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Expecting the Unexpected: Responding to Force Majeure and COVID-19

The battle against COVID-19 has caused disruptions to industries across the US. Based on the trajectory of the virus' impact in countries like China, Italy and Spain, it appears inevitable that COVID-19 will continue to affect businesses – both large and small – for the coming weeks and months. Many of these businesses are parties to contracts that will become increasingly difficult to perform. By now, prudent business owners have reviewed their contracts with particular attention on each contracts' *force majeure* clause (if not, resources can be found here and here). As businesses and their employees plan for this unprecedented time, and react to the unexpected, it is important to keep the following issues in mind.

Foreseeability

In its most basic form, a *force majeure* clause allocates risk amongst contracting parties. A risk that is, or should have been, foreseeable is presumed to have been intentionally allocated between the contracting parties. If a general contractor in Florida, for example, is concerned about the impact of weather-related delays on timely delivery of a project, she may include severe thunderstorms and hurricanes as *force majeure* events. If an automobile manufacturer in Michigan is unwilling to bear the risk of a labor union dispute on its ability to deliver products, it may identify labor strikes as a *force majeure* event. However, a defense based in *force majeure* can fail if a court determines that the alleged event was, or should have been, foreseeable by the breaching party.[1] Therefore, a court may be hesitant to excuse the performance of the general contractor or the automobile manufacturer due to a tropical storm or a labor shortage when such events were clearly foreseeable.

There is little case law addressing whether virus-related events implicate *force majeure* provisions in contracts. However, courts historically frown upon *force majeure* defenses that are advanced based on economic downturns. For example, a change in circumstances that results in a contract being economically disadvantageous is generally considered a foreseeable event that is not protected as a *force majeure* event.[2] As can already be seen in highly infected locations like San Francisco and New York City, "non-essential" businesses, including shopping centers, entertainment venues and manufacturers, are being ordered to close their doors. In response, we are likely to see an increase in loan defaults, delinquent rents and nonpayment of product orders. As businesses begin to examine COVID-19 as a *force majeure* event, those that are able to point to defaults resulting from government mandates or labor shortages will be more successful than those whose claims are based solely on economic hardships.

Causation

A successful *force majeure* defense must demonstrate the cause and effect of the *force majeure* event and the resulting nonperformance.[3] Typically, an affected party must demonstrate that the *force majeure* event was not the result of negligence, intentional conduct or inevitable default. An already struggling party's inability to obtain financing, for example, is unlikely to support a *force majeure* claim, even if a *force majeure* event further frustrated that party's financial position.[4] For instance, a tenant that is in default under a lease as a result of abandoning its premises will not be completely excused because a government-imposed shelter-in-place order would otherwise have required the tenant to close. In other words, the occurrence of a disaster at an opportune time can undercut a defense based in *force majeure*.

[1] But parties can contract around this requirement.

[2] See e.g., *N. Ill. Gas Co. v. Energy Coop., Inc.*, 122 Ill. App. 3d 940 (1984); Kel Kim Corp., Central Markets, Inc., 70 N.Y.2d 900 (1987).

[3] *Aquila, Inc. v. C.W. Mining*, 545 F.3d 1258 (10th Cir. 2008).

[4] *Glen Hollow Pshp. ex rel. Big Hollow Land Tr. v. Wal-Mart Stores, Nos. 97-1433 & 97-1510*, 1998 U.S. App. LEXIS 3214 (7th Cir. Feb. 26, 1998); *Sun Operating P'ship v. Holt*, 984 S.W.2d 277 (Tex. App. 1998).

Mitigation

As a general principle, the party seeking to assert a *force majeure* defense must demonstrate that it could not have avoided the contractual breach or, alternatively, that it took reasonable steps to mitigate its damages. Any business seeking to rely on a *force majeure* defense should, therefore, take immediate efforts to limit the impact of supply chain disruptions, shipping delays and labor shortages. As one court noted, a party "cannot put its head in the sand and then scream Act of God when a storm comes."[5] In response to COVID-19, some innovative breweries that cannot remain open to the public have repurposed their equipment to manufacture hand sanitizer. In the event such a brewery defaults on its loan due to diminished income, a court is more likely to look favorably on the brewery that took steps to continue to turn a profit than one that did not.

A party seeking to excuse its performance is expected to use reasonable efforts to overcome obstacles.[6] As a result, it is also important that businesses plan for disruptions to the extent possible, as impacts of COVID-19 may be felt for months. For example, a manufacturer experiencing a delay in production could notify its distributor or explore alternative means of production. Moving forward, the businesses that take steps now to mitigate the impacts of COVID-19 will fare better than those that elect to do nothing.

Timely Notice

Timely notice has historically been an important contracting principle. Timely notice allows a counterparty to attempt to mitigate, or prepare for, its own damages. For example, a restaurateur who notifies their upstream supplier of a decrease in demand allows that supplier to address and limit its own damages. Importantly, failure to provide timely notice of a *force majeure* event may act as a waiver of the defense. As a result, it is important to notify counterparties of anticipated defaults as soon as they are known.

Whether a party may successfully rely on a *force majeure* clause is highly fact dependent. The bottom line is that business owners should actively consider the risks arising out of COVID-19 on their particular contracts. Proactive business owners will review their contracts, supply agreements and insurance policies. It is important that such owners begin to address potential impacts on supply and demand so they are in a position to react quickly when COVID-19 related disruptions affect their businesses. Preemptive planning may involve reviewing supply chains, implementing alternative transportation plans or accelerating product development. Prompt action will be the best way to reduce the risk of major costs, delays and claims as the impacts of COVID-19 expand.

As with every impactful world event, our firm will continue to monitor closely the domestic and global ramifications of COVID-19 and will assist clients with development of contingency plans, if requested. In the meantime, we all should continue to wash our hands and try to keep our sanity.

[5] *TGI Office Automation v. Nat'l Elec. Transit Corp.*, No. 13-CV-3404, 5-6, 51 (E.D.N.Y. Sept. 14, 2015).

[6] *N. Ill. Gas Co. v. Energy Coop., Inc.*, 122 Ill. App. 3d 940 (1984).

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