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INSIGHTS

Contractual Performance in the Age of Coronavirus: Force Majeure, Impossibility and Other Considerations

March 16, 2020

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The Coronavirus (COVID-19) pandemic is causing unprecedented disruptions to business operations on a global scale. As these disruptions continue, and the economic effects mount, more industries will be significantly impacted. All companies need to assess not only their own, but also their counter-parties' contractual rights, obligations, and remedies in case performance is delayed or performance becomes too difficult or impossible. A careful analysis of rarely-invoked "force majeure" clauses and related doctrines of impracticability and impossibility are critical to understand in these uncertain times.

Force Majeure

When a party cannot perform its obligations under a contract because of an "act of God" or other unforeseen circumstance, the "act of God does not relieve the parties of their [contractual] obligations unless the parties expressly provided otherwise."[1] However, where the parties include a force majeure clause in the contract—a provision that allocates risk of non-performance in circumstances beyond the parties' control—such "acts of God" or other circumstance may excuse performance.

Courts typically construe force majeure clauses narrowly. Therefore, whether disruption based on a pandemic like COVID-19 can excuse performance will depend on the language of the particular force majeure clause. Under the law of many states, including New York and Texas, the force majeure clause will be triggered only where the clause expressly includes the contingent event. Where a force majeure clause explicitly uses terms such as "disease," "epidemic," "pandemic," "quarantine," "act of government" or "state of emergency," parties may, depending on the circumstances, be able to assert force majeure as a defense to non-performance or anticipatory breach in the case of the COVID-19 pandemic.

Notably, it is not enough for the party asserting the force majeure clause to show that the "act of God" or other event made performance merely more difficult or more economically burdensome; the party must show that performance of its contractual obligations has been prevented by the event. Taking precautionary measures or making a voluntary decision not to perform is not the same as being prevented from performance.

"Catch-all" phrases in force majeure clauses

The analysis is more complicated when the parties include a "catch-all" phrase that does not enumerate triggering events. In those instances, courts will not typically apply force majeure when the parties could have expected the event at issue to occur at the time of contracting. The foreseeability of the coronavirus is likely to be subject to debate. Some commentators consider a pandemic to be "inevitable," but "quite unpredictable," such that it would classify as a "classic force majeure event."[2] However, others argue that after the SARS outbreak in 2005, "[e]pidemics and diseases that could affect [the impacted contract or industry] are now foreseeable and should be contemplated in the contract" such that parties "waive the right to use it as a defense if [they] don't mention it in the contract."[3]

A party to a contract executed prior to the escalation of the virus spread and its classification as a pandemic could be more likely to successfully rely on a force majeure clause. On the other hand, parties who elected to enter contracts with reasonable knowledge of the virus's potential consequences, such as in January of 2020 when the virus began to attract attention in China, may have a more difficult foreseeability argument. The point at which this balance tipped will be a question for the court based on the industry, the parties, the particular disruption, and the specific language of the clause.

Is COVID-19 an "Act of God"?

The party seeking to assert the force majeure clause typically has the burden of proving its applicability, including that the event was beyond its control and without its fault or negligence. While this burden will likely not be difficult where the contract lists specific events like viruses, epidemics or pandemics, the analysis may become more complicated when the force majeure clause is not explicit and simply uses the term "act of God," which is boilerplate language in many force majeure clauses.

Nearly all attempts to define the phrase "act of God" use words such as "unusual," "extraordinary," "sudden," "unexpected," "unanticipated" or "grave." The appearance of one or more of these adjectives in almost every definition or description of the phrase reflects the general requirement that, in order for a casualty or phenomenon to qualify as an act of God, it must have been so unusual or abnormal a force that it could not have been anticipated or expected under normal circumstances.[4] Whether courts ultimately determine that COVID-19 is an "act of God" remains to be determined, but we can expect that many court filings in the months and years to come are likely to feature the sentiments of the World Health Organization's Director-General, who recently remarked that "[w]e are in unchartered territory. We have never before seen a respiratory pathogen that is capable of community transmission, but which can also be contained with the right measures."

Alternatives to Force Majeure

In the absence of an applicable force majeure provision, or as an alternative, parties could be excused from performance by claiming impossibility or impracticability.

Contract law has long recognized and accommodated situations where performance is made impracticable. Section 261 of the Restatement (Second) of Contracts explains:

Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language

or the circumstances indicate the contrary.[5]

For performance to be truly impracticable, the event must be unforeseeable and not caused by the party expected to perform. However, circumstances that make performance merely unprofitable or inconvenient usually are insufficient. Therefore, the application of the impracticability doctrine based on the coronavirus outbreak will depend upon the facts and circumstances of the contractual relationship. In most courts, proving that performance is impracticable is a high bar.

As to the closely-related impossibility doctrine, both Texas and New York courts construe the doctrine narrowly, applying it only where performance is objectively impossible, such as the destruction or deterioration of a thing necessary for performance or the prevention of performance by governmental regulation. Depending on the circumstances, unanticipated government decrees arising from the coronavirus outbreak—such as prohibiting public gatherings and border closures—may give rise to a valid impossibility defense. However, parties typically cannot rely upon an impossibility defense where an inability to perform is due to subjective impossibility or inconvenience.

Finally, in contrast to force majeure clauses, a party seeking to rely upon an objective impossibility defense must show that it made reasonable efforts to overcome the obstacle to performance. For example, the destruction of a manufacturing facility which produces a product may not excuse performance if the product can be found elsewhere and the manufacturer could have made reasonable efforts to acquire the product from another party. Similarly, a government action or regulation does not necessarily excuse performance if a party does not exhaust all reasonable and available resources to overcome, bypass, or find alternatives to government action. Therefore, parties seeking to use an objective impossibility defense should take steps to ensure that all reasonable options for performance are exhausted before asserting that performance is impossible under a contract.

Checklist for Businesses Affected by COVID-19

Companies with contracts affected by the coronavirus should take the following steps:

- Review contracts to identify what force majeure rights, remedies, and requirements may apply if a party's operations are disrupted by the effects of COVID-19.
- Identify the notice requirements and deadlines that have been or may be triggered. Many contracts require the party invoking a force majeure clause to provide prompt written notice to its counterparty, often within a specific time period. Parties must be aware of these notice requirements, as the application of force majeure could be precluded absent compliance.
- Before deciding to invoke the contract's force majeure clause, parties should assess and document alternative means of performance or the availability of steps that may be taken to avoid or reduce disruption to operations.
- Parties should also identify and assess the consequences of a breach or default, including collateral issues such as SEC reporting requirements and potential loan covenant defaults or cross defaults.

- Counterparties should communicate as early in this process as possible. The sooner the parties notify one another of concerns about performance or inability to perform , the greater likelihood of resolution of disputes.

- Assemble and retain all supporting documentation.

Conclusion

The coronavirus pandemic presents unprecedented challenges and is sure to disrupt contractual relationships. Parties should be ready to invoke, and defend against, force majeure clauses and related doctrines that may operate to excuse performance.

Bracewell attorneys are experienced with contractual circumstances across industries domestically and internationally, and are ready and available to provide further information and discuss particular circumstances.

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1 GT & MC, Inc. v. Texas City Ref., Inc., 822 S.W.2d 252, 259 (Tex. App.—Houston [1st Dist.] 1991, writ denied); *see also Kel Kim Corp. v. Cent. Markets, Inc.*, 70 N.Y.2d 900, 902, 519 N.E.2d 295 (NY 1987).

2 Patrick J. O'Connor, Allocating Risks of Terrorism and Pandemic Pestilence: Force Majeure for an Unfriendly World, Constr. Law., Fall 2003, at 5, 10.

3 Martha Collins, Cancellation and Force Majeure Issues in the SARS Era (March 1, 2005) available at ***https://www.meetingsnet.com/negotiatingcontracts/cancellation-and-force-majeure-issues-sars-era***.

4 6 Am. Jur. Proof of Facts 3d 319 (Originally published in 1989).

5 Apart from common law, § 2-615 of the Uniform Commercial Code similarly excuses performance where it has been made "impracticable" by the occurrence of an event, "the non-occurrence of which was a basic assumption on which the contract was made." Likewise, certain international contracts may be governed by the United Nations Convention on Contracts for the International Sale of Goods ("CISG"). Article 79 of the CISG excuses performance when "the failure was due to an impediment beyond [its] control and that [it] could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences."