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## **IMPACT OF CORONAVIRUS ON CONTRACTS – FORCE MAJEURE CLAUSES**

The main focus of the coronavirus outbreak has been, understandably, on its health impact. But it has also had – and will continue to have – a significant economic and legal impact.

“Force majeure” clauses in commercial contracts, while sometimes overlooked, are being tested by travel restrictions, supply chain disruptions, and public fears. These clauses identify a series of events beyond a party’s control that will excuse the performance of the affected party. Among contracts, however, the requirements of these clauses frequently differ. Further, while the current outbreak has largely involved supply chain contracts (mainly due to closed factories in the most affected areas), it is quickly becoming an issue with other types of commercial contracts (*e.g.*, venue agreements, financing agreements, etc.).

Accordingly, it is important for businesses to review their current contracts to assess and understand the implications of a force majeure clause (or lack thereof) – along with other related clauses in connection with the constantly changing environment – and to manage legal risks in future contracts by addressing potential pandemic-type events.

This article focuses on the structure and implications of force majeure clauses, and provides guidance to practitioners and businesses on assessing and managing the issues surrounding them.

### **Relevant Agreement Provisions**

Naturally, the first step in the review process is to determine if the subject contract contains a force majeure clause. But it is also imperative to review other provisions in the contract that may relate to such a clause, such as representations/warranties, breach, termination, material adverse change/effect, and governing law.

For example, the breach and termination provisions may supplement the force majeure provisions, or may otherwise provide additional relief options. A material adverse change/effect clause may give one party the right to escape or delay performance or even terminate the agreement. Further, the governing law clause should provide guidance on how both the force majeure provision, and the contract as a whole, will be interpreted.

Additionally, another relevant factor is the jurisdiction by which interpretation of the contract will be governed. Some jurisdictions tend to construe force majeure provisions narrowly. Other jurisdictions may even permit an implied force majeure theory, in the absence of a specific force majeure provision.

### **Definition of Force Majeure Event**

What exactly constitutes a force majeure event can vary widely among agreements. Many such provisions include a specific list of examples, or may specifically list words like “disease,” “pandemic,” “quarantine,” or even “government action.”

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The contract reviewer must also be careful to determine whether the specific list is exhaustive, or just examples of a broader concept. For example, if the agreement states that “neither party will be in breach of this Agreement where the failure results from fire, flood, Act of God, [etc.],” then a force majeure event only occurs if one of the listed items occurs. If, however, the agreement states that “neither party will be in breach of this Agreement where the failure results from any cause beyond such party’s reasonable control, including fire, flood, Act of God, [etc.],” then a force majeure event can occur if any event beyond the party’s reasonable control occurs – not just if one of the specified events occurs.

It is generally easier to make a force majeure claim if the event is specifically listed, as the broader language may be interpreted differently based on the governing law. By the same token, the agreement may contain exemptions to the force majeure events (*e.g.*, an agreement may state that changes in demand cannot lead to a force majeure event).

## **Cause/Effect/Mitigation Obligations**

Even if the coronavirus outbreak is clearly included within the definition of force majeure events, the outbreak must be the cause of the party’s inability to perform, in order to be able to invoke force majeure. Some force majeure provisions even include specific mitigation language, such as requiring the affected party to demonstrate it has used commercially reasonable efforts to avoid or mitigate the event and its consequences.

In certain cases, a mitigation obligation can be implied. For example, if a party is relying on a broader “event beyond its reasonable control” definition (rather than a specifically listed event), the failure to take potential proactive actions (*e.g.*, telling workers to stay home, implementing back-up plans) could adversely affect that party’s ability to claim that the event was beyond its reasonable control. Given the amount of attention given to the coronavirus outbreak, we believe that a party must take at least some mitigating steps prior to having the right to make a force majeure claim.

Another determinative factor is what the impact was on the affected party’s performance. Some provisions include very high thresholds, such as requiring that the force majeure event “prevented” performance, or made performance “illegal” or “impossible.” Other provisions have lower thresholds, only requiring that the event “delayed,” “hindered,” or “rendered impractical” performance. These lower thresholds can be met even if performance still remains possible. For higher thresholds, a party may have to wait until governmental action is taken before its ability to perform becomes impossible. Poor performance or increased cost alone may not be enough to meet a threshold.

It is also important to assess the applicable obligations themselves. For example, if you have an agreement with a venue for a convention or meeting, and most of your attendees have cancelled due to coronavirus concerns, you will likely want to try and invoke a force majeure clause. It is unlikely, however, that one of your obligations under the agreement that you must hold the convention or meeting. Rather, you will have an obligation to *pay* for the convention or meeting, regardless of whether it is actually held. Accordingly, while the outbreak may have caused the cancellations, it likely will not have prevented your ability to pay the venue. And, even if there is a lower threshold such as “hindered,” it would still likely be a challenge to claim that the cancellations hindered your ability to pay for the convention (unless you have few other sources of income).

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Further, you should determine what type of notice you must provide to the other party in connection with your force majeure claim – as the clock may already be ticking. The ability to assert a force majeure clause may be conditioned upon giving notice to the other party (*e.g.*, “the ability to terminate this agreement without liability is conditioned upon delivery of written notice to the other party setting forth the basis of the determination as soon as reasonably practical, but in no event longer than 10 days.”). Failure to provide the required notice within the required time period may prevent you from making the force majeure claim.

## **Remedies/Implications**

The implications of – and the remedies available for a party as a result of – a force majeure event also vary among agreements. Important considerations include:

- Are all of the affected party’s obligations excused, or only those that are directly related to the force majeure event? Are the non-affected party’s obligations also excused?
- Are the affected party’s obligations only suspended until the applicable force majeure period ends (or some period thereafter), or are such obligations terminated in their entirety? The affected party may have the option to either suspend or terminate such obligations.
- If the force majeure event continues for a certain period (*e.g.*, 30 days), does the affected party (or do both parties) have the right to terminate the agreement? Pay particular attention to when such period begins (*e.g.*, does it begin upon the occurrence of the force majeure event or when the affected party provides notice to the other party?).
- Does a party have the right to renegotiate or amend certain terms of the agreement (*e.g.*, pricing clauses)?

## **Additional Considerations**

In addition to performing a thorough review of the applicable agreement, and prior to invoking any force majeure clauses, you should also consider the following:

- Whether insurance may cover losses arising out of a party's failure or inability to perform due to the force majeure event. Certain insurance coverages, such as business interruption, force majeure, or political risk, may be applicable. Ultimately, however, coverage will be determined by a policy’s specific terms and conditions.
- What impact will the force majeure claim have on other agreements or obligations, such as financial agreements or other disclosure obligations. Many financing agreements include covenants to provide notice of potential or actual material adverse events or losses.
- Whether there are alternative means to perform the applicable obligations under the agreement, or preemptive actions that can be undertaken to mitigate/prevent future effects of the force majeure event.
- Whether to engage the other party in discussions, as they may be willing to work with you to adjust the agreement or otherwise negotiate a compromise. Often, the other party realizes that maintaining good relations may lead to future business, and they will not want to burn bridges or damage their reputation.

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## Conclusion

The environment regarding the coronavirus outbreak continues to fluctuate daily. Circumstances that today may not permit invoking a force majeure clause may change if things get worse, and governmental and legal requirements may add restrictions and limitations on your ability to perform your obligations.

You should continue to monitor the situation, and keep detailed records regarding the impact that the outbreak has on your business. You should pay particular attention to evidence demonstrating your impossibility or inability to perform under any agreements. Ultimately, whether you will be able to successfully invoke a force majeure clause will depend on the language in the agreement and its application to the circumstances. For all newly negotiated agreements, however, you should pay close attention to the force majeure clause, and strongly consider including a specific reference to an epidemic or similar event.