandemic restrictions. This is why pandemic insurance must be purchased separately, with insureds paying an additional premium when they add a pandemic insurance rider.

Insurance companies offer a variety of riders, some of which are customized to meet demand from particular customers for insurance against a variety of types of typically low probability events. Businesses that are especially dependent upon a particular supplier, for example, might purchase a contingent business interruption rider to cover losses suffered if the primary supplier shuts down. Apparently not many businesses were that concerned about pandemic-related losses, so not many purchased pandemic loss coverage riders. Givati et al. may well be correct that insurers could not have profitably included pandemic loss coverage as standard, but insurers achieve diversification across the range of rider coverages offered, and pandemic loss insurance was among such coverages.

This reality of insurance and markets meant that small businesses bore most of the cost of COVID-19 lockdowns. Only about 30–40% of small and medium sized

118. This was especially true of some of the world's largest retailers. *See* Molly Kinder, Laura Stateler & Julia Du, *Windfall Profits and Deadly Risks: How the Biggest Retail Companies Are Compensating Essential Workers During the COVID-19 Pandemic*, BROOKINGS INST. (Nov. 2020), https://perma.cc/93C3-KMYM.

businesses buy business interruption insurance and apparently rarely negotiate for separate pandemic coverage.[119] While large commercial lessees were by all accounts the first to demand renegotiation of their leases after lockdowns were imposed, thousands of small businesses failed due to COVID-19 lockdowns.

Since lockdowns were imposed by governments, it would not seem unreasonable to think that governments should have compensated for the costs of such lockdowns, especially the costs borne by small businesses lacking the market power to insure such losses or renegotiate to lessen them. And the U.S. federal government did implement a number of programs providing such compensation.[120]

IV. CONCLUSION

As shown here, rather than seizing upon the COVID-19 lockdowns as an opportunity to toss out contracts as "obsolete" or a source of "negative externalities," the courts generally viewed the COVID-19 lockdowns as simply the latest in a long series of economic and social shocks whose occurrence does not excuse contractual performance, unless the parties have so specified. I say "generally," because some courts did find that COVID-19 lockdowns and similar orders excused some contractual obligations. That they did so reflects two problems: one with the default excuses as articulated by the Restatement (Second), and one with contract drafting.

Based on a few very old opinions, the Restatement (Second) drafters somehow inferred the existence and formulated the contours of the default excuses of impossibility, frustration, and impracticability. From their inception, courts were hostile to these default excuses. Were one to look at actual outcomes in cases—whether performance was excused or not—the conclusion is inescapable that in most jurisdictions, the Restatement (Second)'s doctrinal requirements for excuse are never met. Thus if law is, per Justice Holmes, not what courts say, but what an able lawyer predicts a court will do, then the default excuse is no excuse, according to the complex multi-pronged Restatement (Second) tests.[121]

Excuse is not the only area of contract doctrine where the Restatement (Second) is wildly inaccurate as an actual summary of what courts do. Its rules on contract interpretation, for example, closely track the open-ended, highly contextual and decidedly atextual approach to contract interpretation that Grant Gilmore drafted into Article 2 of the UCC. The vast majority of U.S. jurisdictions do not follow this approach. Most courts are plain meaning textualists who are loath to go beyond the language of a written contract in discerning its meaning. As I hope to elaborate in future work, the Restatement (Second) is best understood as a set of proposed contract

119. Heppen & Cooper, *supra* note 113, at 6.

120. Jason Hildago, *COVID-19 Relief, Here's a List of Pandemic Relief Programs for Small Businesses*, USA TODAY (Apr. 21, 2021), https://perma.cc/V3PJ-G798.

121. Oliver Wendell Holmes Jr., *The Path of the Law*, 10 HARV. L. REV. 457 (1897).

doctrines which its drafters preferred, but which very often only a minority of jurisdictions have actually followed.

When a court did find that COVID-19 lockdowns excused contract performance, it almost invariably was because the parties included a poorly drafted force majeure clause that the court found triggered by COVID-19 lockdowns. It is hardly news that poor contractual drafting can lead to outcomes that at least one of the parties did not intend. My survey of force majeure clauses interpreted in COVID-19 excuse opinions suggests that such poor drafting is not uncommon. Whether such poor drafting represents a market inefficiency, however, is a far different question. As with any task done by any professional class, lawyers differ in their skill and effort levels, and the ex ante efficient level of client investment in attorney skill and experience depends upon the client's assessment of the marginal expected value of hiring a more highly skilled and experienced attorney versus the cost of such an attorney.

One would therefore expect to find well-drafted force majeure clauses in contracts that large, sophisticated businesses use in a large number of similar transactions. Conversely, smaller firms using contracts in a much smaller number of transactions might be expected to know less about contract value and to spend much less on attorneys responsible for drafting contracts, leading to a higher frequency of outcomes that deviate from what such firms desired. Even if true, however, this does not indicate a market inefficiency, but rather the economic reality—sometimes forgotten by academic lawyers—that efficiency is fully compatible with a positive probability of error, while perfection is almost never efficient.

V. APPENDICES

A. Appendix 1

Consider an executory contract between a buyer and seller which calls for exchange at a fixed price p_k at some future point in time when it is known that market price will either be high, p_h, which price occurs with probability q or low, p_l, which occurs with probability $(1-q)$. Let the buyer's value (wealth increase) from the contract be given by $V(i)$, where i is the level of the buyer's relationship-specific investment, with $V'(i) > 0$ and $V''(i) < 0$. Suppose that the buyer is risk averse, with utility function over wealth given by $U(w)$, with $U'(w) > 0$ and $U''(w) < 0$.

The buyer's utility from a fixed price executory contract that is perfectly performed or enforced (which I refer to as a "perfect executory contract") is given by:

$$U(V(i^*) - p_k),$$

where i^* denotes the optimal level of relationship specific investment induced by the perfect executory contract. Let r denote the probability that the contract is enforced with $0 < r < 1$. With such imperfect enforcement, the contract generates expected utility

for the buyer equal to:

$$q[rU(V(i) - p_k) + (1 - r)U((V(i) - p_h))] + (1 - q)[rU(V(i) - p_k) + (1 - r)(U(V(i) - p_l))].$$

Assembling terms, this reduces to:

$$(qr + (1 - q)r)U(V(i) - p_k) + q(1 - r)U(V(i)) - p_h) + (1 - q)(1 - r)U(V(i)) - p_l)$$

$$= rU(V(i) - p_k) + (1 - r)[q(U(V(i)) - p_h) + (1 - q)(U(V(i)) - p_l)]$$

$$< U(V(i) - p_k),$$

where the final inequality follows from the fact that $0 < r < 1$ and the buyer's preference for the fixed price contract over the lottery, that is, because from risk aversion,

$$U(V(i) - p_k) > qU(V(i) - p_h) + (1 - q)(U(V(i) - p_l).$$

From the foregoing, it can be seen that the expected utility from the contract falls when r, the probability of enforcement, falls.

B. Appendix 2

The assertion to be proven is that a buyer's contract value-increasing investment is higher under an executory contract with price equal to future spot market price than under the spot contracting alternative. To prove this, I retain the notation of previous Appendix 1.

Letting $c(i)$ denote the buyer's cost of value-increasing investment, with $c'(i) > 0$ and $c''(i) < 0$, the buyer's problem under the spot market alternative is given by:

$$\max_i \quad qU(V(i) - p_h) + (1 - q)U(V(i) - p_l) - c(i),$$

For an interior solution to this problem, the optimal investment under the spot market gamble, i^*_m, solves the first order condition:

$$V'(i^*_m)[q(U'(V(i^*_m) - p_h) + (1 - q)(U'(V(i^*_m) - p_l))] = c'(i^*_m) \qquad (1)$$

Under the executory contract with price equal to the expected spot market price given by $p = qp_h + (1 - q)p_l$, the (interior) optimal level of investment solves the problem:

$$\max_i \quad U(V(i) - p) - c(i),$$

The first order condition defining optimal investment under the contract, i^*_k, is given by:

$$V'(i^*_k)U'(V(i^*_k) - p) = c'(i^*_k) \tag{2}$$

By the definition of p, for any level of investment i,

$$U'(V(i) - p) = U'(q(V(i) - p_h) + (1 - q)(V(i) - p_l)$$

$$= U'(qV(i) + (1 - q)V(i) - qp_h - (1 - q)p_l$$

$$> qU'(V(i) - p_h) + (1 - q)U'(V(i) - p_l),$$

where the final inequality follows from risk aversion, that is from $U''() < 0$. With $V''(i) < 0$, that is, declining marginal productivity of investment, we have that the solution to first order condition (1) defining optimal investment under the executory contract, i^*_m, must be larger than that which solves (2), the first order condition under the spot market gamble, i^*_k, that is, we have that $i^*_k > i^*_m$.

C. Appendix 3

The following appendix demonstrates the assertion that excusing performance will reduce the incentive to diversify against the risk of loss in such states.

Consider a farmer taking out a loan for her crops. At the time she takes the loan, she knows only the probability that the growing season will be normal (high productivity) or drought-ridden (low productivity). I suppose that these are the only two states, but the analysis can be easily generalized to more than two states. The farmer's problem is to choose the fraction of her fields that she plants with a drought resistant crop variety. Such drought resistant variety generates a lower yield in the normal (well-watered) state of the world than the normal variety but a higher yield in the drought state. In this way, it acts as insurance against the drought state. I assume that the farmer is a price taker, and that the price of her crop is unaffected by her decisions or by the state of the world.

Defining notation, we have:

p_i for $i = n, d$ gives the probability of the drought (d) and normal (n) states, with $p_n = (1 - p_d)$.

Y_i for $i = n,d$ gives the yield for normal and drought resistant crop varieties,

respectively, with $Y_n > Y_d$

θ = fraction of field planted with the drought resistant variety (so that $(1 - \theta)$ is the fraction planted with the normal variety)

C = cost of planting, tending and harvesting crop (with $(1 + r)C = C(r)$, for r the market interest rate giving the default amount that must be repaid to the lender for the loan that financed the farmer's season)

To simplify the analysis, I assume that the normal variety generates 0 yield under drought conditions.

1. Risk Neutral Farmer

a. No Excuse

Suppose that the farmer is risk neutral. The risk neutral farmer does not diversify her variety choice. To establish this, we write the farmer's objective function as:

$$[p_d(\theta Y_d - C) + (1 - p_d)(\theta Y_d + (1 - \theta)Y_n - C)] = R(\theta) \quad (1)$$

where the objective function, $R(\theta)$, gives the expected net revenue of the farmer. The first order condition defining an interior optimum to problem (1) is given by:

$$\frac{\partial R}{\partial \theta} = p_d Y_d + (1 - p_d)(Y_d - Y_n) = 0 \quad (2)$$

From equation (2), we see first that there is no interior solution to problem (1). We can also see that:

$$\frac{\partial R}{\partial \theta} \begin{cases} > 0 \\ = 0 \\ < 0 \end{cases}$$

as,

$$pd \begin{cases} > \frac{Y_n - Y_d}{Y_n} \\ = \frac{Y_n - Y_d}{Y_n} \\ < \frac{Y_n - Y_d}{Y_n} \end{cases} \quad (3)$$

Only in the case where (3) holds with equality will the farmer be indifferent between the drought resistant variety and the normal variety. When the relative

probability of a drought year is higher than the relative loss from planting the drought resistant crop (the left hand side in (3) is bigger than the right hand side), the farmer will plant only drought resistant crop. When the relative loss from so doing is higher than the probability of drought, the farmer will plant only the normal variety.

b. Risk Neutral Choice with Excuse

As explained in the text, courts have consistently required that excuse from contractual performance on grounds of increased cost (impracticability) will only be granted when the adverse event has caused a total (or nearly total) loss of the value of the contract. Here, the adverse event is drought. In terms of the notation used here, a total loss for the farmer occurs in the drought state when $\theta Y_d < C_r$, or, equivalently, when,

$$\theta < \frac{\partial R}{\partial \theta} \equiv \underline{\theta}$$

Under this representation of excuse, the risk neutral farmer's problem is identical to (1) when $\theta > \underline{\theta}$, but when $\theta \leq \underline{\theta}$, the farmer's problem changes because she is excused from making the contractually promised payment $C(r)$. Her objective then becomes maximizing:

$$[p_d(\theta Y_d) + (1 - p_d)(\theta Y_d + (1 - \theta)Y_n - C(r))] \quad (4)$$

Thus the farmer's payout function does not change shape, it just shifts up by an amount $p_d C(r)$ when the fraction planted in drought resistant crop type is less than or equal to $\underline{\theta}$. This is the perverse incentive created by excuse: the farmer is rewarded for taking lower precautions to cushion against loss in the adverse state.

Because the slope of the farmer's payout function $R(\theta)$ does not change under excuse, that payout is still either always increasing or always decreasing in θ. If always decreasing, then excuse is irrelevant to the farmer's choice as she will set $\theta = 0$ in any event. If the farmer's payout is, aside from excuse, always increasing in θ, then it is possible that the decrease in $R(\theta)$ caused by increasing the fraction θ so far that $C(r)$ must be paid even in the drought state is so large that the farmer is better off setting $\theta = \underline{\theta}$ than setting $\theta = 1$. In this sense, after simplifying (1), we can see that the excuse doctrine binds and alters behavior provided that:

$$\underline{\theta} Y_d + (1 - p_d)(1 - \underline{\theta})Y_n - (1 - p_d)C(r) > Y_d - C(r) \quad (5)$$

Now whenever $p_d > 0$, (5) is certain to bind whenever $\underline{\theta} \to 1$. When this is true, excuse drops the farmer's costs at a level of precautions (drought resistant fraction) that is so high that the farmer has to be better off lowering his costs by staying below this fraction than going all the way to planting only the drought resistant variety.

But excuse may bind even for smaller $\underline{\theta}$. To see this, note that when $\underline{\theta} \to 0$, (5) becomes:

$$p_d C(r) > Y_d - (1 - p_d)Y_n,$$

which simplifies to:

$$p_d < \frac{Y_n - Y_d}{Y_n - C(r)} \tag{6}$$

Provided that $Y_n > c$ (which is necessary for planting to be profit maximizing), inequality (6) may hold even though

$$\frac{\partial R}{\partial \theta} > 0,$$

which occurs when $p_d > \frac{Y_n - Y_d}{Y_n}$. Inequality (6) holds when $p_d \ll C(r)$.

2. Risk-Averse Farmer

a. No Excuse

Now assume that the farmer is risk averse, with utility function u(Y) defined over payouts, with u′ > 0 but u′′ < 0. The risk-averse farmer's objective function is given by:

$$p_d u(\theta Y_d - C(r)) + (1 - p_d)u(\theta Y_d + (1 - \theta)Y_n - C(r))] \tag{7}$$

By taking the partial derivative of (7) with respect to θ, we find that the first order condition defining the optimal (interior) value of θ, which I will call θ^*, is given by:

$$\frac{p_d Y_d}{(1-p_d)(Y_n - Y_d)} = \frac{u\prime(\theta Y_d + (1-\theta)Y_n - C)}{u\prime(\theta Y_d - C)} \tag{8}$$

Note that because u′′< 0, the right hand side in (8) is less than 1 and so (8) can hold if and only if the left hand side is also less than 1, and this condition on the left hand side requires that:

$$p_d < \frac{Y_n - Y_d}{Y_n} \tag{9}$$

If we look back, we can see that condition (9) is the same as condition (3); however, whereas under risk neutrality, condition (9) holding dictates that the farmer plant no

drought resistant variety (a corner solution), under risk aversion, it ensures that a positive fraction of both varieties will be planted.

b. Risk-Averse Choice with Excuse

Now consider the regime of contractual excuse. Under this regime, the risk-averse farmer's objective function becomes:

$$[p_d u(\theta Y_d) + (1 - p_d)u(\theta Y_d + (1 - \theta)Y_n - C)] \tag{10}$$

The first order condition defining an interior maximum for problem (10) is given by:

$$\frac{p_d Y_d}{(1-p_d)(Y_n - Y)} = \frac{u\prime(\theta Y_d + (1-\theta)Y_n - C)}{u\prime(\theta Y_d)} \tag{11}$$

Because $u'' < 0$, for any given θ, the right-hand side in (11) is unambiguously bigger than the right hand side in (6). Because the right-hand side in (11) is also increasing in θ,[122] the optimal fraction of crop planted with the drought resistant variety under contractual excuse θ_e^*, must be less than θ^*, the fraction of drought resistant variety planted under no excuse. Inasmuch as the precaution against the bad state of the world in this simple world is to increase the fraction of crop planted with the drought resistant variety, this result establishes that the incentive to take precautions is cut by liberal excuse.

122. This follows because the partial derivative of the right hand with respect to θ is given by $[(Y_d - Y_n)u''()u'() - Y_d u'()u''()]/u'()^2 > 0$.