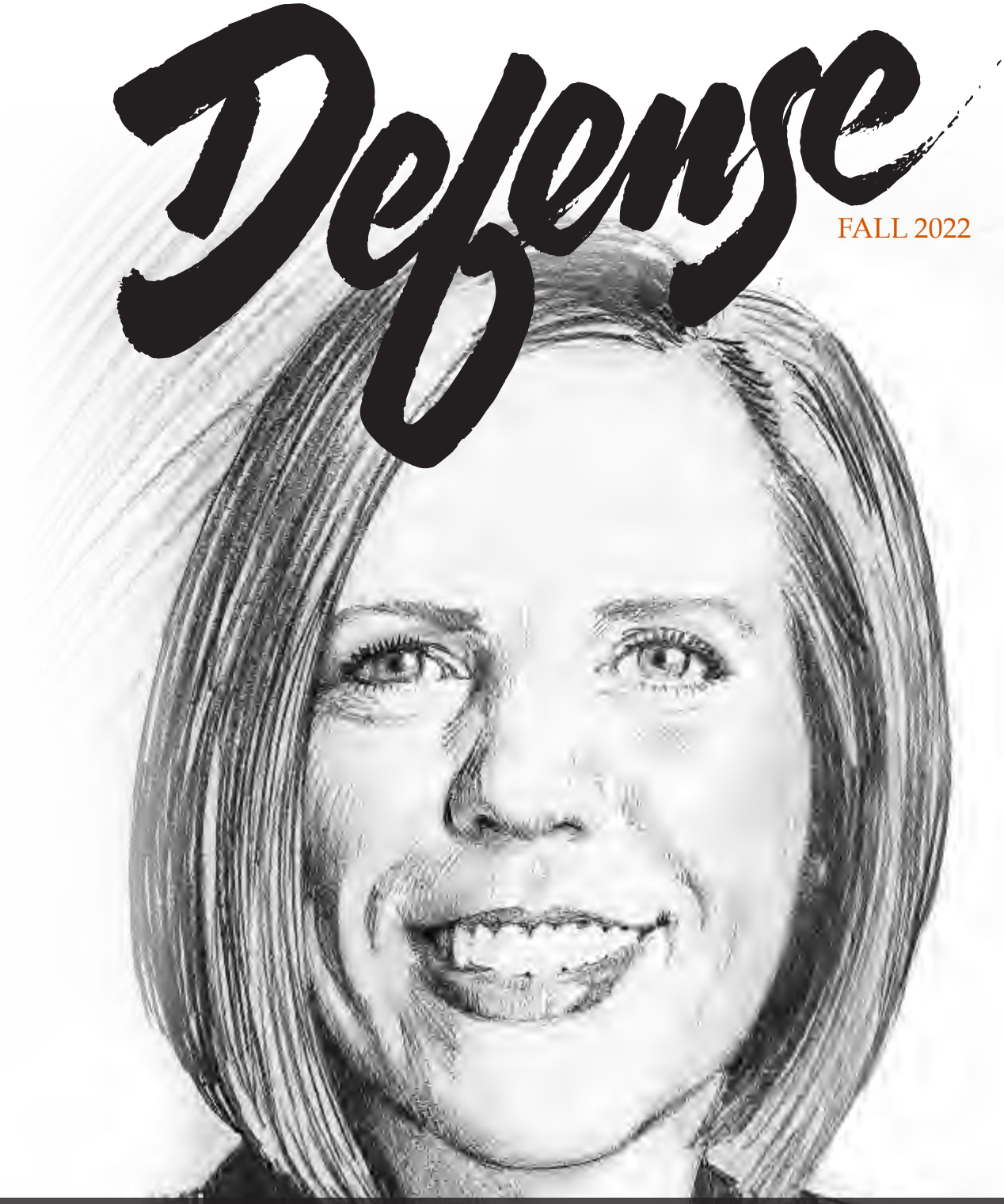
MINNESOTA

Defense

FALL 2022



FINDING THE BALANCE BETWEEN TRIAL LIFE AND HOME LIFE

SUPPLY CHAIN DISRUPTIONS & BREACH OF CONTRACT CLAIMS

THE WIDENING PATH TO CRIMINAL LIABILITY FOR MEDICAL NEGLIGENCE

SUPPLY CHAIN DISRUPTIONS & BREACH OF CONTRACT CLAIMS

By Elizabeth Roff, Stellpflug Law PLLC, Minneapolis, MN

Foreign conflicts, global politics, and renewed COVID-19 lockdowns in China have magnified supply chain issues already faced by the construction industry since 2020. A disruption in the performance of one contract in the supply chain causes a ripple effect. The consequences of the supply chain issues are therefore not felt by just material suppliers. Manufacturers, wholesalers, general contractors, subcontractors, developers, and architects are all experiencing interruptions necessitating changes to how they conduct business. Best practice is for the parties to cooperate in finding a solution to supply chain disruptions. Sometimes, despite the parties' best efforts, litigation occurs. The outcome of the litigation turns to the contract language or, in limited circumstances, application of common law doctrines excusing performance. This article provides a birds-eye view of these contract law principles as applied to supply chain disruptions.

TIME-IS-OF-THE-ESSENCE PROVISION

Like any contract dispute, the actual language of a construction contract usually governs. A well-written contract will anticipate potential disputes regarding timing and any party's inability to perform. For example, some construction contracts have time-is-of-the-essence provisions and a delivery and/or completion deadline. This provision refers to the amount of time the parties have to complete their contractual obligations. Its inclusion in a contract makes "timing" (the timeframe or deadline for an action to take place) material to the contract and, therefore, provides grounds for a breach of contract claim if a party fails to perform timely.

Not all time-is-of-the-essence provisions are treated equally. To be enforceable, the provision must be expressly stated and unequivocal. Most standard construction agreements contain some sort of time-is-of-the-essence provision. For example, the American Institute of Architects, Document No. A201, General Conditions of the Contract for Construction, states:

> 8.2.1 Time limits stated in the Contract Documents are of the essence of the Contract. By executing the Agreement, the Contractor confirms that the Contract Time is a reasonable period for performing the Work.

Minnesota has not analyzed whether § 8.2.1 is a true time-is-of-the-essence provision. The answer will depend on what the contract documents state vis-a-vis time limits.

Even if a contract has an enforceable time-is-of-the-essence-provision, the party seeking enforcement may have acted in a manner that constitutes waiver of enforcement of the completion date. For example, a party that unreasonably delays enforcing a completion deadline may ultimately be barred from later enforcement because such actions are inconsistent with time being of the essence. *See BOB Acres, LLC v. Schumacher Farms*, LLC, 797 N.W.2d 723, 727 (Minn. Ct. App. 2011). Best practice during negotiations to avoid this accidental waiver regarding supply chain disruptions is to put in writing that the negotiations do not constitute a waiver of the time-is-of-the-essence-provision and/or completion date.

FORCE MAJEURE CLAUSE

Other provisions in the contract may excuse performance delays, even if time-is-of-the-essence. One such provision is a force majeure clause, which relieves parties from performing their contractual obligations when certain circumstances beyond their control arise that make performance inadvisable, commercially impracticable, illegal, or impossible. As with time-is-of-the-essence

Supply Chain Disruptions **continued on page 14**

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Supply Chain Disruptions **continued from page 13**

provisions, force majeure clauses will be enforced according to their express and unequivocal terms.

An event that is foreseeable at the time a contract is made cannot be a force majeure. For example, freezing temperatures between November and January is a foreseeable event in Minnesota and thus not a force majeure event. *Matter of Licensing Order Issued to Gaffney Constr.* LLC, A21-0441, 2022 WL 433305, at *5 (Minn. Ct. App. Feb. 14, 2022). In contrast, sudden, extreme, and generally unpredictable weather events — such as floods, hurricanes, and tornadoes — are considered unforeseeable. *See Matter of Welfare of Child of J.H.*, 968 N.W.2d 593, 605 (Minn. Ct. App. 2021), review denied (Dec. 6, 2021).

Some construction contracts list supply issues as an event that would excuse performance. If not specifically listed, look for a catch-all phrase for any event beyond the parties' control. Minnesota has not addressed whether supply chain disruptions and the pandemic are force majeures.

In other jurisdictions, animal outbreaks are considered force majeure events. *See SNB Farms, Inc. v. Swift & Co.*, C01-2077, 2003 WL 22232881, at *10 (N.D. Iowa Feb. 7, 2003). It thus follows that a global pandemic in humans would also be a force majeure event.

For a supply chain disruption to constitute a force majeure, the invoking party will likely have to identify the specific event that caused the disruption. Not all events that cause supply chain disruptions are necessarily force majeures — the actual language of the clause governs its scope. For example, a contract may explicitly include delay or failure of a supplier as a force majeure. *See InterPetrol Bermuda Ltd. v. Kaiser Aluminum Int'l Corp.*, 719 F.2d 992, 1001 (9th Cir. 1983). AIA A201-2017, used by many contractors, does not explicitly list supply chain issues as justification for delay in performance. Instead, A201-2017 contemplates delays caused "by labor disputes, fire, *unusual delay in deliveries*, unavoidable casualties, adverse weather conditions. . . or other causes beyond the Contractor's control." The party seeking to avoid performance will argue that supply chain disruptions fall within this language as either an unusual delay in deliveries or under the catch all language. Whether a court will agree has yet to be seen.

Most contracts with force majeure clauses require written notice of the force majeure event. Failure to comply with the exact notice requirements may render the force majeure defense inapplicable.

Application of the force majeure clause may only temporarily excuse performance versus voiding the contract. For example, the remedy listed in AIA A201-2017 is an extension of time to complete the work, not cancellation or refunds. For most construction contracts, performance delay versus cancellation will be the ultimate result.

Many construction contracts may also have other provisions addressing assumption of risks. Minnesota courts will enforce those provisions with some limitations. For example, indemnification provisions in construction contracts are governed by Minnesota's Anti-Indemnity Statute, Minn. Stat. § 337.02. This article is not meant to provide an exhaustive list of all risk-transfer possibilities.

IMPOSSIBILITY

If the contract itself does not provide a basis for cancellation, common law contract doctrines of impossibility and/or frustration of purpose may. Under each doctrine, all parties may have every intention to perform their obligations, but cannot do so because of circumstances beyond their control. The ability to avoid performance in certain circumstances based on impossibility and frustration of purpose are exceptions to the longstanding rule that contracts are enforced as written.

To avoid obligations pursuant to "impossibility", the invoking party must show the occurrence of an event, the non-occurrence of which was a basic assumption of the contract, that makes performance impossible. *Powers v. Siats*, 70 N.W.2d 344, 348 (Minn. 1955). Buyer's remorse is not a valid application of impossibility. And, the fact that a job simply became more costly or difficult than anticipated is also not automatic grounds to avoid performance. *L.J. McNulty, Inc. v. Village of Newport*, 187 N.W.2d 616, 621 (Minn. 1971); *DJD Partners, VII, L.L.C. v. Finest Foodservices, L.L.C.*, C7-01-2245, 2002 WL 1613844, at *2 (Minn. Ct. App. July 23, 2002). Each party takes on certain risks when entering into a construction contract. Impossibility is not intended to be a means to avoid agreed-upon risk transfer. Instead, it is meant to protect parties from unforeseen events that render performance impossible.

"Impossibility" is not limited to actual or scientific impossibility. *Powers v. Siat*s, 70 N.W.2d 344, 348 (Minn. 1955). Instead, it means a "great increase in expense or difficulty." *Id*. For example, death renders performance of physical work under a contract impossible. *Metro Gold, Inc. v. Coin*, 757 N.W.2d 924, 928 (Minn. Ct. App. 2008). In a less obvious case, the court of appeals excused a landlord from a contractual obligation to perform major repairs because of financial hardship caused by unforeseen rulings in bankruptcy court. *Burgi v. Ecke*s, 354 N.W.2d 514, 518 (Minn. Ct. App. 1984).

In cases of impossibility, Minnesota has decided to relieve a party of their duty to perform. However, a party that becomes aware of facts that will make performance impossible in time to avoid or mitigate the consequences of non-performance, has a duty to take reasonably prudent steps to avoid the consequences. The failure to take these steps renders the impossibility defense inapplicable. This aligns with Minnesota's reluctance to rewrite unambiguous

Supply Chain Disruptions **continued on page 15**

Supply Chain Disruptions **continued from page 14**

contracts and supports a goal of encouraging open dialogue and settlement.

FRUSTRATION OF PURPOSE

Frustration of purpose is another exception to the general rule that a party is strictly bound to perform obligations they undertook via contract. In contrast to impossibility, frustration of purpose may apply even if the party could still technically perform the obligation. Frustration of purpose requires the invoking party to prove that their principal purpose in entering the contract is frustrated by the occurrence of an event, the non-occurrence of which was a basic assumption on which the contract was made. *Nat'l Recruiters, Inc. v. Toro Co.*, 343 N.W.2d 704, 707 (Minn. Ct. App. 1984). In addition, the event must not have been the invoking party's fault. The frustrated purpose must be the principal purpose, not a secondary purpose. A principal purpose is one that is "so completely the basis of the contract that, as both parties understand, without it the transaction would make little sense." Restatement (Second) of Contracts § 265, comment a (1981) (adopted in Minnesota).

For example, *City of Savage v. Formanek*, 459 N.W.2d 173 (Minn. Ct. App. 1990), addressed whether a new rule requiring industrial use permits frustrated the purpose of a development contract. The parties agreed that the purpose of the development was to build industrial-use property. Importantly, the parties admitted that they had not contemplated the need for permits when they entered the agreement, and the contract was silent on the issue. Therefore, the court concluded that the permit denial frustrated the primary purpose of the contract and excused performance.

Had the parties in *Formanek* contemplated potential permit denials at the time the contract was executed, the court may not have excused performance. In *Metro. Sports Facilities Comm'n v. Gen. Mills, Inc.*, 460 N.W.2d 625 (Minn. Ct. App. 1990), aff'd, 470 N.W.2d 118 (Minn. 1991), the contract actually contemplated the adverse government action, thereby rendering frustration of purpose inapplicable. Application of the frustration of purpose doctrine therefore, unsurprisingly, depends on the contract language.

THE TAKEAWAY

Application of any of the aforementioned contract provisions and common law doctrines turns on the actual cause of the disruption affecting that contract. Showing the cause of the disruption is unlikely to be straightforward or undisputed. And, significant discovery and expert opinions will drastically increase litigation costs. Therefore, before turning to litigation, the parties should attempt to find voluntary solutions.

Ultimately, as applied to the supply chain disruptions, the party seeking to avoid performance must show that they did not know or have reason to know of the cause of the disruption when the contract was made. The defenses then have a stronger likelihood of applying to contracts made before the market appreciated the supply chain disruptions.

As the adage goes, the best defense is a good offense. The first line of defense is the contract language: whether a downstream or upstream entity, negotiation and agreeing upon specific risk transfer language is the best practice. For current disputes, the parties have the right to renegotiate and amend the terms of the contract. Understanding the cost and uncertainty of litigation will hopefully bring the parties to the table. There is no one-size-fits-all answer. Ultimately, the terms of the contract will decide whether performance is excused under force majeure or any other contract law doctrine.