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Key Issues to Watch in Commercial Litigation in Light of COVID-19

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Ropes & Gray's litigation & enforcement practice group is actively monitoring developments in commercial litigation relating to COVID-19. Commercial disputes have already arisen from the many disruptions to ordinary-course business across all industries. In this Alert, we have highlighted the most important developments and trends in litigation connected to the pandemic.

Widespread court closures and restrictions at both the state and federal level may limit the options for speedy relief and resolution available to civil litigants.

- Nationwide, courts have taken **protective measures** to curb the spread of COVID-19.
  - Some have restricted the public's access, while others have implemented teleconferencing and virtual services in lieu of in-person hearings. Nearly all courts have extended all civil trials, and many have pushed out other civil litigation filing deadlines.
  - For example, in the New York state court system, the Chief Justice limited court operations to "essential" matters during the pendency of the health crisis. Litigants are precluded from filing new, non-essential cases, and from making filings in any existing matters. Governor Cuomo also suspended the statute of limitations and all other court deadlines.
  - Summaries and updates relating to federal courts can be accessed here. State court information can be accessed here.
- Thorny issues stem from court closures relating to contractual **forum selection clauses**.
  - A forum selection clause designates the specific jurisdiction that will hear and resolve any issue arising out of a contract. Courts typically enforce these clauses so long as they were negotiated and agreed to by the parties.
  - In the event a forum selection clause identifies a jurisdiction in which courts are currently closed or restricting filings, litigants will have to strategize whether and when to file suit seeking judicial resolution of disputes. Absent emergent circumstances, a plaintiff may well have to wait for its day in court.
- Some states have **tolled or extended statutes of limitations** during the pending public health crisis, while other states have remained silent or specifically declined to toll.
  - For example, the Massachusetts Supreme Judicial Court and the Delaware Supreme Court issued orders tolling all statutes of limitations for defined periods. The Governor of Connecticut tolled limitations periods by executive order. Litigants are already challenging whether courts have the legal authority unilaterally to toll all statutory and common law limitations periods.
  - Some state courts (*e.g.*, Alabama) concluded that they do not have the power to toll limitations periods.

- Other states' court public health orders are silent as to tolling (*e.g.*, California, Illinois). Where courts are closed to litigants filing new actions, we expect litigants to seek equitable tolling or other case-specific, court-fashioned relief.

- To date, there has not been a common approach taken by federal courts, though the Department of Justice promoted draft legislation asking Congress to pause the federal statutes of limitations for criminal investigations and civil proceedings.

- The availability of **emergency relief** is jurisdiction-specific.

  - Most courts are still considering requests for emergency relief, including temporary restraining orders and preliminary injunctions. Different jurisdictions define what constitutes an emergency in civil cases differently, so it is critical to review carefully the court's operative COVID-19 order(s) to determine whether a dispute warrants emergent treatment.

  - Parties should carefully weigh whether the relief sought is truly exigent before seeking expedited or emergent review, as judges may have limited patience for unwarranted or overblown demands for quick resolution.

  - For example, in March, a judge in the U.S. District Court for the Northern District of Illinois harshly rebuked counsel in an order denying the plaintiff's repeated requests for emergency hearings in a case about counterfeit unicorn drawings, writing: "The world is facing a real emergency. Plaintiff is not." *Art Ask Agency*, 20-cv-1666 (N.D. Ill.).

- Ropes & Gray is carefully monitoring how the courts respond to COVID-19, and we will be collecting updates on this site.

Businesses across a broad spectrum of industries are already grappling with certain key contractual issues that may lead to litigation and other dispute resolution.

- The applicability of contractual **force majeure clauses** during the public health crisis is emerging as a key action area.

  - A force majeure clause is a contractual provision that may excuse parties' performance obligations when circumstances arise that are unforeseeable, beyond the parties' control, or make performance impracticable or impossible.

  - Whether COVID-19 constitutes a force majeure is a contract-specific question. While there are some common formulations, the specific relief granted by a force majeure clause is dictated by the language of the contract. Such clauses typically specify which events will be deemed a "force majeure event," and commonly include acts of God, war, and acts of terrorism. Some clauses reference epidemics, strikes, and/or labor disputes. Certain clauses include catch-all phrases intended to capture events "beyond the control of the parties."

  - Governing law of the contract matters. Some jurisdictions construe force majeure clauses narrowly, while others may be inclined to take a broader view.

- Parties wishing to invoke force majeure clauses should carefully review the language of the contract to determine whether invocation requires the party to take any affirmative steps, including notice or mitigation measures. The language of the clause will also dictate how long performance is excused.

- When properly invoked, these clauses may be used as an affirmative defense to a breach of contract claim. For instance, if a supplier is unable to perform or performance is delayed due to a qualifying force majeure event, generally no claim for breach of contract applies, and the non-performance or delay would be excused.

- Parties negotiating new agreements will need to evaluate the availability of force majeure relief or other contract defenses now that COVID-19 is a known risk.

- Where no force majeure clause applies, parties seeking to excuse performance under a contract for the sale of goods may try to invoke **commercial impracticability under UCC 2-615**.

  - Article 2 of the Uniform Commercial Code governs contracts for the sale of goods. Under UCC 2-615, contract non-performance may be excused when an extraordinary and unforeseen occurrence, the non-occurrence of which was a basic assumption of the contract, makes it impracticable to perform.

  - Contract parties should consider, among other factors, the following issues before invoking this defense:

    - Whether COVID-19 was foreseeable when the parties entered into the contract;

    - Whether the non-performing party is able partially to perform, and thus has a duty to allocate resources fairly and reasonably among its existing customers;

    - Whether the non-performing party gave adequate notice to the other party about the delay;

    - Whether the non-performing party was at fault or negligent; and

    - Whether the non-performing party contractually assumed the risk of impracticability under the terms of the contract.

- **Frustration of Purpose**

  - In the absence of a force majeure provision in a contract, parties might rely on the frustration of purpose doctrine, by claiming the circumstances surrounding the contract have radically changed.

  - However, courts apply this doctrine very narrowly. They will not excuse non-performance merely because of financial hardship to the party expected to perform. Rather, the frustration must stem from some unforeseeable event that makes the contract essentially worthless to one of the parties.

  - Courts have not yet weighed in to determine whether COVID-19 warrants application of the frustration of purpose doctrine.

- Parties should be aware that there is substantial risk in invoking "frustration of purpose" to avoid performance. Improperly invoking this defense, or doing so too soon, may itself constitute a distinct breach of contract. Accordingly, parties should seek advice from counsel before attempting to invoke this doctrine.

- **Impossibility**

  - A breaching party might also be excused for non-performance by raising the defense of impossibility. In most instances, impossibility likely does not apply, as it requires the destruction of the contract's subject matter or the means of performance.

  - Impossibility must be due to unforeseen and uncontrollable circumstances against which the parties to the contract could not have guarded. However, courts have not yet weighed in on whether the COVID-19 pandemic was unforeseeable.

  - Like frustration of purpose, improperly raising the defense of impossibility may constitute a breach of contract.

- **Material Adverse Change/Effect**

  - Under most merger agreements, one of the conditions to closing is the nonexistence of a material adverse change ("MAC"). Whether COVID-19 constitutes a MAC—thereby providing a right to terminate or an opportunity to renegotiate for more favorable terms—requires a fact-intensive analysis and a close read of the relevant agreement.

  - Historically, courts have set a high bar for proving a MAC. Nevertheless, there are several cases currently pending in the Delaware Court of Chancery and other courts centered on this question. Ropes & Gray is actively monitoring these dockets for developments in the law. Examples include:

    - Bed Bath & Beyond seeks specific performance from 1-800-Flowers to close on the $252 million purchase of Personalizationmall.com, LLC;

    - Level 4 Yoga seeks specific performance to close on the purchase of 34 CorePower Yoga-branded studios and damages for CorePower Yoga's refusal to close;

    - The owner of a Houston dine-in movie theater chain seeks to require Cinemex to move forward with an acquisition; and

    - An affiliate of Sycamore Partners seeks declaratory judgment that its termination of its acquisition of a stake of Victoria's Secret was valid, and the seller separately seeks specific performance of the transaction.

- As the pandemic unfolds, Ropes & Gray is keeping a close eye on all of these contractual issues, including watching court dockets for litigation developments and monitoring the trends in these disputes.

Public companies now face an increased risk of securities claims, resulting both from recent dramatic market volatility and the inherent difficulty in crafting accurate disclosures in the context of an unprecedented and unpredictable pandemic.

- Companies may be subject to stock-drop suits based on a variety of theories related to COVID-19, including:
  - Alleged failure to adequately disclose the extent to which the company was vulnerable to pandemic-related risks;
  - Supposedly inadequate disclosures regarding COVID-19's negative effect on the business; and
  - Purported overstatements regarding positive impacts the business may experience as a result of the pandemic.
- Securities plaintiffs' firms have already kicked off the first wave of new actions relating to COVID-19. Examples include:
  - Norwegian Cruise Lines: The company is facing two complaints for allegedly inaccurately downplaying the harmful effects of COVID-19 on its business; and
  - Inovio: The company is currently defending both a securities action and a related derivative action based on allegedly overly optimistic statements regarding its ability to develop a successful vaccine for COVID-19. These suits were triggered by a negative report on the company from a short-selling research firm.
- The plaintiffs' bar will likely ramp up their filing activity as more courts reopen and as companies begin to report disappointing results from Q1 2020.
- In the face of this heightened risk environment, there are a number of steps that public companies can take to minimize their exposure to stock-drop suits, including:
  - Enhancing pandemic disclosures by (i) transparently describing anticipated headwinds presented by COVID-19; (ii) accurately characterizing the effect of the pandemic on the company's business; and (iii) affirmatively withdrawing or updating prior statements that are no longer accurate in light of the pandemic;
  - Implementing or enhancing proactive, risk-adjusted measures to identify and correct in real time potentially inflammatory conduct or communications; and
  - Instituting a federal forum-selection provision to guard against duplicative state and federal litigation based on alleged misstatements in offering documents.
- We will continue to monitor COVID-19-related stock-drop suits in the wake of the public health crisis.