Contracting COVID: Private Order and Public Good (Standstills)

*By Jonathan C. Lipson and Norman M. Powell**

COVID (2019) rendered many contracts in or near breach. If commercial actors in these circumstances marshaled their presumptive legal rights—whether to sue or to shelter in bankruptcy—the result could be catastrophic for the legal system and for an economy that is increasingly interconnected through contract. The fact that the economy might revive quickly would mean that terminating relationships through litigation could be especially wasteful.

Responses to COVID's effect on contract have focused largely on public interventions such as government mandates and subsidies, as well as adjudication. This essay explores the important but underappreciated role that private ordering can play through the use of standstill/forbearance agreements ("SFAs") as supplements to, or substitutes for, public action. Under an SFA, parties agree not to take legal action until some defined period of time has passed or a stipulated exit event has occurred. SFAs can address problems of enforceability, network effects, and exit created by COVID across a broad range of commercial contracts. This essay explores their use through consideration of a model published with the Business Law Section of the American Bar Association.

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> "*[T]he state cannot risk the loss of its citizens even to preserve inviolate the contracts of individuals.*"**

> "*We do have a biological challenge in this [COVID] problem, but the economic problem is growing and is much larger. . . . [I]t's always the American government's position to say in the choice between the loss of our way of life as Americans and the loss of life of Americans, we have to always choose the latter.*"
>
> Trey Hollingsworth, U.S. Rep., R-Ind.***

Introduction

The novel coronavirus (2019) (COVID)[1] presented a difficult question: open the economy and spread disease, or quarantine and choke the economy? Responses to the COVID question were framed largely as questions about public interventions: What can government do to create and enforce health-safety standards, prevent or resolve litigation, and float the economy? While government has played a vital role, too often the responses have been politically controversial, poorly executed, or excessively costly.

Public interventions have taken one of three broad forms: mandates, bailouts, and adjudication. Mandates have been the most politically difficult, as the federal government largely refused to order prescriptive health-safety standards, and

** Note, *Contracts—Defenses—Impossibility of Performance*, 17 Harv. L. Rev. 197, 200 (1904).

*** Quoted in Poppy Noor, *The US Politicians Volunteering Other People's Lives to Fight Covid-19*, Guardian (July 22, 2020), https://www.theguardian.com/world/2020/jul/22/us-reopening-politicians-volunteering-peoples-lives-coronavirus?CMP=Share_iOSApp_Other.

1. More fully known as "severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2)." Steven Sanche et al., *High Contagiousness and Rapid Spread of Severe Acute Respiratory Syndrome Coronavirus 2*, 26 Emerging Infectious Diseases 1470, 1470 (2020).

states were divided over whether (or how) to proceed.[2] Shutdowns were challenged on both liberty and economic grounds: Many Americans did not believe that COVID warranted the cessation of all or almost all social, political, and economic activity that happened to occur in real space and time.[3]

A partial (or partially enforced) shutdown is nevertheless what we got, which contributed to a devastating short-term contraction in economic activity.[4] In anticipation of this contraction, the federal government enacted the Coronavirus Aid, Relief and Economic Security Act ("CARES Act") on March 27, 2020.[5] The CARES Act was created to "provide emergency assistance and a health care response for individuals, families, and businesses affected by the 2020 coronavirus pandemic"[6] and in its first iterations pumped over $2 trillion[7] into the economy in order to maintain liquidity in ways that would, one hoped, tide the market over until "ordinary" economic activity resumed.

The CARES Act proved problematic, however. The Small Business Administration ("SBA"), which administered its Paycheck Protection Program ("PPP"),[8] took the position that companies reorganizing under chapter 11 of

2. There was variation even within states. In Las Vegas, for example, the union that represents food-service workers created a website showing differences in health-safety precautions among commercial kitchens. *Culinary Union Website Tracking Hotel Performance on Cleaning Safety*, 8 News Now Las Vegas (June 4, 2020, 1:34 PM), https://www.8newsnow.com/news/local-news/culinary-union-website-tracking-hotel-performance-on-cleaning-safety/. An opinion piece in the *New York Times* argued that, while the Nevada Gaming Control Board "does require casinos to submit 'adequate' Covid-19 mitigation plans as a prerequisite for reopening . . . safety precautions aren't standardized enough." Brittany Bronson, *When Pandemic Precautions and Vegas' Hedonism Collide*, N.Y. Times (June 21, 2020), https://www.nytimes.com/2020/06/21/opinion/coronavirus-reopening-vegas.html?referringSource=articleShare.

3. Jeremy W. Peters, *Will Herman Cain's Death Change Republican Views on the Virus and Masks?*, N.Y. Times (July 30, 2020), https://www.nytimes.com/2020/07/30/us/politics/herman-cain-gop-coronavirus.html?action=click&module=Top%20Stories&pgtype=Homepage; *see also* Donald G. McNeil, Jr., *Your Ancestors Knew Death in Ways You Never Will*, N.Y. Times (July 15, 2020), https://www.nytimes.com/2020/07/15/sunday-review/coronavirus-history-pandemics.html?referringSource=articleShare. Historically, "[l]ibertarians battled almost every step" to create public-health infrastructure. *Id.* "Some fought sewers and water mains being dug through their properties, arguing that they owned perfectly good wells and cesspools. Some refused smallpox vaccines until the Supreme Court put an end to that in 1905, in Jacobson v. Massachusetts." *Id.*

At the consumer level, mandates sometimes took the form of moratoria on evictions, foreclosures, or debt collections. *See, e.g.*, HAPCO v. City of Philadelphia, No. CV 20-3300, 2020 WL 5095496, at *18 (E.D. Pa. Aug. 28, 2020) (upholding temporary eviction moratorium in Philadelphia).

4. From a peak in the fourth quarter of 2019, the United States experienced two consecutive quarters of declines in gross domestic product ("GDP"), one of which, a decrease of 9 percent in the second quarter of 2020, was the greatest quarterly drop in domestic GDP since record-keeping began. *Gross Domestic Product (Third Estimate), Corporate Profits (Revised), and Gross Domestic Product by Industry, Second Quarter of 2020*, Bureau Econ. Analysis (Sept. 30, 2020), https://www.bea.gov/sites/default/files/2020-09/tech2q20_3rd.pdf. GDP recovered significantly in the third quarter of 2020, but the long-term prospects remained uncertain. Anneken Tappe, *The Economy as We Knew It Might Be Over*, CNN (Nov. 12, 2020, 4:57 PM), https://www.cnn.com/2020/11/12/economy/economy-after-covid-powell/index.html ("The Covid-19 pandemic brought the economy to a screeching halt, and while it has started its long road to recovery, the economy we knew is probably a thing of the past, said Federal Reserve Chairman Jerome Powell on Thursday.").

5. *See* Coronavirus Aid, Relief and Economic Security Act, Pub. L. No. 116-136, 134 Stat. 281 (2020).

6. *Id.*

7. *See id.*

8. CARES Act § 1102, 15 U.S.C. § 636(a)(36) (Supp. III 2020).

the United States Bankruptcy Code could not borrow under it.[9] This meant that distressed companies faced a choice: they could use chapter 11 to reorganize, or they could borrow under the PPP, but not both. Courts split on whether the SBA's approach flunked under the Administrative Procedures Act, though the better-reasoned view appears to be that the SBA's interpretation of the PPP exceeded its authority.[10] Moreover, the uncertain duration of the pandemic made it difficult to predict whether additional funding would be forthcoming in a politically volatile environment.

Judicial intervention, the third public response, has often been a byproduct of the fact that COVID rendered many contracts in or near breach. The "sudden stop" in economic activity left many obligors unable or unwilling to make payments when due, in order to conserve cash for an uncertain period of privation.[11] Even with CARES Act dollars coursing through the economy, COVID caused commercial and corporate obligors of all sorts—borrowers, tenants, buyers, licensees—to default under such common covenants as the ordinary course operation of business, earnings ratios, and so on.

Judicial intervention in commercial disputes arising from COVID has, in turn, taken one of two general forms: contract breach litigation or bankruptcy, the latter sometimes following close on the heels of the former. Although courts did not experience the massive flood of cases that was initially expected, litigation over *force majeure*, impossibility, and similar contract defenses became a prominent concern.[12] Mid-2020 also saw a spike in filings for chapter 11 reorganizations, as many well-known companies such as Hertz sought protection from creditors in bankruptcy court.[13]

9. Requirements: Promissory Notes, Authorizations, Affiliation, and Eligibility, 85 Fed. Reg. 23450, 23451 (Apr. 28, 2020).

10. Although this glosses over some detail, the courts split on this. The U.S. Court of Appeals for the Fifth Circuit has held that a bankruptcy court cannot enjoin the SBA in its implementation of the CARES Act. *See In re* Hidalgo Cnty. Emergency Servs. Found., 962 F.3d 838, 840–41 (5th Cir. 2020). More recently, the United States District Court for the District of Alaska held, in a thoughtful opinion, that the SBA could be enjoined where it exceeded its statutory authority. *See* Alaska Urological Inst., P.C. v. U.S. Small Bus. Admin., 619 B.R. 689, 700 (D. Alaska 2020) ("In the instant case, an injunction based on violations of the APA would 'not interfere with agency functioning,' but 'merely require[ ] the SBA to function within the parameters created for it by Congress.'" (quoting *In re* Vestavia Hills, Ltd., 618 B.R. 294, 300–01 (Bankr. S.D. Cal. 2020))).

11. A "sudden stop" occurs when inflows of capital halt with little or no warning. Guillermo A. Calvo, *Capital Flows and Capital-Market Crises: The Simple Economics of Sudden Stops*, 1 J. Applied Econ. 35 (1998). We are indebted to Mitu Gulati for drawing our attention to this colorful phrase.

12. *Impact Survey: COVID-19 and Easing of Stay-at-Home Orders*, Morrison Foerster (June 15, 2020), https://www.mofo.com/resources/insights/200615-impact-survey-easing-stay-orders.html?utm_source=other_publication&utm_medium=email (containing a survey of corporate general counsels finding that contract breach litigation was second-greatest concern).

We put to one side questions about the role that arbitration may have played here, in part because insight about the use of arbitration can be hard to come by. *See* Avinash Poorooye & Ronán Feehily, *Confidentiality and Transparency in International Commercial Arbitration: Finding the Right Balance*, 22 Harv. Negot. L. Rev. 275, 283 (2017) (observing that "arbitration proceedings have historically occurred in a virtual black box").

13. As of September 2020, chapter 11 filings were up, but chapter 7 liquidations were not. *See* Lauren Bauer et al., *Ten Facts About COVID-19 and the U.S. Economy*, Brookings (Sept. 17, 2020),

Both forms of judicial intervention can be problematic. Litigation involving doctrines such as *force majeure,* impossibility, and so on[14] is fraught and expensive. Courts may have difficulty allocating losses in a principled way in light of the COVID dilemma. Chapter 11 reorganization may be a necessary antidote when other efforts fail but is costly in terms of professional fees and operational disruptions. The SBA's irrational refusal to permit PPP lending to companies in chapter 11 complicated matters. Moreover, and more importantly, both types of proceedings would threaten to end or impair relationships that might otherwise be economically viable.

Ultimately, the real challenge presented by COVID was not merely that it may have led to contract breach on a massive scale, but also that there was good reason to believe that the ensuing shutdown would be relatively short-lived. Unlike the Great Recession of 2007–2008,[15] the economy was basically sound until the pandemic hit.[16] If the economy would not exactly come "roaring back," as some politicians hoped,[17] there was still good reason to think a strong recovery plausible, as happened after the influenza pandemic of 1918–1919.[18] There were thus serious costs not only to shutting down, but also to doing so in ways that made it harder to open back up.

A number of writers have explored various aspects of these public interventions, whether worrying about the "executive underreach" of the Trump administration's

https://www.brookings.edu/research/ten-facts-about-covid-19-and-the-u-s-economy/ ("Fact 2: So far, only Chapter 11 bankruptcies have increased relative to last year.").

14. *See, e.g.*, Complaint, Pac. Collective LLC v. Exxonmobil Oil Corp., No. 20STCV13294 (Cal. Super. Ct. filed Apr. 3, 2020) (real estate acquisition); Complaint, E2W LLC v. Kidzania Operations S.A.R.L., No. 1:20-cv-02866 (S.D.N.Y. filed Apr. 6, 2020) (franchise fees); Complaint, Level 4 Yoga LLC v. CorePower Yoga LLC, No. 2020-0249 (Del. Ch. filed Apr. 2, 2020) (acquisition); Complaint, LFG Acquisitions LLC v. CSPS Hotel Inc., No. 107048560 (Fla. Cir. Ct. Hillsborough Cnty. filed May 5, 2020) (real estate).

15. *See* Matthew O'Brien, *How the Fed Let the World Blow Up in 2008*, ATLANTIC (Feb. 26, 2014), https://www.theatlantic.com/business/archive/2014/02/how-the-fed-let-the-world-blow-up-in-2008/284054/; Ron Rimkus, *The Financial Crisis of 2008*, CFA INST. (Aug. 17, 2016), https://www.econcrises.org/2016/08/17/the-financial-crisis-of-2008/.

16. *See* Paul Davidson, *How Quickly Can the Economy Bounce Back from the Coronavirus?*, USA TODAY (Apr. 1, 2020, 1:57 PM), https://www.usatoday.com/story/money/2020/03/31/coronavirus-how-quickly-can-eco nomy-bounce-back-crisis/5090355002/.

17. David J. Lynch, *Trump Expects Quick Economic Comeback from Coronavirus, but China's Incomplete Recovery Hints at Long-lasting Problems*, WASH. POST (Apr. 7, 2020, 10:51 AM), https://www.washingtonpost.com/business/2020/04/07/trump-china-economy-coronavirus/. On June 3, 2020, President Trump tweeted, "I feel more and more confident that our economy is in the early stages of coming back very strong." Donald Trump (@realDonaldTrump), TWITTER (June 3, 2020, 9:45 PM), https://twitter.com/realDonaldTrump/status/1268358305170296833.

18. Thomas A. Garrett, *Economic Effects of the 1918 Influenza Pandemic*, FED. RES. BANK ST. LOUIS 21 (Nov. 2007), https://www.stlouisfed.org/~/media/files/pdfs/community-development/research-reports/pandemic_flu_report.pdf ("Most of the evidence indicates that the economic effects of the 1918 influenza pandemic were short-term."). The longer-term effects may have been more subtle, but equally problematic, as there is evidence that children born in the wake of that pandemic suffered various developmental and physical debilities. *See id.* at 20–21 (citing Douglas Almond, *Is the 1918 Influenza Pandemic Over? Long-Term Effect of* In Utero *Influenza Exposure in the Post-1940 U.S. Population*, 114 J. POL. ECON. 672 (2006)).

erratic response[19] or the social costs of contract litigation.[20] This essay looks at the flip side: the role that ex ante contracting can play in ameliorating the commercial costs of COVID or similar future calamities. Specifically, we focus on standstill/forbearance agreements ("SFAs"). Under an SFA, the parties to a contract that is in or near breach agree, in essence, to "stand still" and forbear from exercising legal rights that they might otherwise have. Although SFAs can take many forms and address many different issues, they generally offer significant yet underappreciated benefits over public interventions.

The principal private benefits of SFAs will be behavioral and relational. In most cases, SFAs will be more efficient in terms of transaction and opportunity costs than judicial intervention. Because switching costs during and after a pandemic may be especially high, maintaining potentially viable relationships will often be preferable to terminating them, as is more likely in litigation or bankruptcy.[21] The principal institutional benefits will be reduced pressure on courts and increased capacities to manage through other public interventions, whether mandated shutdowns or bailouts. A borrower that was able to stay out of chapter 11 due to a successful SFA, for example, would have been more likely to receive funding under the CARES Act.

Law firms have jumped into the breach to offer guidance on issues to spot in the use of SFAs and techniques to address them.[22] This work is often quite helpful, and the rise of free legal advice may be a public good in itself. But it does not address three critical challenges for SFAs: (i) enforceability, (ii) network effects, and (iii) exit.

Although SFAs are likely to be enforceable in a technical legal sense, enforcement will be difficult as a practical matter because litigation over the question is

19. David Pozen & Kim Lane Schepple, *Executive Underreach, in Pandemics and Otherwise*, 114 Am. J. Int'l L. (forthcoming 2020).

20. *See* David A. Hoffman & Cathy Hwang, *The Social Cost of Contract* 7 (U. Penn. Inst. L. & Econ. Research Paper No. 20-42, Sept. 10, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3635128; *see also* Ian Ayres, *Corona and Contract*, Balkinization Blog (Mar. 23, 2020, 11:40 AM), https://balkin.blogspot.com/2020/03/corona-and-contract.html; Hanoch Dagan & Ohad Somech, *When Contract's Basic Assumptions Fail* (June 9, 2020) (unpublished manuscript available at https://ssrn.com/abstract=3605411); Matthew Jennejohn, Julian Nyarko & Eric L. Talley, *COVID-19 as a* Force Majeure *in Corporate Transactions* (Columbia L. & Econ. Working Paper No. 625, Apr. 16, 2020), https://ssrn.com/abstract=3577701. An important and interesting exception that focuses on sovereign debt, and is thus tangential to the claim here, appears in Patrick Bolton et al., *Born Out of Necessity: A Debt Standstill for COVID-19*, Ctr. Econ. Pol'y Res. (Apr. 2020), https://cepr.org/active/publications/policy_insights/viewpi.php?pino=103.

21. Of course, chapter 11 does not result in termination of all contracts. But it is likely to be much more disruptive to an obligor's contracting network than an SFA.

22. Van M. White, III, *COVID-19 & Forbearance Agreements*, Samuels Yoelin Kantor (May 22, 2020, 2:06 PM), https://samuelslaw.com/2020/05/covid-19-forbearance-agreements/; Daniel R. Weede & Lee Lyman, *Loan Restructuring and Forbearance Agreements in the Face of COVID-19—The Hotel Borrower's Perspective*, Carlton Fields (Mar. 25, 2020), https://www.carltonfields.com/insights/publications/2020/loan-restructure-forbearance-agreements-covid-19-2; Daniel R. Weede et al., *Loan Restructuring and Forbearance Agreements in the Face of COVID-19—The Lender's Perspective*, Carlton Fields (Mar. 19, 2020), https://www.carltonfields.com/insights/publications/2020/loan-restructuring-forbearance-agreements-covid-19; Cameron Adderly, *COVID-19: Holding The Line—Standstill Agreements and Moratoria*, Appleby (June 4, 2020), https://www.applebyglobal.com/news/covid-19-holding-the-line-standstill-agreements-and-moratoria/?utm_source=Mondaq&utm_medium=syndication&utm_campaign=LinkedIn-integration.

unlikely to be a good use of scarce resources. In a networked economy, the shutdown caused cascades of defaults, which could ripple through chains of contracts. Most difficult of all would be defining exit events. How long should parties agree to stand still? How could they know, ex ante, whether the exit event should be the passage of time or some external signal? Because it was unlikely that any single government actor could credibly declare the pandemic "over," it was (and would remain) difficult for contract parties to express in advance when their commercial relationship should return to "normal," or what normal would look like.

This essay cannot fully solve these problems, but it can offer insights from experience with a Model SFA that we published in *Business Law Today* in the early days of the pandemic.[23] That model frames approaches to problems of enforceability, network effects, and exit presented by COVID and which are incompletely addressed by public interventions.

This essay has four parts. Part 1 summarizes COVID's three underlying challenges to commercial actors in their contractual relationships: the sudden stop of the shutdown, the interconnectedness of contracts, and the problem of defining exit. Part 2 focuses on the work that courts have attempted to do in contract breach litigation and chapter 11 reorganization. Part 3 describes the supplementary and interstitial work that SFAs can do in this context. Part 4 considers some of the underappreciated benefits of using SFAs in response to events like the COVID-19 pandemic.

1. Three Commercial Problems with COVID

The overarching commercial problem with COVID has been severe uncertainty. Especially in the early days of the pandemic, there was, as John Maynard Keynes might have said, "no scientific basis on which to form any calculable probability whatever"[24] regarding its scope and duration.[25] Commercial actors have experienced this uncertainty in at least three concrete ways: (i) the "sudden stop" of the shutdown meant there was little time to prepare for it; (ii) the interconnected nature of contractual relationships meant that defaults could spread rapidly and unpredictably through networks of contracts; and (iii) the

23. Jonathan C. Lipson & Norman M. Powell, *Don't Just Do Something—Stand There! A Modest Proposal for a Model Standstill/Tolling Agreement*, Bus. L. Today (Apr. 14, 2020), https://www.americanbar.org/groups/business_law/publications/blt/2020/04/standstill-tolling/ [hereinafter Lipson & Powell, *Model SFA*]. This model was viewed over 3,700 times in its first three months on the internet. *See* E-mail from Richard Paszkiet, Am. Bar Ass'n, to authors (July 20, 2020, 12:17 PM). The American Bar Association ("ABA") does not record the number of times the Model SFA was downloaded.

24. John Maynard Keynes, *The General Theory of Employment*, 51 Q.J. Econ. 209, 214 (1937); *see generally* Frank H. Knight, Risk, Uncertainty and Profit (1921).

25. Keynes, *supra* note 24, at 214. "We simply do not know." *Id.* He might have viewed it as analogous to attempting to predict a war in Europe or "the price of copper and the rate of interest twenty years hence, or the obsolescence of a new invention, or the position of private wealth owners in the social system in 1970." *Id.*

duration was, in *media res*, difficult to forecast, and indeed exit may have no clear marker.

1.1 The Sudden Stop

Although pandemics are in the abstract foreseeable, it is difficult to say that parties entering into medium-term contracts in 2018 or 2019 should have foreseen the COVID pandemic.[26] Thus, contracts in place as of March 2020 might have had terms responsive to those conditions—*force majeure* clauses, for example—but those terms were probably boilerplate or given little attention precisely because it is difficult and perhaps pointless to spend significant amounts of time and energy negotiating over future states of the world that, in the moment, seem highly improbable. While "black swan" events may be more common than we wish to admit, they remain quite rare and thus ex ante contracting has not been expected to do much work here.[27]

Nevertheless, the response to the pandemic was an abrupt contraction in economic activity, as governments ordered lockdowns. The second quarter of 2020 saw an unprecedented drop in U.S. gross domestic product. As shown in Figure 1, the third quarter saw an equally unprecedented increase in it, though economists have been quick to point out that this mostly reflects the enormous stimulus of the CARES Act and was, in any case, insufficient to bring the U.S. economy back to where it would have been in the absence of COVID.[28]

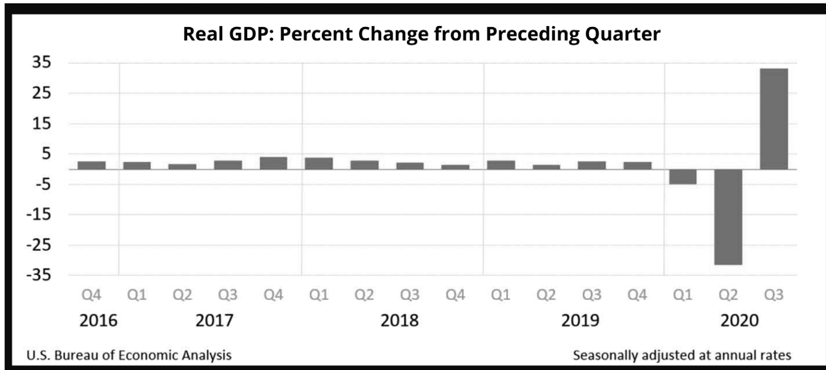
26. *See, e.g.*, Jeffrey Manns & Robert Anderson, *Contract Design, Default Rules, and Delaware Corporate Law*, 77 Wash. & Lee L. Rev. 1197, 1211 (2020) ("Parties may not be able to anticipate some risks at all, such as the absence of liquidity in the depths of the 2008 financial crisis or the exogenous economic shock caused by the COVID-19 pandemic, which may make it challenging for a contract to cover all contingencies.").

One could say that there was a Bayesian prior for COVID: Singapore's experience with SARS in 2003. "Thanks to an efficient bureaucracy in a single small territory, world-class universal health care and the well-learned lessons of SARS . . . Singapore acted early. It has been able to make difficult trade-offs with public consent because its message has been consistent, science-based and trusted." *The Politics of Pandemics*, Economist (Mar. 14, 2020), https://www.economist.com/leaders/2020/03/12/the-politics-of-pandemics.

27. *See* Jennejohn et al., *supra* note 20, at 4 (finding that fewer than half of a sample of about 1,700 "material adverse effects" clauses from 2003 to 2020 specifically referenced "pandemic" or similar events). Some observers, however, have argued that "Covid-19 is by no means a 'black swan' since it was totally predictable and predicted." *See* Andrea Bonime-Blanc, *If Companies Behave Well Now, They Will Build Up a Bank of Trust to Sustain Them Post-COVID-19*, Reuters Events (May 2, 2020), https://www.reutersevents.com/sustainability/if-companies-behave-well-now-they-will-build-bank-trust-sustain-them-post-covid-19; *see also* Andrea Renda & Rosa Castro, *Towards Stronger EU Governance of Health Threats After the COVID-19 Pandemic*, 11 Eur. J. Risk Reg. 273, 274 (2020) ("[W]e have argued elsewhere that COVID-19 was not only predictable ex post but it was amply predicted ex ante." (citing A. Renda & R.J. Castro, *Chronicle of a Pandemic Foretold*, CEPS Policy Insights No. 2020-05, Mar. 2020)).

28. "Getting the economy back to where it would have been without Covid-19 would have taken a 63 percent gain in the third quarter," Politico reported. "'To look at this more substantively,'" said Ian Shepherdson, chief economist at Pantheon Macroeconomics, "'what these numbers tell you is fiscal policy works.'" Ben White, *GDP Rebounds at Record Pace, But Dark Clouds Reappear*, Politico (Oct. 29, 2020, 11:02 AM), https://www.politico.com/news/2020/10/29/gdp-coronavirus-trump-433524.

Figure 1



Bolton, Gulati, and Panizza have warned that the sudden stop in the economy could have wide-ranging, global implications, affecting not only businesses, but also sovereign borrowers. As of October 2020, "over a dozen nations look to be on the brink of public debt crises."[29] Because those sovereigns have no established mechanism for simultaneously renegotiating their obligations, the ripple effects through the economy could lead to another sudden stop.[30]

1.2 Network Effects

All commercial actors are, wittingly or not, part of some network.[31] This may be most pronounced in supply chain agreements ("SCAs").[32] In an SCA, buyer (B) purchases from seller (S); S is able to perform its contract with B because its suppliers, S2 and S3, perform, and so on through the chain. Buyers with sufficient market power, such as large multinational corporations ("MNCs"), are able to use their leverage to embed standard terms in SCAs that may then be

29. Patrick Bolton, Mitu Gulati & Ugo Panizza, *Legal Air Cover* (Duke L. Sch. Pub. L. & Legal Theory Series No. 2020-63, Oct. 11, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3704762.

30. *Id.* at 5 ("It is quite possible that another sudden stop is in the offing. Six months after the sudden stop in March 2020, we still do not have any mechanism in place to mitigate the costs of the defaults that would inevitably follow.").

31. Robert E. Scott, *The Paradox of Contracting in Markets*, 83 L. & Contemp. Probs. 71, 85 (2020) ("Commercial networks are mechanisms for coordination and cooperation between formally independent but functionally interdependent entities."); *see also* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 Va. L. Rev. 757, 762–63 (1995).

32. In 2013 the United Nations Conference on Trade and Development (UNCTAD) estimated that 80 percent of global trade occurred through global value chains governed by multinational corporations either through ownership of foreign affiliates or various kinds of contractual relationships. U.N. Conf. on Trade & Dev., World Investment Report 135 (2013).

transmitted through the chain. But all businesses, large and small, are connected to other businesses through contract, whether formal or informal.

Vincent Glode and Christian Opp have recently explored COVID's implications for contracting networks, which they call "debt chains."[33] Any given obligee's willingness to provide concessions to an obligor "depends on his own liabilities and how they are expected to be renegotiated."[34] They surmise that

> The more a lender's own liabilities are expected to be reduced, the likelier he is to internalize his borrower's default costs, thereby increasing his incentives to renegotiate with his borrower. On the other hand, a lender who is himself deeply indebted typically finds it suboptimal to reduce his borrower's liabilities—while the probability of being paid is higher after making concessions, the payment collected in case of no default is lower. Whereas a tough renegotiation strategy may be privately optimal, it not only increases the potential for costly default in the specific bilateral credit relationship but also creates negative externalities to renegotiation efforts elsewhere in the chain.[35]

They make three policy recommendations, two of which call for public intervention. First, they argue that subsidies are more likely to be effective if targeted at what they call "downstream" borrowers.[36] To start with those closer to the end of the chain, rather than those at the beginning (such as large, money-center banks), "strengthens 'upstream' lenders' incentives to renegotiate their borrowers' debt to default-free levels."[37] Second, they argue that public mandates, such as government-imposed enforcement moratoria, are more likely to be effective upstream than downstream.[38] Third, "the timing of information matters throughout a network." Renegotiation outcomes in the whole chain "are more efficient when they occur before each agent has had the chance to obtain sufficiently precise negative information about his idiosyncratic condition. An implication of this mechanism is that government policies facilitating early renegotiation following a large shock tend to be desirable as they tend to lead to more efficient outcomes."[39]

This last insight is consistent with the intuition behind the 1978 reforms that led to the chapter 11 reorganization system. Prior law had made commencing a bankruptcy case more difficult, which led corporate borrowers to delay the decision to go into bankruptcy until it was too late.[40] Congress believed that by

33. Vincent Glode & Christian C. Opp, Renegotiation in Debt Chains 1 (Nov. 12, 2020) (unpublished manuscript available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3667071) ("[B]usinesses tend to be sequentially interconnected through their liabilities, a financing structure we refer to as a debt chain.").

34. *Id*. at 2.

35. *Id*.

36. *Id*. ("First, we show that providing subsidies to 'downstream' borrowers like the retail store (whose debt payments are expected to flow up the chain) can be particularly effective in eliminating default waves.").

37. *Id*.

38. *Id*. at 3 ("[P]reventing an upstream lender from being able to choose his renegotiation strategy and instead mandating him to reduce his borrower's debt can incentivize downstream agents to voluntarily renegotiate the debt owed to them to levels that avoid default.").

39. *Id*. at 4.

40. According to the Report of the Commission on the Bankruptcy Laws of the United States, a "major factor explaining the smallness of distributions in [involuntary] business bankruptcies

making it easier to commence a reorganization case, chapter 11 would enable more businesses to preserve more value through a better-informed and -negotiated process. In the absence of a judicial intervention such as a chapter 11 reorganization, however, how are participants in the network to learn what they need to know to adjust quickly and effectively?

1.3 Duration—Exit

Indeed, part of the challenge of COVID has been that it rendered adverbs like "quickly" unintelligible due to the pandemic's uncertain duration. Unlike recessions, which can have long and slow recovery periods, there was reason to think that a rebound might occur soon—or might not. Was Q3 of 2020 really the recovery? Or would the recovery more prudently come with a widely available vaccine or naturally achieved herd immunity? If so, when, and how would one know? The "end" of a pandemic may not be clear.[41]

The mere increase in economic activity, as seen in Q3 2020 GDP, was no assurance that we could return to "normal." A vaccine may protect many people, but distributing it to the point where we achieved herd immunity would take some time. While there seems to be a consensus that successful vaccination of about 70 percent of the population provides significant protection for the rest, it has not been clear how long it would take to get to that level.[42] There was also no assurance that future mutations would not defy forthcoming vaccines, yet another reason there may be more sudden stops and an unpredictable recovery.[43]

2. Courting COVID

As noted in the introduction, the dominant responses to these uncertainties have been public: government mandates and bailouts and, as developed in this part, judicial interventions. While these are all important pieces of the puzzle, they are not complete solutions, collectively or respectively, leaving an important but under-explored role for COVID-induced SFAs.

[was] the delay in the institution of proceedings for liquidation until assets are largely depleted." H.R. Doc. No. 137, 93d Cong., 1st Sess. pt. 1, at 14 (1973).

41. Joe Pinsker, *There Won't Be a Clear End to the Pandemic*, Atlantic (Sept. 16, 2020), https://www.theatlantic.com/family/archive/2020/09/pandemic-over-end-how-will-we-know/616372/ ("As a matter of epidemiology, there's no clear-cut criterion that determines a pandemic to be over. 'You can't sign a treaty with a virus, so we have to settle for a kind of cease-fire,' says Stephen Morse, an epidemiologist at Columbia University.").

42. Ludwig Burger & Kate Kelland, *Analysis: Can First COVID-19 Vaccines Bring Herd Immunity? Experts Have Doubts*, Reuters (Nov. 18, 2020, 4:25 AM), https://www.reuters.com/article/us-health-coronavirus-immunity-analysis/analysis-can-first-covid-19-vaccines-bring-herd-immunity-experts-have-doubts-idUSKBN27Y124 ("'The problem is that for now we don't know exactly how fast the virus spreads without any precautions and with the normal travel and social activities we had a year ago,' said Winfried Pickl, professor of immunology at the Medical University of Vienna.").

43. James Glanz, Benedict Carey & Hannah Beech, *Evidence Builds that an Early Mutation Made the Pandemic Harder to Stop*, N.Y. Times (Nov. 24, 2020), https://www.nytimes.com/2020/11/24/world/covid-mutation.html.

2.1 Contract Breach Litigation

The "sudden stop" in response to COVID severely disrupted contractual ordering: many contracts were rendered in breach, or nearly so. Uncertainty about the duration of the shutdown, and what would come next, made it likely that pre-COVID promises would not be performed as expected, at least in the near term. In these cases, the promisee might seek to enforce the contract, and the promisor might wish to escape liability using doctrines such as *force majeure,* impossibility, commercial impracticability, and frustration of purpose.[44]

Broadly speaking, contract law seems to approach questions about the allocation of loss due to a calamitous event based on whether the calamity was foreseen and articulated in the contract. If so (e.g., under a *force majeure* clause), courts will try to interpret the language. If not, they will wrestle with common law or statutory (e.g., Uniform Commercial Code) defenses such as impossibility or impracticability.

A *force majeure* clause defines a class of events that might excuse nonperformance within the contract period.[45] It will always be a matter of contract interpretation.[46] In the wake of COVID, *force majeure* ("superior force") has been asserted when a tenant could not perform under a lease[47] or a buyer did not want to consummate the purchase of a business.[48]

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44. *See, e.g.*, Complaint, Pac. Collective LLC v. Exxonmobil Oil Corp., No. 20STCV13294 (Cal. Super. Ct. filed Apr. 3, 2020) (real estate acquisition); Complaint, E2W LLC v. Kidzania Operations S.A.R.L., No. 1:20-cv-02866 (S.D.N.Y. filed Apr. 6, 2020) (franchise fees); Complaint, Level 4 Yoga LLC v. CorePower Yoga LLC, No. 2020-0249 (Del. Ch. filed Apr. 2, 2020) (acquisition); Complaint, LFG Acquisitions LLC v. CSPS Hotel Inc., No. 107048560 (Fla. Cir. Ct. Hillsborough Cnty. filed May 5, 2020) (real estate).

45. *See* VICI Racing, LLC v. T-Mobile USA, Inc., 763 F.3d 273, 287 (3d Cir. 2014) (applying Delaware law). Strictly speaking, *force majeure* is not a common law concept but is used to describe clauses that excuse a party from certain specified supervening events. The equivalent doctrine under English law is frustration of contract. *See* Force Majeure and Frustration of Contract 33 (Ewan McKendrick ed., 2d ed. 1995) (referring to *Force Majeure and Frustration—Their Relationship and a Comparative Assessment*).

46. 30 Richard A. Lord, Williston on Contracts § 77:31 (4th ed. West 2020) ("What types of events constitute *force majeure* depend on the specific language included in the clause itself."); Kel Kim Corp. v. Cent. Mkts., Inc., 519 N.E.2d 295, 296 (N.Y. 1987) (holding that the *force majeure* defense is narrow and excuses nonperformance "only if the *force majeure* clause specifically includes the event that actually prevents a party's performance").

47. Complaint, Bath & Body Works, LLC v. 304 PAS Owner LLC Successor, No. 651836/2020 (N.Y. Sup. Ct. N.Y. Cnty. filed June 8, 2020) (plaintiff sought rescission of commercial property lease and declaration that lease is unenforceable because COVID-19 and related government mandated shutdowns "frustrated the purposes of the lease"); Complaint, Gap, Inc. v. Ponte Gadea N.Y. LLC, No. 1:20-cv-04541 (S.D.N.Y. filed June 12, 2020) (tenant sought to rescind lease, arguing that COVID-19 crisis and civil orders constitute a casualty within the meaning of the *force majeure* clause); Complaint, Victoria's Secret Stores v. Herald Square Owner LLC, No. 651833/2020 (N.Y. Sup. Ct. N.Y. Cnty. filed June 8, 2020) (plaintiff sought to annul commercial property lease under doctrines of frustration of purpose and impossibility resulting from COVID-19 and related government-mandated shutdowns); Complaint, Williamsburg Climbing Gym Co. v. Ronit Realty LLC, No. 1:20-cv-02073 (E.D.N.Y. filed May 6, 2020) (describing how a tenant sought to rescind lease pursuant to common law doctrines of impossibility and frustration of purpose because COVID-19 pandemic and governor's executive orders mandated business closure and stoppage of construction).

48. Forescout Techs., Inc. v. Ferrari Grp. Holdings, L.P., No. CV 2020-0385-SG, 2020 WL 3971012, at *1 (Del. Ch. July 14, 2020) (challenging the enforceability of merger agreement under "material adverse effect" clause).

Jennejohn, Nyarko & Talley recently analyzed a sample of about 1,700 merger agreements from 2003–2020, and they found that less than one out of eight material adverse effects ("MAE") provisions explicitly carve out pandemics from *force majeure* events.[49] Their data, which treat carveouts from an MAE as analogous to a *force majeure* clause, suggest that it "enters through a *carve out* to the MAE . . . rather than through an affirmative provision . . . . Consequently, when present, such provisions would appear to push pandemic-related risks onto the buyer (and away from the seller)."[50] Presumably, buyers with market power accounted for this shift after the pandemic began.

In the absence of a *force majeure* clause, a court may be reluctant to recognize such a supervening force as a defense to performance.[51] To assert the defense of impracticability or impossibility, a defendant must demonstrate the following: "(1) the occurrence of an event, the nonoccurrence of which was a basic assumption of the contract; (2) the continued performance is not commercially practicable; and (3) the party claiming impracticability did not expressly or impliedly agree to performance in spite of impracticability that would otherwise justify nonperformance."[52]

Parties may feel pressure to litigate because they may not be able to look to insurance to cover COVID-related losses. After the SARS outbreak of 2002, many insurance companies excluded coverage for such events.[53] Yet, such contract defenses are plagued by questions of causation,[54] mitigation,[55] and consistency in application.[56]

49. Jennejohn et al., *supra* note 20, at 4.

50. *Id.* at 5.

51. Gen. Elec. Co. v. Metals Res. Grp. Ltd., 293 A.D.2d 417, 418 (N.Y. App. Div. 2002) ("The parties' integrated agreement contained no *force majeure* provision, much less one specifying the occurrence that defendant would now have treated as a *force majeure*, and, accordingly, there is no basis for a force majeure defense.").

52. Bobcat N. Am., LLC v. Inland Waste Holdings, LLC, C.A. No. N17C-06-170 PRW CCLD, 2019 WL 1877400, at *6 (Del. Super. Ct. Apr. 26, 2019).

53. Jing Yang, *Why Many Businesses Will Be on the Hook for Coronavirus Losses*, Wall St. J. (Feb. 21, 2020, 6:00 AM), https://www.wsj.com/articles/why-many-businesses-will-be-on-the-hook-for-coronavirus-losses-11582282802 ("Now insurers across the board exclude epidemics in standard business-interruption policies, which mainly cover property damage from events such as fire, terrorism and natural catastrophes."); Noor Zainab Hussain et al., *Many Global Firms, Excluded from Epidemic Insurance, Face Heavy Coronavirus Costs*, Reuters (Jan. 29, 2020, 6:30 AM), https://www.reuters.com/article/us-china-health-insurance/many-global-firms-excluded-from-epidemic-insurance-face-heavy-coronavirus-costs-idUSKBN1ZS1CU.

54. *See, e.g.*, Complaint, Banco Santander (Brasil), S.A. v. Am. Airlines, Inc., No. 20-cv-3098 (E.D. N.Y. 2020) (arguing that cessation of air travel between the United States and Brazil was due to the COVID-19 pandemic and the resulting government-imposed measures and unprecedented decline in demand for air travel, excusing performance).

55. *See, e.g.*, Butler v. Nepple, 54 Cal. 2d 589, 599 (1960) (finding that labor strike did not excuse performance when the invoking party could have found an alternate supplier whose increased costs were not "extreme and unreasonable").

56. *See, e.g.*, Michael H. Traison et al., Force Majeure *Provisions Likely to Give Tenants Leverage with Landlords in COVID-19 Defaults*, 39 Am. Bankr. Inst. J. 12, 12 (2020) ("Before the 2020 pandemic, courts addressed *force majeure* provisions with inconsistent results."); *see generally* Dagan & Somech, *supra* note 20.

In *E2W LLC v. Kidzania Operations S.A.R.L.*, for example, a franchisee invoked the *force majeure* clause in a franchise agreement, claiming that it could not lawfully operate its amusement park during the pandemic and resulting government shutdown, and therefore could not make payments to Kidzania, the franchisor.[57] Not surprisingly, the franchisor took the position that the *force majeure* clause might excuse non-performance for governmental orders and acts of God, but that did not explain how COVID caused non-payment.[58] In May 2020, the United States District Court judge declined to declare the agreement at an end, and instead ordered the parties to freeze the status quo and arbitrate, as provided in the agreement itself.[59]

It is difficult to estimate the amount of COVID-induced contract litigation, in part because judicial operations have been scaled back and because parties may have taken a wait-and-see approach. Nevertheless, if the economy does not "roar back" as politicians hope,[60] it is reasonable to fear that contract breach litigation will continue to grow. A recent survey by law firm Morrison Foerster found that breach litigation was one of the top worries for corporate general counsels.[61]

But we must concede the limited utility of contract litigation in these conditions. Judicial responses are often poor and expensive proxies for the performance of broken promises. The parties in *Kidzania* apparently ended up where they would have been but for litigation—in arbitration, as required by the agreement—minus the legal fees. And even if one party wins on the merits—for example, the *force majeure* clause does not excuse payment, as the franchisor argued in *Kidzania*[62] —what then? There is no reason to think that a losing defendant will simply wire payment or otherwise comply with the court's decision. In many cases, the breach may have been a failure to make timely payment because the debtor was part of a network in which its obligors did not pay. The judgment creditor and judgment debtor may play a game of hide and seek until either the creditor finds assets and recovers, or the debtor goes into bankruptcy. While these dynamics are common whenever commercial relationships falter, the scale of potential breach traceable to COVID gave them a systemic weight they would not ordinarily have.

2.2 COVID and Bankruptcy

Bankruptcy has been an equally important form of judicial intervention during COVID. Businesses can use chapter 11 of the Bankruptcy Code to "restructure"

57. Complaint at 15, E2W LLC v. Kidzania Operations S.A.R.L., No. 1:20-cv-02866 (S.D.N.Y. filed Apr. 6, 2020).

58. Defendant's Sur-Reply in Opposition to Plaintiff's Application for Preliminary Injunction, E2W LLC v. Kidzania Operations S.A.R.L., No. 1:20-cv-02866 (S.D.N.Y. May 1, 2020).

59. E2W LLC v. Kidzania Operations S.A.R.L., No. 1:20-cv-02866 (S.D.N.Y. May 11, 2020) (order).

60. *See* sources cited at *supra* note 17.

61. *See* Morrison Foerster, *supra* note 12.

62. *See* Defendant's Sur-Reply, *supra* note 58.

debt, rather than liquidate under chapter 7, which often involves quick sales that reduce recoveries for creditors and eliminate jobs. Although restructuring "has no single template," it "typically involves the refinancing and discharge of debt, sale of certain lines of business, entity reconfiguration, and changes in management and personnel and firm governance."[63]

Chapter 11 restructuring is considered preferable to chapter 7 liquidation because it can preserve going concern value and the jobs and potential profit that come with it. Although both chapter 7 liquidation and chapter 11 reorganization are subject to judicial supervision, the latter is intended to be a consensual process, an "invitation to a negotiation."[64] If the debtor is unable to develop a "plan" by which it will reorganize that is acceptable to most creditors, it will have to liquidate—a result that most stakeholders in most debtors wish to avoid.

COVID increased pressure to use bankruptcy. Commercial chapter 11 bankruptcies grew by 14 percent in the first quarter of 2020 compared to the first quarter of 2019.[65] In May 2020, the number of companies filing for chapter 11 bankruptcies continued to rise, with a 48 percent increase compared to May 2019.[66] Even high-profile businesses were subject to chapter 11 filings due to COVID-induced economic harm. J.Crew became the first major U.S. retailer to succumb, filing for chapter 11 on May 4, 2020;[67] Gold's Gym filed for chapter 11 bankruptcy on May 4, 2020, due to coronavirus lockdowns;[68] and Neiman Marcus filed on May 7, 2020, due to financial struggles caused by COVID shutdowns.[69] The Hertz car rental company may be the largest and most notable of the chapter 11 filings thus far.[70]

Although chapter 11 is a negotiated process, it still depends on courts, and judicial resources are likely to be under considerable strain as a result of the pandemic.[71] While bankruptcy can cast a broader remedial net than traditional civil

63. Kathleen G. Noonan et al., *Reforming Institutions: The Judicial Function in Bankruptcy and Public Law Litigation*, 94 Ind. L.J. 545, 548 (2019).

64. *See In re* Arnold, 471 B.R. 578, 592 (Bankr. C.D. Cal. 2012) (quoting Elizabeth Warren & Jay Westbrook, The Law of Debtors and Creditors 397 (6th ed. 2009)).

65. *Commercial Chapter 11 Bankruptcies Increase 14 Percent in the First Quarter of 2020, Total Filings Down 5 Percent Before COVID-19 Financial Distress Fully Reflected in Filings*, Am. Bankr. Inst. (Apr. 6, 2020), https://www.abi.org/newsroom/press-releases/commercial-chapter-11-bankruptcies-increase-14-percent-in-the-first-quarter.

66. Khristopher J. Brooks, *Bracing for the Next Phase of the Coronavirus Recession: Bankruptcies*, CBS News (June 9, 2020, 3:30 PM), https://www.cbsnews.com/news/bankruptcy-coronavirus-recession-2020/.

67. *Our Announcement*, J.Crew, https://jcrewgrouprestructuring.com/our-announcement/ (last visited June 24, 2020).

68. *Information About the Gold's Gym Chapter 11 Restructuring*, Gold's Gym, https://www.goldsgym.com/restructure/ (last visited June 24, 2020).

69. *Neiman Marcus Group Enters into a Restructuring Support Agreement with a Significant Majority of Its Creditors to Substantially Reduce Debt and Position the Company for Long-Term Growth*, Neiman Marcus Grp., http://neiman.gcs-web.com/static-files/2749e148-82d3-42d5-976e-f8fe331b4866 (last visited June 24, 2020).

70. *See* Chapter 11 Voluntary Petition, *In re* Hertz Corp., Case No. 20-11218 (Bankr. D. Del. filed May 22, 2020).

71. Benjamin Iverson et al., *Estimating the Need for Additional Bankruptcy Judges in Light of the COVID-19 Pandemic*, 11 Harv. Bus. L. Rev. (forthcoming 2020). The judiciary asked Congress for

litigation—the bankruptcy stay and estate are collectivizing mechanisms that can force all of a debtor's stakeholders to adjust—it remains an expensive approach, one that may be out of reach for many small- and medium-sized firms, even as Congress sought to make chapter 11 more attractive for such businesses shortly before COVID.[72] Even large businesses may resist. Scott Kirby, CEO of United Airlines, which has already been through chapter 11 once, declared that "we are not going to file for bankruptcy [because] . . . it's worse for shareholders, for creditors, for employees. It's worse for every constituent that we have."[73]

2.3 Coordination Problems

To say that bankruptcy is "worse" than something is to make a comparison. Chapter 11 may be bad, but it is almost surely better than shutting United Airlines down via a chapter 7 liquidation. Those are not the only options, however. Chapter 11 may not be as good as a bailout, which is what Congress delivered to many businesses and individuals, chiefly in the CARES Act and PPP.

Bailouts are not axiomatically problematic—if interest rates are low and there is not much alternative in the near term—but government subsidies offer little certainty. They may temporarily enable some recipients to pay some bills, but that will last only as long as Congress and the President remain ready, willing, and able to borrow and spend more. With a politically divided Congress—and a federal deficit likely to exceed 18 percent of GDP[74]—it was difficult to predict how much, or for how long, federal funds would flow. Bailouts are at best a brief and incomplete fix.

One might think that President Trump would have wanted to encourage parties to renegotiate their contracts in bankruptcy. His casinos did so in chapter 11 a record four times.[75] But that is not how the bailouts worked in the early days of

$36.6 million in supplemental funding and legislative reforms to help federal courts respond to COVID. Letter from John W. Lungstrum, Chair, Comm. on the Budget & James C. Duff, Sec'y, Judicial Conf. of the U.S., to Hon. Nita Lowey, Chairwoman, H. Comm. on Appropriations et al. (Apr. 28, 2020), https://www.uscourts.gov/sites/default/files/judiciary_covid-19_supplemental_request_to_house_and_senate_judiciary_and_approps_committees.4.28.2020_0.pdf.

72. Small Business Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079. The Coronavirus Aid, Relief and Economic Security Act, Pub. L. No. 116-136, § 1113 134 Stat. 281, 310–12 (2020), amends the SBRA by increasing the debt limit to $7.5 million, so that companies with larger debt loads can take advantage of its streamlined approach to chapter 11 reorganization.

73. Brian Sumers, *New United Airlines CEO Says No to Bankruptcy and Mandating Blocked Middle Seats*, Yahoo Fin. (May 28, 2020), https://finance.yahoo.com/news/united-airlines-ceo-says-no-212639883.html.

74. David Wessel, *How Worried Should You Be About the Federal Deficit and Debt*, Brookings (July 8, 2020), https://www.brookings.edu/policy2020/votervital/how-worried-should-you-be-about-the-federal-deficit-and-debt/ (citing Congressional Budget Off., An Update to the Budget and Economic Outlook: 2019–2029 (Aug. 2019)). The Congressional Budget Office estimated that the federal budget deficit was $2.7 trillion in the first nine months of fiscal year 2020, $2.0 trillion more than the deficit recorded during the same period last year. Congressional Budget Off., Monthly Budget Review for June 2020 (July 8, 2020), https://www.cbo.gov/publication/56458.

75. Three times under his command. The casinos owned and operated by President Trump appear to have set a record for repeat filings, with four sets of chapter 11 cases, in 1991–1992, 2004, 2009, and 2014, respectively. *See* Jonathan C. Lipson, *Making America Worse: Jobs and Money at Trump Casinos, 1997–2010* (Temple Univ. Beasley Sch. of L., Working Paper No. 2016-47, 2016) (presenting

the pandemic. The SBA, which ran the PPP, took the position that companies restructuring under chapter 11 were ineligible to borrow under this program,[76] even though neither the statutory nor regulatory criteria create this limitation.[77] The SBA stated that companies in bankruptcy cannot apply for PPP funds under the CARES Act because the Bankruptcy Code "does not require any person to make a loan or a financial accommodation to a debtor in bankruptcy."[78] The SBA based this opinion upon a determination that "providing PPP loans to debtors in bankruptcy would present an unacceptably high risk of an unauthorized use of funds or non-repayment of unforgiven loans."[79]

The SBA's position was irrational.[80] Corporate debtors in a chapter 11 case understandably need to finance their operations, which can require them to borrow more, which they can do pursuant to section 364 of the Bankruptcy Code.[81] Chapter 11 debtors can borrow while in chapter 11 only under this provision, and this provision creates a significant amount of oversight authority in, among others, bankruptcy judges and creditors. In other words, chapter 11 borrowing is not without risk, but includes important mechanisms to reduce that risk.

In any case, the whole point of the PPP was to help businesses that were in financial trouble. Being under judicial supervision should hardly be a disqualifier. The SBA's position was thus surprising because it was assumed PPP lending to chapter 11 debtors would advance the CARES Act's broad remedial goals.[82] The SBA, however, refused, and its refusals became the subject of litigation in chapter 11 cases, thus increasing the uncertainty of this path. Courts have

empirical study of employment and revenue patterns at Atlantic City casinos in connection with Trump casino bankruptcies).

76. Dykema Gossett, *Are Debtors Eligible to Receive PPP Loans? Bankrupt Companies and the SBA Wage War over Critical CARES Act Program Eligibility*, Lexology (May 5, 2020), https://www.lexology.com/library/detail.aspx?g=2d07536f-467d-46d5-9be6-89cd6043d1da.

77. *See supra* note 72. The SBA has argued that in order to obtain a PPP loan, a borrower must meet the requirements of section 7(a) of the Small Business Act, and this cannot be done if a borrower is a debtor in a bankruptcy proceeding. Dykema Gossett, *supra* note 76.

78. Business Loan Program Temporary Changes; Paycheck Protection Program, 85 Fed. Reg. 23450 (Apr. 28, 2020).

79. The SBA stated, in its Interim Final Rule issued on April 24, 2020, that "[i]f the applicant . . . is the debtor in a bankruptcy proceeding, either at the time it submits the application or at any time before the loan is disbursed, the applicant is ineligible to receive a PPP loan." *Id.*

80. This is a view some courts would seem to support. *See, e.g.*, *In re* Vestavia Hills, Ltd., 618 B.R. 294, 307 (Bankr. S.D. Cal. 2020) ("The SBA's reasoning here was anything but reasoned. Instead, its exclusion of chapter 11 debtors from participation in the PPP is arbitrary and capricious and it runs counter to clear Congressional intent, in excess of the SBA's statutory authority and in violation of 5 U.S.C. §§ 706(2)(A) and (C)."); *In re* Gateway Radiology Consultants, P.A., 616 B.R. 833, 854–55 (Bankr. M.D. Fla. 2020) (characterizing SBA prohibition on lending to chapter 11 debtors as "'illogical on its own terms'" and thus "arbitrary and capricious"). *But see In re* Hidalgo Cnty. Emergency Servs. Found., 962 F.3d 838, 841 (5th Cir. 2020) ("Under well-established Fifth Circuit law, the bankruptcy court exceeded its authority when it issued an injunction against the SBA Administrator.").

81. 11 U.S.C. § 364 (2018).

82. *See* Danielle Mashburn-Myrick & Patrick M. Shelby, *SBA: No, Bankrupt Companies Are Not Eligible to Receive PPP Loans*, Phelps (Apr. 28, 2020), https://www.phelps.com/sba-no-bankrupt-companies-are-not-eligible-to-receive-ppp-loans-4-28-2020.

gone different ways. Some have deferred to the SBA's decision.[83] One held that special provisions in the Bankruptcy Code precluding discrimination against debtors apply here, which unsurprisingly led to an appeal.[84]

Although both chapter 11 reorganizations and bailouts are important parts of the commercial response to COVID, both have important limits, in some cases self-imposed. Chapter 11 is expensive, and the CARES Act bailout may deter companies from using it. In any case, both suffer from uncertainties that may make economic recovery more difficult.

If neither judicial nor government intervention fully addresses the contracting crisis induced by the COVID shutdown, what remains? More private ordering. An important and under-appreciated solution to commercial challenges created by COVID would then be the Standstill/Forbearance Agreement.

3. Standstill/Forbearance Agreements

SFAs have received little academic attention, even though they can be a critical feature of commercial practice and could play an especially important role in addressing the unique economic challenges of COVID or similar events in the future.[85] They are, in simple terms, an agreement to refrain for some period from taking legal action that a party otherwise could take to resolve a dispute. Some sticklers might argue that there is a meaningful distinction between agreements involving "forbearance," "tolling," or "standstill."[86] While they do sometimes

83. *See, e.g.*, Cosi, Inc. v. Small Bus. Admin., No. 1:20-ap-50591 (Bankr. D. Del. Apr. 30, 2020) (bench ruling).

84. *In re* Hidalgo Cnty. Emergency Servs. Found., Case No. 19-20497, 2020 WL 2029252 (Bankr. S.D. Tex. 2020). In *Hidalgo*, the judge applied section 525(a) of the Bankruptcy Code, which provides that a government unit cannot "deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to . . . a person that is or has been a debtor under this title . . . solely because such bankrupt or debtor is or has been a debtor under this title." 11 U.S.C. § 525 (2018). On appeal, the Fifth Circuit "found one issue dispositive: under 15 U.S.C. § 634(b)(1), injunctions directed toward the SBA are absolutely prohibited." John T. Baxter, *The Fifth Circuit Sides with SBA on PPP Loan Issue, Dealing Blow to Debtors*, Nelson Mullins (June 29, 2020), https://www.nelsonmullins.com/idea_exchange/blogs/the_bankruptcy_protector/bankruptcy-rules/the-fifth-circuit-sides-with-sba-on-ppp-loan-issue-dealing-blow-to-debtors.

85. Alan M. Christenfeld, *Forbearance Agreements in Funded Credit Arrangements*, 42 UCC L.J. 385, 386 (2011) (observing that forbearance agreements "have been all but ignored by law reviews and other scholarly journals as well as by professional publications directed toward practicing lawyers"). A search of Westlaw's all-content database on December 13, 2020, at 9:43 AM using "TI(forbear! & (agree! contract))" found fifteen law review articles with the term "forbearance agreement" (or any near variation) in the title. Three were a set of case notes from the *Harvard Law Review* published between 1888 and 1901. *Contract—Consideration—Forbearance to Sue*, 2 Harv. L. Rev. 49 (1888) (discussing Rue v. Miers, 12 Atl. Rep. 369 (N.J. 1888)); *Contracts—Consideration—Forbearance*, 13 Harv. L. Rev. 148 (1899) (discussing Di lorio v. Di Biazio, 42 Atl. Rep. 1114 (R.I. 1899)); *Contracts—Consideration–Forbearance of a Bona Fide Claim*, 15 Harv. L. Rev. 316 (1901) (discussing Price v. First Nat'l Bank, 64 Pac. Rep. 639 (Kan. 1901)).

86. Christenfeld, *supra* note 85, at 387 ("Forbearance agreements are sometimes referred to as 'standstill agreements.' That label is unsuitable, however, because rarely do both parties to a forbearance agreement simply 'stand still.'"). The nomenclature of local cultures of practice does seem to recognize a difference between a "standstill" and "forbearance" agreement. The former is more often associated with hostile takeovers of corporations, while the latter is more often associated with debt default and workout. *Compare* Brian K. Kidd, *The Need for Stricter Scrutiny: Application*

differ in their practice settings—standstills tend to be more commonly associated with acquisitions, and forbearance with financial distress—the key features are the same: they reflect a voluntary decision to refrain from using, for a time, the formal legal system to resolve an actual or potential dispute.

The issues that an SFA covers will, to a significant extent, be driven by the dollars involved. A 2014 survey of 100 loan forbearance agreements involving an average amount of $24 million found that the single most common term—93 percent of the agreements had them—was an admission by the borrower of a default.[87] This is a bit surprising, both because it may trip cross-defaults for non-borrower affiliates[88] and because it would seem not to get at the heart of the matter, which is delimiting what is forborne and for how long. Cases involving companies with debt loads averaging $24 million are likely to have different, and more complex, needs than companies with debt loads of $240,000. Yet, the latter—small and medium-sized enterprises ("SMEs")—are both critical to the economy and suffer the uncertainties of the pandemic as much as, if not more than, larger companies.[89]

In all cases, SFAs in COVID or other similar events in the future will have to confront the same three commercial challenges identified in Part 1: (i) enforceability, (ii) network effects, and (iii) duration, and in particular delimiting exit. The first has probably received the most attention and is in many ways the least interesting. All present opportunities for innovation by lawyers, which they may wish to consider as the post-pandemic dust settles.

The discussion in this part draws on a model SFA ("Model SFA") that we developed and published through this journal's sibling, *Business Law Today*, which attempts to address some of these issues.[90] That model is aimed at SMEs on the theory that they are more plentiful in absolute numbers than large corporations and will lack the resources of larger companies, but their legal needs in COVID may nevertheless be significant.

3.1 Enforceability

As ordinary contracts, SFAs must meet the usual legal requirements. Although questions sometimes arise as to whether forbearance lacks consideration

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of the Revlon *Standard to the Use of Standstill Agreements*, 24 Cardozo L. Rev. 2517, 2522 (2003), *with* Christenfeld, *supra* note 85.

We also put to one side the somewhat metaphysical question whether the SFA is itself a "new" agreement or an amendment to the underlying contract.

87. Michael D. Hamilton, *Forbearance Agreement Analysis*, *in* Commercial Real Estate Financing: Structuring and Documenting Transactions in a Reviving Market (Am. L. Inst. Continuing Legal Educ. 2014).

88. *Id.* (noting that "this number seems extremely high").

89. Alexander W. Bartik et al., *The Impact of COVID-19 on Small Business Outcomes and Expectations*, PNAS (July 28, 2020), https://www.pnas.org/content/pnas/117/30/17656.full.pdf.

90. Lipson & Powell, *Model SFA*, *supra* note 23.

(because the obligor has a pre-existing duty to perform), most courts seem to find consideration for these purposes.[91]

Questions also sometimes arise as to whether the enforcement of an SFA supports or impedes "public policy." Bankruptcy courts have stated that "[p]erhaps the most compelling reason for enforcement of a forbearance agreement is to further the public policy in favor of encouraging out of court restructuring and settlements."[92] While it is "against public policy for a debtor to waive the prepetition protection of the Bankruptcy Code,"[93] waivers of specific protections (such as the automatic stay of foreclosure) may be permissible, again on a public policy analysis. Similarly, in the context of contests for control of publicly traded corporations, standstill agreements that would eliminate voting rights of shareholders may be struck on grounds that they violate public policy.[94]

Ultimately, however, the problem of enforcing a standstill, especially for SMEs, is likely to be practical: In breach on a large scale, most parties will be in little or no position to go to court to enforce the SFA and, indeed, keeping parties out of court is its whole point. Thus, the question arises whether, or to what extent, the SFA can be made, in effect, "self-enforcing."

The Model SFA was aimed not at large and well-resourced parties, who presumably have access to the sort of counsel that might draft an elaborate and bespoke SFA, and who can afford to litigate the SFA if need be, but instead at SMEs, who may lack the resources to hire a lawyer, but who may nevertheless benefit from an SFA.

The Model SFA defines obligors as "debtors" and obligees as "creditors," in part to capture the breadth of those terms as they are used in the Bankruptcy Code, and in part to make the Model fairly accessible to lay users. Under the Model, the creditor agrees to take no "legal action" during the agreed standstill period, which would include commencing a lawsuit or exercising self-help rights, while the debtor agrees not to sell its assets outside the ordinary course of business or otherwise fundamentally change its structure so as to disturb the creditor's basic expectations.

A distinguishing feature of the Model SFA is that it does not require the parties to identify and articulate the specific defaults that may exist under the underlying agreements. Instead, it merely uses recitals to alert the users to the fact that "the COVID-19 pandemic has caused, or may cause, substantial disruptions in commercial relationships and that . . . such disruptions may result in the breach of contracts between Debtor and Creditor."[95] This language seeks to frame for

91. MM Ariz. Holdings LLC v. Bonanno, 658 F. Supp. 2d 589, 593 (S.D.N.Y. 2009) ("Under New York law, forbearance of any length can constitute valid consideration." (citing Sun Forest Corp. v. Shvili, 152 F. Supp. 2d 367, 392 (S.D.N.Y. 2001))).

92. *In re* Cheeks, 167 B.R. 817, 819 (Bankr. D.S.C. 1994); *see also In re* DB Capital Holdings, LLC, 454 B.R. 804, 814 (Bankr. D. Colo. 2011) (approving stay waiver).

93. *In re* Huang, 275 F.3d 1173, 1177 (9th Cir. 2002).

94. Steven A. Baronoff, *The Standstill Agreement: A Case of Illegal Vote Selling and a Breach of Fiduciary Duty*, 93 Yale L.J. 1093, 1099 (1984) ("[R]estrictive voting provisions of typical standstill agreements violate public policy").

95. Lipson & Powell, *Model SFA*, *supra* note 23.

the parties the need for the SFA and that the legal consequences for them are problematic and uncertain.

Because the SFA is not geared toward lawyers, it cannot realistically ask the parties to try to catalogue the defaults under the operative agreement, or indeed even to ask that they recognize the existence of one at all. This not only relieves the parties of the obligation to figure this out, but also reduces the likelihood that, should there be later litigation over the use of the Model, the parties' adaptation of it would not be unduly prejudicial to either side (the debtor for having admitted a default; the creditor for having omitted one).

Although the Model SFA does not require the parties to catalogue defaults, it does require them to articulate in a general sense the issues of concern, describe the disruptions to the relationship caused by COVID in a provision on "scope,"[96] and specify a period of time during which the parties will forbear and toll applicable statutes of limitation. Because the duration of the pandemic seemed highly uncertain, the best the Model SFA could offer would be short-term (e.g., thirty- or sixty-day) increments. As discussed below, the model deliberately eschewed the use of an external reference point, such as delivery of a vaccine or declaration by a governmental authority.[97]

Unlike more elaborate SFAs, the Model SFA seeks to be self-enforcing in the sense that breach by either party is met with a stipulated remedy. If the debtor takes non-ordinary course action, the creditors' rights return as if the parties had not entered into the SFA; the creditors may again pursue legal action against the debtor. In the interest of developing a balanced agreement, the Model would also penalize creditors who take precipitous action during a standstill period, providing that they would lose interest or penalties that "would otherwise have accrued during the Standstill Period but for this Standstill Agreement."[98]

Thus, debtor and creditor have, in a sense, given modest hostages as a token of their commitment to stand still and forbear. In this sense, the Model SFA is self-enforcing because it contains mechanisms that do not merely define breach, but seek to deter it.

3.2 Network Effects

As discussed in Part 1 above, Glode and Opp focus on the economics of renegotiation in debt chains. They argue for public intervention in the form of subsidies to "downstream" (presumably smaller) borrowers and mandates constraining "upstream" (presumably larger) lenders.[99] Their analysis assumes,

96. *Id.* ¶ 1 (The "Standstill Agreement covers the rights and obligations provided for in the Underlying Agreement and those reasonably anticipated to arise with respect to the Underlying Agreement during the Term (as defined below) of this Standstill Agreement.").

97. The annotation to the Model SFA provides: "Nor is it linked to announcements by public authorities that it is safe to resume 'normal' economic activity because those announcements may come from different sources (e.g., the governors of different states) and in any case would be difficult to define." *Id.* ¶ 2.

98. *Id.* ¶ 8.

99. Glode & Opp, *supra* note 33, at 2.

consistent with the Model SFA, that a given debtor–creditor pair will be networked to others in ways that will be opaque to the other party (and indeed may be obscure to the party in the network) and that capacities for renegotiation will be affected by perceptions of one's position in the network. A borrower that believes its receivables are collectible is more likely to agree to terms that its creditors find acceptable, and vice versa. Their policy intuition seems to be that preserving value and relationships among SMEs may be more important than enabling better-resourced firms to maximize their legal rights.

The Model SFA was developed before the Glode and Opp paper was released, so their paper obviously had nothing to do with it. The Model SFA was, however, motivated by the shared concern that the pandemic could readily result in "massive cascades of defaults."[100] In principle, legal action would be permitted and, given certain strategic conditions, might be appropriate. But in a world where many commercial actors are both defaulting on their own obligations and declaring others in default, recourse to the ordinary legal systems seemed potentially destructive, and other public interventions too remote or uncertain:

> [T]he very courts' [parties'] approach may be swamped by the continuing crisis. Even where payment obligations are secured, in many instances it seems doubtful that exercising rights against collateral would meaningfully improve a secured party's position vis-à-vis its debtor. Mass foreclosures would be economically suicidal.[101]

Consistent with the Glode and Opp analysis and more general thinking about network contracting, the Model SFA assumes the existence of what Porat and Scott would call a "spiderless network," a system in which participants are connected by contract but in which there is no overarching authority, as might be the case with a trade association in which all network participants must or want to maintain membership.[102] In such situations, a coordinating mechanism that promotes rational decision-making and reduces friction will doubtless produce greater aggregate welfare.

Without such a mechanism, however, networks under pandemic pressures may fall apart rapidly. If the pandemic threatens to tear the web apart, then SFAs can be seen as temporary patches. Lacking a central authority—or public

100. Lipson & Powell, *Model SFA*, *supra* note 23.

101. *Id.*

102. Porat and Scott explain the difference between networks with and without "spiders" as follows:

> Some networks, for example, can deploy standard contractual mechanisms—whether in the form of a master contract as in the case of a franchise, or a bureaucratic contractual structure as in the case of trade associations—that support network collaboration. These relationships have a "spider in the web": a controlling party or hierarchy at the center of the network that facilitates network formation and maintains stability. Other networks, however, are fundamentally symmetric or parity based. Lacking a controlling entity, they are webs without any spider. In the case of these "spiderless networks," there are fewer legal mechanisms to control moral hazard and free riding risks during the period of network formation and operation.

Ariel Porat & Robert E. Scott, *Can Restitution Save Fragile Spiderless Networks?*, 8 HARV. BUS. L. REV. 1, 3 (2018).

actors who might proxy for them—interstitial SFAs may be the best that we can hope for in many cases.

3.3 Duration—Exit

As noted above, a special challenge of COVID has been uncertainty about duration. Unlike economic downturns, there may not be a gradual return to economic health. Instead, as suggested by the dramatic swings in GDP between 2020 Q2 and Q3, the economy may recover quickly, though unpredictably. SFAs may address this challenge through their choice of exit mechanism.

In the absence of breach of the SFA (which would be a form of exit that is comparatively easy to identify), the parties must decide whether to use the passage of time or some other marker to denote when the standstill has come to an end. The Model SFA recommended short increments of time because defining the "end" would otherwise be difficult.[103] It does not ask the parties to stipulate to an external event because "announcements by public authorities that it is safe to resume 'normal' economic activity . . . may come from different sources (e.g., the governors of different states) and in any case would be difficult to define."[104]

There are, however, costs to linking exit to time rather than an external benchmark. It will not be possible for the parties to define, ex ante, precisely how much time will be needed, so the best they can probably do is to specify short increments. At the same time, if the parties wish to do some business with one another on a modified basis until exit, the Model SFA provides for that.[105] But all of this requires the parties to negotiate and interact in ways that are not costless.

Still, continuous renegotiation may be preferable to many other alternatives. In some sectors, it may be possible to agree to an exit standard that is objective and appropriate, not unlike benchmarking interest rates to an index. But in most cases, SMEs will not have access to information that would make it plausible early in a crisis to say that a particular event or condition is the basis for reanimating the underlying agreement. Indeed, forced periodic check-ins may actually be a positive feature of an SFA precisely because they enable the parties to continuously adjust as conditions change.

4. Why Stand Still?

Viewed in a certain way, there is a puzzle at the heart of any claim that parties should enter into standstill/forbearance agreements. If the parties are already disposed to work together—as they were prior to disruption, and as they would have to be to enter into an SFA—what added benefit does an SFA offer? If the parties are already collaborating through calamity, in other words, why formalize

103. Lipson & Powell, *Model SFA*, *supra* note 23, ¶ 2.
104. *Id.*
105. *Id.* ¶¶ 5, 6.

that, especially if it is only likely to be temporary? The literature suggests behavioral, relational, and institutional answers.

4.1 The Behavioral Economics of SFAs

The behavioral explanation is rooted in recent work which emphasizes the psychological effects of formal contracting as a distinct performative act. Contracts are (or can be) "reference points" which function as behavioral markers.[106] We tend to endow others with greater trust once we have formalized an agreement in some way. The "solemnity that accompanies the writing of a legally binding contract," Hart and Moore have observed, "may help to give weight to the expectations and entitlements embodied in the contract."[107]

Standstill/forbearance agreements are complicated from this behavioral perspective. On one hand, they presuppose that the parties have already committed to some form of a reference point in the underlying agreement, and thus trust one another more than without one. On the other hand, external events would have led one or both parties to breach or worry about a breach significantly. This anxiety may have drained whatever quantum of trust previously existed between the parties based on the underlying agreement.

While it will have to await empirical study, it seems plausible that entering into an SFA can function as a temporary reference point for parties enduring a shared destabilizing event such as COVID. The act of confronting the possibility of breach (without necessarily requiring elaborate specification) and negotiating to some sort of intermediate resolution may have a number of behavioral benefits, including that it might help to clarify capacities for cooperation, identify areas for adjustment, and preserve or restore trust, which would be especially valuable as and when the end of the crisis comes into focus. While "trust" at an individual level is not necessarily the same thing as trust at the organizational level, it is not difficult to see the intuition that the device of an SFA may have behavioral benefits internal and external to firms that use them.[108]

Consistent with the findings of Jennejohn, Nyarko, and Talley, there is evidence that contract parties tend to underinvest in precautions against catastrophic events, such as pandemics.[109] This may leave SMEs especially vulnerable to

106. Ernst Fehr, Oliver Hart & Christian Zehnder, *Contracts as Reference Points—Experimental Evidence*, 101 Am. Econ. Rev. 493, 518–22 (2011); Oliver Hart & John Moore, *Contracts as Reference Points*, 123 Q.J. Econ. 1, 5–13 (2008). Or, more complicated, they might be "classification institutions." *See* Gillian K. Hadfield & Barry R. Weingast, *What Is Law? A Coordination Model of the Characteristics of Legal Order*, 4 J. Legal Analysis 471, 472–74 (2012).

107. Hart & Moore, *supra* note 106, at 12–13. Or, as Hoffman and Wilkinson-Ryan put it, "the moment of contracting is a reference point: at moments before contracting, we take precautions against harm; afterward, we lower our defenses." *See* David A. Hoffman & Tess Wilkinson-Ryan, *The Psychology of Contract Precautions*, 80 U. Chi. L. Rev. 395, 397 (2013).

108. For an interesting discussion of the distinction between individual- and firm-level trust, see Uriel Haran, *A Person–Organization Discontinuity in Contract Perception: Why Corporations Can Get Away with Breaking Contracts but Individuals Cannot*, 59 Mgmt. Sci. 2837 (2013).

109. *See* Jennejohn et al., *supra* note 20; Howard Kunreuther, Robert Meyer & Erwann Michel-Kerjan, *Overcoming Decision Biases to Reduce Losses from Natural Catastrophes*, *in* Behavioral Foundations of Public Policy 398, 401–08, 411 (Eldar Shafir ed., 2013).

uncertainty going into an extraordinary event like COVID. But it also creates pressure, and thus an incentive, to reframe the relationship temporarily through an SFA. Where parties have failed to provide elaborate definitions of what constitutes a *force majeure,* for example, they will then have to muddle through when one occurs. Perhaps because the underlying agreement fails to so specify, or because litigation would be needlessly costly, the parties would have a greater inclination to restabilize their relationship. An SFA is a temporary way to adjust and reaffirm expectations when placed in doubt on a large scale.

4.2 Relational Contract and SFAs

The behavioral thus begets a relational story. "Relationalism" is the idea that contract in a formal sense—meaning the words in the writing and the black-letter law that backstops it—is both more and less than the relationship of the parties to the contract. It rejects the view that a contract is merely "the paradigm transaction of traditional contract law, [the] discrete transaction."[110] Rather, relationalism focuses on "the commitment that [parties] have made to one another, and the conventions that the trading community establishes for such commitments."[111]

Relationalists acknowledge that formal contract law matters more in certain moments, such as when the parties expect no further dealings (e.g., as in a merger or acquisition) or when a relationship has failed irreparably.[112] The relational intuition behind an SFA, however, is that even if COVID has caused (or may soon cause) breach, the parties should not marshal their legal rights, but instead negotiate a short-term, second-order contract that seeks presumptively to preserve the relationship in order to enable the parties to figure out how to adjust it.

Lisa Bernstein has observed in a slightly different context that network contracts may use "interior" remedies, systems within a formal contract to incentivize compliance without resorting to conventional legal remedies or contract

110. *See* Jay M. Feinman, *Relational Contract Theory in Context*, 94 Nw. U. L. Rev. 737, 741 (2000) ("Relational contract simultaneously dramatically broadens and dramatically fragments the scope of contract law as compared to neoclassical law."); Victor P. Goldberg, *Relational Contract*, *in* The New Palgrave Dictionary of Economics and the Law 289, 292 (Peter Newman ed., 2002) (defining "relational contract").

111. Robert W. Gordon, *Macaulay, Macneil, and the Discovery of Solidarity and Power in Contract Law*, 1985 Wis. L. Rev. 565, 578. Goetz and Scott provide the following:

> A contract is relational to the extent that the parties are incapable of reducing important terms of the arrangement to well-defined obligations. Such definitive obligations may be impractical because of inability to identify uncertain future conditions or because of inability to characterize complex adaptations adequately even when the contingencies themselves can be identified in advance . . . . [L]ong-term contracts are more likely than short-term agreements to fit this conceptualization, but temporal extension per se is not the defining characteristic.

Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 Va. L. Rev. 1089, 1091 (1981).

112. Stewart Macaulay, *An Empirical View of Contract*, 1985 Wis. L. Rev. 465, 470–71, 475.

termination.[113] If, for example, a buyer such as Starbucks discovers a violation of its supplier code of conduct, it may not seek traditional contract remedies at all, but instead "develop and implement a corrective action plan."[114]

SFAs can be seen as a kind of interior remedy, at least when they become salient in a crisis like COVID. They are by definition not within the underlying agreement, but they are an ex post mechanism to remediate a problem without resort either to the legal system or to walking away from the relationship. They are an extension of the underlying agreement and may be a bridge to a new and different contract, to a later return to the original agreement, or to a decision to end the relationship. They are weighted in favor of preserving the parties' relationship if possible, but in any event of providing time and space in which the parties may peer around the corner together, rather than turning their sights on one another.

In all but a small number of cases, SFAs are likely to be better for the parties than any form of judicial intervention, whether litigation or bankruptcy. Either of those paths is likely to be costly in terms of professional fees and managerial energy and, ultimately, the parties' relationship. While reorganization under chapter 11 may preserve some relationships, it will terminate or distort many others. Straight contract litigation is likely to kill most relationships.

In either case, those that seek to survive (that is, not simply to liquidate their own business) will be faced with equally difficult decisions, such as whether to switch to other contract counterparts or simply to do without. Switching costs are often high, and the uncertainties of the pandemic would seem to exacerbate that. Establishing new relationships in a crisis may be fraught if the parties have had little pre-pandemic experience with one another and little reference for how to assess performance going forward, due to the inherent uncertainty of the situation and the fact that most market actors and their relationships are strained.

A standstill/forbearance agreement, by contrast, may support efforts to obtain new financing, whether from the government or privately. As noted above, the SBA has taken the position under the PPP not to approve lending to companies in chapter 11, and the pendency of significant litigation may deter private lenders from offering new financing. It will almost certainly be better for a firm to tell a new source of capital that it has its relationships with major contract counterparts under control (i.e., not in active dispute). The fact that it has entered into a standstill may signal a collaborative capacity and cautious optimism, which may be a credible source of comfort to new investors.

This is not to say that commercial relationships should be preserved at all costs. Many relationships are fragile, and an event like COVID may reveal for

113. *See, e.g.*, Lisa Bernstein, *Beyond Relational Contracts: Social Capital and Network Governance in Procurement Contracts*, 7 J. Legal Analysis 561, 571 (2015) (observing that most master supply agreements she studied "contain a self-help damage remedy that enables buyers to obtain some monetary compensation without ending a relationship," which she characterizes as "interior remedies").

114. *See Starbucks Disclosure in Compliance with California Transparency in Supply Chains Act of 2010 (SB 657)*, Starbucks, https://globalassets.starbucks.com/assets/2994ceff517a44aca17df6f1237c4c13.pdf [https://perma.cc/FJP9-G93H] (last visited June 30, 2020).

the parties that they are better off without each other. Moreover, some relationships are predatory or parasitic. COVID may not change that and, indeed, may make it worse. Judicial intervention may be warranted and an SFA may not always be cost justified.

4.3 Private Order and Public Good

Still, there is a deep preference for private order, such as an SFA, which, used on a large scale, may externalize benefits in ways that have positive institutional effects.

Contract is almost always conceived as a form of "private order."[115] This view, however, tends to distract us from the public implications of contracting behavior. SFAs may show how private order can, at scale under certain conditions, produce public good as part of larger efforts to restabilize the economy.

The claim that contract can have public benefits is not new but is largely omitted from modern discourse. In 1933, in the depths of the Depression, Morris Cohen first argued that contract can and does perform a public function.[116] Although Cohen admitted that many private theories of contract had deep roots in history and religion—and remained vital even then—contract in a large and complex economy should be understood as a "subsidiary branch of public law."[117]

Cohen went further than simply arguing that contract recruited government in service of ex post enforcement. It was also an ex ante mechanism to implement public power. Cohen conceived of contract

115. Lon Fuller, one of the most influential contract theorists of the twentieth century, stated matter-of-factly that "[a]mong the basic conceptions of contract law the most pervasive and indispensable is the principle of private autonomy." Lon L. Fuller, *Consideration and Form*, 41 Colum. L. Rev. 799, 806 (1941). Duncan Kennedy has observed that Fuller's "'principle of private autonomy' [was] first among equals" of the possible justifications for a regime of private promissory ordering. Duncan Kennedy, *From the Will Theory to the Principle of Private Autonomy: Lon Fuller's "Consideration and Form,"* 100 Colum. L. Rev. 94 (2000).

116. Morris R. Cohen, *The Basis of Contract*, 46 Harv. L. Rev. 553 (1933). Others in this vein included Louis Jaffe (Louis L. Jaffe, *Law Making by Private Groups*, 51 Harv. L. Rev. 201, 211 (1937) (arguing "our inherited state machinery [was] inadequate to determine the content which is currently demanded of law")), and Robert Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 Pol. Sci. Q. 470 (1923).

117. As he argued:

> The law of contract, then, through judges, sheriffs, or marshals puts the sovereign power of the state at the disposal of one party to be exercised over the other party. It thus grants a limited sovereignty to the former. In ancient times, indeed, this sovereignty was legally absolute. The creditor acquired dominion over the body of the debtor and could dispose of it as he pleased. But even now, when imprisonment for debt has been, for the most part, abolished, the ability to use the forces of the state to collect damages is still a real sovereign power and the one against whom it can be exercised is in that respect literally a subject. . . . From this point of view the law of contract may be viewed as a subsidiary branch of public law, as a body of rules according to which the sovereign power of the state will be exercised as between the parties to a more or less voluntary transaction.

Cohen, *supra* note 116, at 586.

> [N]ot only as a branch of public law but also as having a function somewhat parallel to that of the criminal law. Both serve to standardize conduct by penalizing departures from the legal norm. Not only by decrees of specific performance or by awards of damages, but also by treating certain contracts as void or voidable and thus withholding its support from those who do not conform to its prescribed forms, does the law of contract in fact impose penalties.[118]

Cohen conceded a role for courts but also recognized the public benefits that would flow from the "standardized conduct" and "prescribed forms" induced by the threat of judicial intercession. In Cohen's vision, contract was neither wholly private nor wholly public, but instead a means of institutional intermediation, a recognition that contracts inherently and inevitably interact with larger social forces. Although "[c]ontracts are voluntary, fixed, and temporary," and "institutions are socially hereditary, grow, and last longer," contracts "grow into institutions."[119]

Cohen's claim about the public nature of contract law—that it not only used public law, but also advanced it—was radical at the time, perhaps a response to severe economic disruption in the Depression. It has largely been abandoned because, as Brian Bix has observed, it was perhaps too obvious.[120] But events such as COVID show that it remains vital. In a world where a pandemic can suddenly render many contracts in or near breach, the contractually connected nature of commerce means that such an event could produce overwhelming cascades of default.

The model of "debt chains" developed by Glode and Opp makes this plain.[121] When all or most links in that chain are shocked by an exogenous event, the structure is more likely to survive if the links can be annealed through mechanisms such as SFAs. Private order in the form of SFAs can thus produce an underappreciated form of public good by preserving economically viable relationships, reducing pressure on courts, and facilitating access to public resources.

Used widely, SFAs can create some of the benefits of a chapter 11 reorganization without the costs or risks of that process. They induce an agreed "stay" of legal hostilities while permitting and promoting renegotiation. While they cannot directly affect commercial actors not party to them (that is to say, others in the parties' networks), if Glode and Opp are correct, they provide a formal way of restabilizing and perhaps better defining discrete pairs of relationships which can, in turn, help to stabilize other pairs of connected relationships.

The temporary certainty of an SFA can, in short, "creat[e] space and time to communicate—to adjust or forgive obligations; to create new, more plausible

118. *Id.* at 589.

119. *Id.* at 590 (citing Hauriou, Principes dr Droit Public a l'Usage des Etudiants en Licence et an Doctorat es Sciences Politiques 196–219 (2d ed. 1916)).

120. Brian H. Bix, *Contract Law and the Common Good*, 9 Wm. & Mary Bus. L. Rev. 373, 388 (2018) ("Morris Cohen's connection in his earlier article between Contract Law and the public interest seems equally obvious, and perhaps ignored in a similar way *because* of its salience.").

121. *See generally* Glode & Opp, *supra* note 33.

ones."[122] This, we believe, is "a critical precondition to economic restabilization and. . . growth."[123]

Conclusion

In moments of severe disruption, we tend to look to forces larger than ourselves for support and guidance. Often, those forces will be public actors. While public interventions have played an important role in responding to COVID, they have been problematic. This essay has explored the role that SFAs have played, and can play, in a crisis like COVID. Properly designed, SFAs can enhance solutions to contract problems of enforceability, network effects, and exit that COVID created for many commercial actors. While public intervention remains crucial, private order has proven to be an unusually important supplement to or substitute for whatever government may try to do in the COVID pandemic, and perhaps in the next.

122. Lipson & Powell, *Model SFA*, *supra* note 23.
123. *Id.*