

COVID-19: Force Majeure Event?

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Practice Area: Business and Corporate Law

With COVID-19 causing the government to impose increasingly more extreme containment measures and more restrictive quarantines, businesses across the country are being forced to consider their ability to fulfill contractual obligations. Lack of workforce, lack of supplies, and lack of certainty have already caused some businesses to file lawsuits over the inability to meet contractual obligations. This *Legal Update* discusses the pandemic's effects on business performance and some contractual options businesses should consider going forward.

What is force majeure?

Under general principals of contract law, a party has a defense against performing under a contract where performance becomes impossible due to unforeseeable events outside of the parties' control. These unforeseeable events are called "force majeure" or "acts of God." Parties to a contract can negotiate who bears the risk of these events using a force majeure clause. A strong force majeure provision will at minimum define (1) what constitutes a force majeure (e.g. fire, flood, war), (2) what happens when a force majeure event occurs, including what remedies the parties have (e.g. the parties are excused from performance, the obligations are delayed until the event ends, etc.), and (3) what is required from the parties to take advantage of these remedies (e.g. sending notice to the other side).

What are typical force majeure events?

Force majeure clauses vary substantially in what events are covered and may be subject to significant negotiation prior to entering a contract. Some clauses include a finite list of force majeure events in an attempt to narrow the clause's applicability and thereby excuse performance less often. Some commonly listed force majeure events include natural disasters such as floods, earthquakes, hurricanes, epidemics and quarantines; war; terrorist acts; government action such as eminent domain or changes in laws; union activities such as strikes and slow-downs; and shortages of necessary materials. Other force majeure clauses attempt to broaden the applicability to any unexpected eventuality outside the parties' control by including an open-ended catch-all at the end of the force majeure events such as "all other acts beyond the parties' reasonable control."

How can pandemics prevent contractual performance?

Pandemics can cause a variety of issues for businesses that ultimately impact the ability to perform under a contract. Companies may face a significant workforce shortage as employees become unable to work due to sickness or quarantine (whether self-imposed by the employees or imposed by the business itself or an applicable governmental body). In turn, workforce shortages in affected regions can have a ripple effect even in regions unaffected by the pandemic. The lack of essential supplies or raw materials from one region of the world can also halt production of business elsewhere.

Why might COVID-19 be construed as a force majeure event?

In response to COVID-19, federal, state, and local governmental entities have imposed various containment strategies that will undoubtedly have a trickle-down effect on companies' ability to fulfil contractual obligations. The federal government has placed travel restrictions on international travel. Domestically, individual states and cities have imposed various levels of containment measures such as closing schools, restaurants and bars, and prohibiting gatherings of more than 50 people. These strategies - intended to slow the spread of the COVID-19 outbreak - may eventually lead to workforce and resulting supply shortages. Parties facing these shortages may point to these effects as a means to avoid contractual performance, depending on the specific language in a force majeure provision.

Because of COVID-19, we cannot perform under our contract. Can we use the force majeure provision?

While relatively few cases have interpreted the impact of pandemic on force majeure clauses, previous cases do offer some guidance. Courts have found that generalized economic hardship or increase in expenses, without more, does not constitute a force majeure event. As a result, it will be difficult to avoid an obligation to purchase goods or services merely because customer demand has decreased. Also, even if an unforeseeable and extreme disaster occurs, a contract's force majeure provision will still control with regard to the parties obligations and may override other common law defenses used to avoid performance. For this reason, it is imperative that companies read contracts closely, or consider engaging counsel, to determine what rights they have before acting (or not acting) on a contract. Finally, courts are split as to whether intervening governmental acts (such as changes of regulations, emergency declarations, etc.) will excuse performance under contract, but the contract itself will still likely control as to which party bears the risk of the nonperformance.

If we think we have an arguable basis for invoking a force majeure clause, what do we do?

Businesses anticipating an impending breach of contract from the effects of COVID-19 need to act quickly to mitigate potential damages. Below are some suggested actions to take:

1. **Look For A Force Majeure Clause.** First, review the contract closely and determine whether the contract has a force majeure provision.
2. **Analyze the Clause.** If the contract does have a force majeure clause, analyze whether pandemic might constitute a force majeure event under the terms of the specific provision and then what effect this has on contractual obligations. This may require some amount of interpretation and potentially drawing similarities to previous cases. Engaging legal counsel in this initial stage may be crucial to acting efficiently and decisively to make the best possible arguments that performance is excused.
3. **Communicate Early and Effectively.** Determine what notice is required under the force majeure provision. Some force majeure clauses will require the party suffering a force majeure event to notify other parties of its inability to perform within a certain time frame.

What should we look for in contracts going forward?

Despite quarantines and the potentially resulting reduction in workforce or other adverse effects of a pandemic, the show must go on for many businesses. In light of this evolving reality, companies should take special precaution in entering contracts to understand any applicable force majeure provisions including what will trigger the provision and who bears the risk of a force majeure event. Because it may become more difficult to argue that a pandemic was unforeseeable the longer the pandemic goes on, companies should be hesitant to rely on broadly drafted force majeure provisions. Rather, we recommend expressly including pandemic (and, perhaps for the time being, COVID-19 by name) in the list of force majeure events in contracts going forward.

Parties should further consider pointing to discrete events as triggers for force majeure provisions. For instance, a contract might expressly provide that the parties are relieved of their duties under the contract only upon an emergency declaration by the President of the United States, upon a pandemic declaration by the World Health Organization, upon a certain number of confirmed cases in a jurisdiction, or some other specific and discrete event.

Parties should also consider the potential remedies triggered by force majeure events such as, for example, excusing performance only until the end of the emergency declaration or providing a party the option to purchase a lesser quantity of goods. As with most contractual provisions, force majeure clauses offer significant flexibility to the parties in implementing more creative, flexible solutions to the default rules. In negotiating and drafting better force majeure provisions, all parties can enjoy better outcomes in contractual relationships and better mitigate the risk of unexpected events.

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