# Force Majeure Clauses in the Age of Coronavirus

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## Legal Considerations for Businesses Impacted by COVID-19

The COVID-19 outbreak has officially become a global pandemic, according to the World Health Organization (WHO). In addition to the human toll, the coronavirus outbreak is causing serious disruptions to the global economy and the supply chains on which global manufacturers depend—potentially costing the economy $1 trillion in 2020.

As such, the crisis is testing the terms of many contracts between vendors and customers. As more businesses are temporarily closing down, and meetings are cancelled, companies need to assess their contractual options and liabilities in light of the changed circumstance. Going forward, companies that are negotiating commercial agreements today need to proactively consider the appropriate allocation of risk and consequences of further business deterioration resulting from the COVID-19 outbreak.

The impact of the virus on a particular business under an existing contract will be fact specific. Whether the business is the party unable to perform, or the counterparty, the following should be considered to assess a business' rights, obligations and remedies:

## Review Relevant Contract Provisions

The first step is to determine whether a provision exists in the contract or under applicable law that excuses a failure to perform as a result of events outside of the party's control. This may be covered by an explicit force majeure clause (a

Latin term meaning “superior force”), a similar express or implied doctrine of law (e.g., frustration, impossibility or hardship) or contained in other contractual provisions. Other provisions to review include any breach, termination, cancellation or repudiation terms that may be applicable under the circumstances.

In analyzing a force majeure or an express or implied doctrine of law provision, the reviewer must determine whether: (i) the virus outbreak is a force majeure event or triggers a doctrine of law, (ii) suspension or discharge of performance or termination of the agreement are appropriate based on force majeure or doctrine of law; (iii) notice is required (and what form); (iv) the virus outbreak affected performance; (v) the results of the virus outbreak were unforeseeable or out of the parties’ control; and (vi) any work-arounds exist to mitigate damages.

## Analyze the Performance Circumstances

Force majeure clauses may be written broadly (i.e., anything affecting performance out of control of one party) or more narrowly (i.e., by listing specific events, for example “war,” “acts of government” or “disease”), so even if something may appear objectively as an event of force majeure, it may not constitute a contractual force majeure. Further, even where specific examples of force majeure are listed, it is not very common to include clauses that expressly contemplate a global health emergency, pandemic or epidemic as force majeure events.

When analyzing the situation, first consider whether the party could have timely performed if the outbreak did not occur. If other factors contributed to the party’s nonperformance, a force majeure clause may not be applicable. For example, if a company preemptively implements a work at home policy as a result of coronavirus, but then cannot complete the work, that may not qualify as a force majeure event, because the preemptive company policy caused the nonperformance, not the coronavirus itself.

Further, force majeure clauses often distinguish between being unable to perform and merely being delayed. Delay alone may not necessarily allow a party to claim a force majeure in circumstances where it was not objectively impossible to perform.

## Providing Timely Notice is Crucial

Almost all force majeure clauses are conditional upon providing proper notice. If this is applicable, determine when notice is required and how notice must be provided to be effective. Compliance with notice requirements and mechanisms are important, as failure to do so might result in a breach of the contract even if the underlying nonperformance might otherwise have been excused as a force majeure.

Further, parties must be cautious in declaring a force majeure event on the basis of the recent coronavirus outbreak and ceasing performance of their obligations. Incorrectly declaring a force majeure event may result in a party repudiating the contract, and may provide the other party with a right to damages.

## Examine Implications of Force Majeure Event

If the current health crisis does in fact constitute a force majeure event under the applicable contract, the next steps are to determine what obligations are excused and what obligations remain. For example, the contract may require the impacted party to allocate limited production among the various purchasers and not allow a supplier to play favorites. It is possible that all of the impacted party's obligations are excused, but it is more likely the excused obligations are limited to those directly related to the coronavirus outbreak.

The force majeure may also affect the obligations of the non-impacted party. For example, the non-impacted party's payment obligations may be tolled or an exclusive supply relationship may become non-exclusive, allowing the non-impacted party to find other sources of goods or services.

Notwithstanding the above, parties have an obligation to mitigate damages and actually try to perform where possible. This involves determining whether there are other means through which a party can perform or at least partially perform. If other options exist, a party is likely required to take commercially reasonable steps to perform through such other means, and will not be relieved of its contractual obligations.

Force majeure events often result in contract renegotiations or agreed upon cancellations. Other times, if the force majeure event continues for a specific

length of time, the contact may automatically expire. In the case of an automatic termination, the parties may need to determine when the force majeure event began, but the applicable time period may be tied to when notice was received rather than when the event itself began.

## Review Impact on Other Agreements

Parties seeking to invoke, or who are faced with, a declaration of force majeure should also consider the effect of such a declaration on other agreements or obligations. Examples may include financing agreements and disclosure obligations. Many loan agreements include representations regarding, or covenants to provide notice of, material litigation, events that could have a material adverse effect on the business or anticipated loss outside of the ordinary course of business. An interruption of business also may constitute an event of default, either expressly or through its impact on financial or other covenants.

## Check Available Insurance Coverage

Consider whether insurance may cover losses arising out of a party's inability to meet its obligations due to the coronavirus outbreak. While business interruption insurance may be an option in some circumstances, historically most infectious diseases are excluded from property and casualty insurance policies, including business interruption insurance.

Where business interruption coverage may exist, as a prerequisite to coverage, these policies frequently require direct physical loss to property of the insured, its customers or its suppliers, something that may not automatically be triggered on the mere basis of the outbreak.

Certain specialized insurance products, such as force majeure insurance, trade disruption insurance, political risk insurance or performance bonds, may also offer an avenue of relief. In all circumstances, coverage will be determined by a policy's specific terms and conditions, which should be carefully evaluated. Just as in the contractual scenario, attention should be given to the applicable policy's notice provisions.

## Note on Material Adverse Change or Material Adverse Effect

Some agreements contain provisions triggered by events occurring that could reasonably be expected to result in a material adverse change ("MAC") or material adverse effect ("MAE") on the business or its prospects. The occurrence of a MAC or MAE may give one party, such as the potential purchaser of a business, a right to avoid performance under or terminate the agreement.

Other agreements may require notice to the counterparty of any circumstance that could constitute a MAC or MAE. An MAC or MAE could be (i) breach or nonperformance of, or any default under, a material contract, (ii) threatened material litigation or arbitration, (iii) any situation materially impacting the ability of the party to perform its obligations under the agreement or conduct business generally or (iv) any situation materially impacting operations or financial performance.

To the extent COVID-19 has triggered or may reasonably be believed to trigger MAC or MAE, necessary disclosure should be made as soon as reasonably possible.

## Updating Force Majeure Clauses

Addressing the ramification of force majeure clauses in active contracts is important at this time, but businesses should also identify where future contracts can be strengthened against future events. Consider adding force majeure clauses with specific language relating to epidemics, pandemics, quarantines or public health emergencies. Further, review notification requirements for impacted and non-impacted parties, and performance priorities for different purchasers when there is a supply shortage. While these changes may not protect against all future force majeure events, they will provide additional guidance for unforeseeable events.

## Case By Case Considerations

Ultimately, whether a party can exercise its rights under a force majeure clause in connection with the coronavirus outbreak must be determined on a case-by-case basis following a close reading of the applicable contracts and a thorough

understanding of the facts. Concerned companies should undertake a review with their attorney of the rights and obligations under their agreements, financing instruments and applicable law. Affected businesses should also assess whether disruptions to their supply chains, personnel and travel restrictions will impact other obligations or remedies, including financing agreements, ongoing acquisitions/sales or the availability of business interruption or similar insurance coverage.

## About Jeremy Waitzman

Jeremy chairs the Corporate Group at the Sugar Law Firm (Sugar Felsenthal), a national boutique serving the affluent and the companies they own or otherwise control. He advises his clients on significant transactions and operational issues in their businesses. Described by clients as "an essential business advisor" and "a partner in the success of my business," Jeremy has substantial experience representing businesses of all types and sizes from inception, guiding them through significant growth, and often through ownership's exit. His clients include privately-held middle market and emerging growth companies, family offices/funds, investors, C-level executives, boards of directors, family-owned businesses and entrepreneurs. Jeremy counsels clients in the areas of corporate law, mergers & acquisitions, private placements, and general contract law. He represents individuals, closely held businesses, start-up companies and serves as outside counsel to several large corporations. His work with companies often includes strategies for the creation of enterprise value.

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