Contracts in the Time of COVID-19

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David A. Hoffman and Cathy Hwang, *The Social Cost of Contract*, __ **Columbia L. Rev.** __ (forthcoming), available at SSRN.

Almost ninety years ago, Morris Cohen taught us that the primary role of contract law is to place the enforcement mechanism of the state at the service of one party against the other (Cohen 1933, Pp. 585–86; see also Zamir 1997, Pp. 1777–78). Since enforcement of contracts entails the exercise of governmental powers and the use of public resources, contract law (like the rest of private law) is part of public law. This means that whatever the role played by freedom of contract, it cannot be the only principle that motivates the law. Contract law inevitably reflects public concerns, as well. Most obviously, it follows that whenever a contract creates substantial negative externalities—that is, whenever it adversely affects the well-being of other people—there are *prima-facie* grounds for curtailing freedom of contract (Zamir & Ayres 2020, Sec. 1.A). Examples of doctrines that serve this goal include the rules concerning illegal contracts, contracts against public policy, and various other mandatory rules.

As in past epidemics, COVID-19 creates situations in which the performance of contracts might adversely affect the public at large. These include contracts pertaining to events with many participants—such as weddings, funerals, and conferences—which may turn into super-spreading events. It also includes more mundane contracts, such as between universities and students, since attending ordinary classes may also result in spreading the disease. Performing such contracts may or may not be forbidden by law. Either way, one of the parties (typically, but not invariably, the customer) may wish to back out of it—in which case a legal dispute may arise. How should such disputes be resolved? What should we advise the parties to do in such circumstances?[1] These questions lie at the heart of David Hoffman's and Cathy Hwang's highly recommended article, *The Social Cost of Contract*.

The article consists of three parts. Part I is more theoretical. It argues that since contracts often entail social costs, the public is involved in contracts, and bargaining is carried out in the shadow of the law. Specifically, the authors highlight three mechanisms by which the law intervenes in contractual relationships. First, there are transactions (such as the sale of illegal substances) that simply cannot be performed through legally enforceable contracts. Second, some transactions require the approval of regulators (such as mergers that require the approval of antitrust authorities)—which often results in actual negotiations between the parties and the regulator. Third, when contractual disputes reach the courts, they may also take into account the negative externalities of contracts as they interpret or reform them, decide about contractual defenses, or design remedies for breach. Even when courts do not make explicit reference to the doctrine of public policy, public concerns inform the courts' decisions in such cases. As the authors conclude, the public always has the last word—through interpretation and enforcement of contracts in court.

I would extend this insightful analysis even further. According to Morris Cohen's argument, any enforcement of a contract, whether it entails externalities or not, is a public matter. If so, the state must ask itself whether to use its coercive powers and spend its limited resources to enforce contracts, even when no externalities are involved. In fact, some of the examples discussed in the article—such as the unenforceability of liquidated damages in tenancies (P. 14) and the rules about mutual mistake (P.

17)—are not primarily about externalities. Moreover, the public is involved in any contractual issue not only through mandatory rules that render contractual obligations unenforceable, or through judicial reformation of contracts, but also in establishing default rules, imposing pre-contractual disclosure duties, and so forth.

It should also be emphasized, as the authors do, that the three mechanisms they describe are only examples. There are additional mechanisms that curtail freedom of contract ex ante (including judicial precedents and regulatory guidelines); regulatory agencies are involved not only in the design of specific contracts, but also in ex ante lawmaking and ex post enforcement; all institutions use a mixture of standards and rules, and employ civil, administrative and even criminal sanctions to handle contractual externalities; and so forth.

Part II of the article contains a nuanced analysis of various doctrines and precedents by which courts reform contracts that give rise to significant negative externalities. These include excuses for non-performance, creative interpretation, reformation, and more. Collectively, they are described as "an anti-canon: a set of disfavored and odd cases that result from extraordinary facts" (P. 20). An interesting aspect of the case law (which lies beyond the scope of the present article, but is worth exploring), is that courts often prefer to use circumventive means (such as interpretation) to reach a sensible outcome, rather than explicitly rely on doctrines such as impossibility or public policy. Such rhetoric enables courts to play down their active role in contractual matters. This inclination is closely related to broader issues of the tension between what Robert Hillman has called "contract lore," and the realities of contracts and contract law (Hillman 2002; 2020).

The practical importance of the doctrinal analysis of Part II is highlighted in Part III. Here, the authors persuasively argue that, rather than follow simplistic advice based on the binding force of contracts, contracting parties should realize that the outcomes of litigation in disputes arising from the COVID-19 pandemic—especially when contracts involve considerable externalities—are far from certain. Courts can use a multiplicity of doctrines to arrive at different results, depending on variables such as "the parties' relative fault, the actions and signaling by public health authorities, and the specificity of contract terms about risks" (P. 27). It follows, that parties "should be more willing to split the difference in COVID-19 contract cases than they would ordinarily be" (P. 34). Interestingly, similar advice—namely, to negotiate in good faith with a view to adapting contracts to the changed circumstances of the pandemic—has recently been given to contracting parties by the Israeli Inter-Ministerial Team for the Examination of the Effect of the Coronavirus on Contracts (July 7, 2020, in Hebrew).

Hopefully, the challenges to contract law posed by COVID-19 will soon be a thing of the past. But Hoffman's and Hwang's analysis will remain relevant and important in many other contexts.

1. Note that these questions focus on the relationships between the parties. A different set of questions arises when people who are adversely affected by contracts wish to impose liability on the contracting parties (see, e.g., Parella 2020).

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