Chamberlain Hrdlicka
Attorneys at Law

Contact

Houston
1200 Smith Street, Suite 1400
Houston, Texas 77002-4310
Tel: 713.658.1818
Fax: 713.658.2553

Atlanta
191 Peachtree Street, N.E.,
Forty-Sixth Floor
Atlanta, Georgia 30303
Tel: 404.659.1410
Fax: 404.659.1852

Philadelphia
50 South 16th Street, Suite 1700
Philadelphia, PA 19102
Tel: 610.772.2300
Fax: 610.772.2305

San Antonio
112 East Pecan Street, Suite 1450
San Antonio, Texas 78205
Tel: 210.253.8383
Fax: 210.253.8384

www.chamberlainlaw.com

Force Majeure Clauses and the COVID-19 Pandemic

Chamberlain Corporate Update - Force Majeure Clauses and the COVID-19 Pandemic

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Many states and cities across the United States have issued “stay at home” or “shelter in place” orders, effectively forcing all “non-essential” businesses to close physical operations and cease doing business unless their employees can work remotely. Business owners, landlords and tenants are now reviewing commercial leases, construction contracts, loan agreements, and other commercial contracts to determine whether force majeure provisions are implicated. This alert analyzes some of the potential consequences of the COVID-19 pandemic on force majeure provisions in commercial contracts.

What is Force Majeure?[1]

Force majeure refers to extraordinary events that are beyond the control of either party to a contract and have the effect of preventing one or both parties from performing under the terms of the contract. Force majeure is governed principally by the terms of the contract, but if the contract is silent as to force majeure, applicable state common law or statutory law may apply.

Uniform Commercial Code

The Uniform Commercial Code (“UCC”) governs the sale of goods and has been adopted by most states across the United States. UCC § 2-615(a) provides that a seller is excused from any delay in delivery or failure to deliver goods if performance has become commercially impracticable as a result of either (i) “the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made” or (ii) “compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.”

Common Law

Common law varies by state, but some jurisdictions provide that performance under a contract may be excused or delayed if (i) it becomes impossible or impracticable to perform the contract due to reasonably unanticipated circumstances, or (ii) unanticipated circumstances frustrate performance such that the impacted party is deprived of the benefit of the bargain.

Contractual Force Majeure Clauses

Force Majeure Clauses and the COVID-19 Pandemic, Continued

A force majeure clause is used to allocate risk of certain events between the parties and excuse performance of an impacted party during the force majeure event. These provisions address the types of events that will trigger the force majeure clause and can be either broadly or narrowly drafted, although courts tend to interpret force majeure clauses narrowly. The list of events often includes some or all of the following:

- Natural disasters
- Epidemics, pandemics and quarantines
- War, terrorist attacks and other instances of violence
- Actions taken by government authorities such as changes in laws, regulations or orders
- Strikes and work slow-downs
- Shortages of power, supplies, infrastructure or transportation
- A catch-all provision, such as “acts beyond the parties’ reasonable control” or acts of God

The force majeure clause will address timing of performance, contractual remedies when performance is excused as a result of a force majeure event, and termination of the contract based on the length of the triggering event. Typically, a force majeure event will only trigger the applicable remedies if it makes performance impossible and not if it becomes more financially burdensome to perform under the contract.

Remedies for Force Majeure

Although remedies are contract specific, contracts may provide that the impacted party has the ability to extend time limitations for performance, terminate performance, suspend performance or avoid liability for failure to perform. In many contracts, in order to avail itself of these remedies, the impacted party must provide notice to the other party and attempt to mitigate losses as a result of the force majeure event.

COVID-19 IMPACT ON THE US

On March 11, 2020, the World Health Organization (“WHO”) officially labeled the novel coronavirus (COVID-19) a pandemic. As of March 24, 2020, seventeen states (California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Louisiana, Massachusetts, Michigan, New Jersey, New Mexico, New York, Ohio, Oregon, Washington, West Virginia and Wisconsin) and a significant number of major cities and counties had issued “stay at home” orders shutting down all “non-essential” businesses. States and cities vary as to which types of businesses are deemed essential, but all businesses that are nonessential must close their physical workplaces. For many businesses that cannot operate through a telework model, these orders are having a significant detrimental impact. If ordered to stay at home, these businesses may be unable to perform their contractual obligations and attempt to utilize force majeure clauses and applicable law to excuse performance under commercial contracts.

IS COVID-19 PANDEMIC A FORCE MAJEURE EVENT?

Unfortunately, as is the case with many legal issues, there is not an absolute and blanket answer to this question because it involves interpreting specific contract language and making a fact-based determination of each party’s obligations under the contract.

Force Majeure Clauses and the COVID-19 Pandemic, Continued

Ideally, the force majeure clause would include “pandemics”, “epidemics”, “quarantines” or “diseases” when attempting to make the argument that the COVID-19 pandemic qualifies as a force majeure event. Even if pandemics is explicitly listed, this is still a fact-based analysis that will require reviewing the relevant contract and the impact of COVID-19 on the impacted party’s ability to perform under the contract.

If the relevant force majeure clause includes “acts of God”, “government actions or regulations”, “acts beyond the control of the parties” or other similar language, an argument could be made that the COVID-19 pandemic qualifies as a force majeure event. Some commentators believe, after some of the past pandemics such as SARS, these types of events are foreseeable and would need to be explicitly included in a force majeure provision in order to apply. On the other hand, the argument may be bolstered for “non-essential” businesses under a “stay at home” order that cannot conduct their business remotely.

Not only must the impacted party show COVID-19 qualifies as a force majeure event, but it must also show the pandemic has caused its inability to perform under the contract. It is not enough to show that it is too burdensome to perform under the contract. Additionally, the impacted party must follow any procedure set forth in the contract in order to avail itself of the provided remedies, including mitigation of any losses resulting from the failure to perform.

For businesses in states that have not yet instituted a stay at home order, it is advisable to take all actions that the business can now in an attempt to avoid or mitigate future losses. This could include attempting to find new suppliers in the event the business’s current suppliers are unable to fulfill their obligations, or setting employees up to work remotely. Given that some states and cities have already instituted these orders, it is arguably foreseeable such orders may be put in place in all states across the nation. By taking steps to attempt to mitigate losses under the contract, the impacted party may bolster the argument that performance was impossible if it becomes necessary to defend the failure to perform in a court of law, because the impacted party can show it has explored all practicable alternatives.

Ultimately, the question of whether an impacted party can avail itself of the remedies available during a force majeure event per the terms of the contract or under applicable law is fact-based. If you believe you may need to invoke the terms of a force majeure clause or you are concerned that a counterparty to your contract may do so, we would recommend consulting with your attorney as soon as possible.

[1] Force Majeure Clauses: Key Issues, Practical Law Commercial Transactions, accessed March 23, 2020.