

## FORCE MAJEURE

COVID-19 has had drastic effects on the marketplace causing the cancellation of major events as well as significant disruptions in supply chains. In this volatile economy, companies must be aware of their contractual obligations as well as what they may encounter from other parties with whom they have contracted. Your company may be faced with contracting parties that indicate they are unable to perform due to the ongoing crisis or your own company may itself have difficulties in performing its obligations. As such, you should be aware of contract terms, most notably force majeure clauses, as well as other legal doctrines that may affect a party's obligation to perform a contract.

### I. FORCE MAJEURE CLAUSES

A force majeure clause is a contract provision that excuses, for a period of time, one or both parties' obligation to perform when circumstances arise that are beyond the control of a party thereby making the contract impractical or impossible to perform. Force majeure clauses can vary substantially, but often include the following:

- Acts of God, such as severe weather events and national disasters like flooding, earthquakes and hurricanes;
- War, terrorism, and acts of war or terrorism;
- Labor strikes and labor disputes;
- Governmental acts such as condemnation or changes in laws or regulations such as the many "shelter in place" orders that are going into effect in various states; and
- Epidemics and pandemics as may be seen with COVID-19.

Determining whether a force majeure event covers your particular situation is a fact intensive inquiry. First, if you seek to have your performance excused, you must demonstrate that the event in question is one of the itemized events in a force majeure clause. Second, you must show that the force majeure event is the direct cause of the inability to perform. Bear in mind that courts may interpret force majeure clauses narrowly understanding that if the parties agreed in advance how to allocate various risks, those agreements should be enforced as written. Further, mere economic hardship does not usually constitute a force majeure event. Instead, it typically must be a legal or physical restraint to excuse the performance of a contract.

COVID-19 and related governmental actions such as shutdowns and shelter in place orders may present a strong basis to invoke force majeure clauses. Further, a quasi-governmental agency in

China, the China Counsel for the Promotion of International Trade, has provided some companies with force majeure “certificates.” Thus, a Chinese business that has been “certified” in a contract governed by Chinese law would likely be successful in invoking a force majeure clause. There are, of course, broader implications. These same companies may supply other businesses further up the supply chain who may also attempt to use the certification as a means to invoke a force majeure clause.

## **II. OTHER RELEVANT LEGAL DOCTRINES**

If you have a contract that does not have a force majeure clause or if it may not successfully be invoked, there are other legal doctrines that may be considered. Under the Uniform Commercial Code (“UCC”) generally governing the sale of goods in the United States, the doctrine of impracticability excuses the performance of a contract when performance is made impracticable by an event the non-occurrence of which was a basic assumption on which the contract was made. Significantly, the UCC also provides that good faith compliance with any applicable foreign or domestic governmental regulation, even if they later prove to be invalid, may also be a legal excuse for non-performance. In conjunction with asserting rights under this doctrine, sellers of goods to multiple parties are required to allocate their supply in a reasonable fashion and are required to provide timely notice to buyers. For contracts not involving goods, the doctrine of impossibility may be invoked. This doctrine excuses performance not only when a contract is impossible to perform but also when it is impracticable because of extreme and unreasonable difficulties.

The Convention on Contracts for the International Sale of Goods (“CISG”) generally applies to contracts for the sale of goods between companies located in the 93 countries that are a party to the Convention and governs a significant proportion of world trade. CISG employs similar concepts and provides that a party is not liable for failing to perform upon proving the failure was due to an impediment beyond the party’s control and that the impediment could not reasonable have been taken into account at the time of contracting.

Another possible doctrine excusing a party’s obligation to perform is the frustration of purpose doctrine. Frustration of purpose is a defense to the enforcement of a contract that may be asserted when an unforeseen event undermines a party’s principal purpose for entering a contract. In such cases, the actual performance of the contract is significantly different from performance of the contract as was originally contemplated by both parties and both parties knew of that purpose at the time of contracting. In other words, a frustration of purpose occurs when a change in circumstances makes one party’s performance of its contractual obligations essentially worthless to the other. In assessing whether this doctrine applies, parties should understand that economic adversity alone is not enough to invoke this as a defense to performance.

## **III. PRACTICAL SUGGESTIONS**

Understanding that each situation is unique and that the law employs fact specific inquiries in these situations, we offer some suggestions in dealing with potential force majeure claims to assist in evaluating and managing your risk:

- Be sure to provide timely notice of a force majeure event. Failure to provide appropriate notice may result in a waiver of what would otherwise be a viable legal excuse for performance.

- Note that a force majeure event may provide only a temporary excuse for non-performance. When the force majeure event subsides, the obligation to perform may resume.
- Parties seeking to invoke force majeure as a defense to performance are typically required to use their best efforts to overcome the force majeure event for their performance to be excused.
- Force majeure events typically are not a valid defense to the obligation to pay. Even if a party is facing force majeure events, that party must honor its obligation to pay if the other party was able to perform its contractual obligations.
- If a party chooses to exercise its rights under a force majeure clause, the other party may choose to immediately terminate the contract entirely. This may result in reputational risks and potential damage to long term supply relationships.
- Consider the option of permitting under performance due to a force majeure event. Under the circumstances, this may be a more viable alternative than terminating a contract entirely.
- Realize that declaring a force majeure event or receiving a claim to be excused from performance based on a force majeure event may impact on insurance arrangements.