Baker McKenzie.

Client Alert

March 6, 2020

When is *force majeure* really *Force Majeure*? Considerations when determining whether a crisis event like COVID-19 triggers *force majeure* rights under US law

On January 30, 2020, the World Health Organization declared the novel coronavirus disease 2019 (COVID-19) outbreak a "Public Health Emergency of International Concern" (PHEIC). As of March 3, 2020, there have been 90,870 reported cases of COVID-19, spanning 73 countries and resulting in 3,112 deaths.

The rapid spread of the outbreak, combined with the impact of various government responses, have caused significant disruption to business on a global scale, including commercial travel, supply chains, and other commercial operations and relationships. As a result, some companies have asserted (or threatened) that the outbreak constitutes a *force majeure* event or gives rise to other legal bases excusing performance.

For companies that are considering issuing a *force majeure* notice, or those anticipating that their contractual counterparties may do so, we provide an overview of how courts in the United States approach *force majeure* and what steps companies should take in considering their options.

What is a *Force Majeure* Clause?

Force majeure clauses define circumstances beyond the parties' control that can render contractual performance too difficult or even impossible. Where an event (or series of events) triggers a *force majeure* clause, the party invoking the clause may suspend, defer, or be released from its duties to perform without liability.

Force majeure clauses in commercial contracts typically provide a list of specific events outside of the contracting parties' control that, upon occurrence, would excuse or delay the invoking party's performance, or permit the cancellation of the contract. Events like war, terrorist attacks, famine, earthquakes, floods, strikes, fire, epidemics, and government action are typically included as *force majeure* events excusing performance. Some *force majeure* clauses also include catch-all language broadly excusing performance based on significant events outside the parties' control.

Many contracts require that a party seeking to assert *force majeure* as a basis for suspending or terminating performance must provide notice to its counterparty. Failure to timely send such notice may result in waiver or have other adverse consequences. For contracts involving the sale of goods, the

Uniform Commercial Code requires that the party in receipt of a *force majeure* notice respond within thirty days, or the contract will lapse with respect to any affected deliveries. *See, e.g.*, N.Y. U.C.C. § 2.616; Cal. Com. Code § 2616; Tex. Bus. & Com. Code § 2.616; Fla. Stat. § 672.616.

Force Majeure Application in the United States

In the event that the parties to a contract disagree as to whether COVID-19 constitutes a *force majeure* event, it will ultimately be up to a court to decide the parties' rights and obligations. The application of *force majeure* is an issue of contract interpretation governed by state law. As a result, jurisdictions vary in their treatment of such clauses. It is safe to say, however, that the vast majority of courts across the United States construe *force majeure* clauses according to their plain language.

New York courts, for instance, typically interpret *force majeure* provisions narrowly, placing paramount importance on the express language of the provision. For example, where a *force majeure* clause lists examples of *force majeure* events and does not contain a catch-all provision, New York courts have found that only those events specifically listed can excuse performance. Where such clauses *do* contain a catch-all provision, New York courts may limit *force majeure* to events similar to those specifically enumerated.

Under New York law, a non-performing party seeking to avoid its contractual obligation must demonstrate the existence of a *force majeure* event and that the party was unable to fulfill its contractual obligation despite reasonable efforts to do so. It is usually not enough to claim that performance was simply hindered because of a listed event. The invoking party must further show that the event was unforeseeable and was the direct cause of the party's inability to perform. In very limited circumstances, courts applying New York law have allowed a party to invoke *force majeure* in instances of indirect causation (for example, shipping delays resulting from congestion caused by a hurricane, rather than by the hurricane itself). A party seeking to invoke *force majeure* usually must also show that there is no alternative means for performing under the contract. Increased costs or other difficulties in performing will not be sufficient under New York law because *force majeure* clauses are not intended to buffer a party against the normal risks of contracting.

California law similarly requires that parties invoking *force majeure* demonstrate that they made "sufficient" or "reasonable" efforts to avoid the consequences of the *force majeure* event, such as by providing cover or sourcing means of performance from external providers. California courts have found, for example, that *force majeure* does not excuse a drilling company from its contractual obligations where the company could not obtain necessary tools because its supplier was on strike. Although strikes were among the *force majeure* events enumerated in the clause, the court found the company was obliged to source the tools from an alternate supplier, even though doing so would cause the company to incur additional expense.

Like California and New York, Texas courts will not excuse performance based on events giving rise to increased economic burden and typically evaluate *force majeure* as expressly defined by the parties' agreement. As a result, Texas courts generally will not excuse performance where a *force majeure* event was arguably foreseeable at the time of contracting but is not specifically enumerated in the *force majeure* clause. Unlike New York and California, however, Texas does not require the party invoking *force majeure* to demonstrate that it exercised "reasonable diligence" to avoid the disruption unless such "reasonable diligence" is expressly required by the *force majeure* clause itself. Again, because Texas courts strictly construe *force majeure* clauses, the exact language of the *force majeure* clause dictates what the non-performing party need and need not prove to escape liability for non-performance.

Ultimately, whether disruption caused by COVID-19 rises to the level of a *force majeure* event under US law will largely depend on the language of the applicable contract, the nature and scope of the effect on a party's ability to perform its obligations under the contract, and (under some state's laws) the steps the invoking party took to avoid the negative consequences of the virus.

What Can Companies Do to Address *Force Majeure* Rights (or Risks) in the Face of Covid-19?

Companies should take proactive steps to mitigate their risk (or maximize their rights) triggered by a *force majeure* event, and to prepare for interruption to their operations or those of their suppliers/commercial contract counterparties.

1. Review commercial contracts to assess what *force majeure* rights, remedies and requirements may apply if a party's operations are disrupted. For example, some *force majeure* provisions require that the invoking party disclose the time period during which its performance will be delayed. Or the clause may provide a right to source from an alternate provider, or terminate the contract for non-performance after a certain period of time.

2. Review the notice and response requirements in the provision to ensure the timeliness, content, and proper delivery method of any invocation of, or response to, a *force majeure* notice.

3. Obtain and retain as much information as possible about any potential *force majeure* claim, documenting the timing, the number of impacted people/parts/facilities, and when the event is expected to conclude. If complete information is not available, the party invoking *force majeure* should supplement its notice as additional information becomes available.

4. Begin considering contingency plans if there is risk that your company may be impacted by COVID-19. Consider whether there are alternative means to perform/satisfy contractual obligations or proactive steps to take in anticipation of the effects of the outbreak. Document efforts to comply with contract terms or to find other means by which to comply.

5. Manage communications with counterparties, bearing in mind the importance of global coordination of what may be local relationships to ensure a company-wide, consistent approach.

6. Understand local regulatory actions and restrictions regarding public policy and public health and monitor new regulatory actions taken in response to COVID-19 to determine if the company must act in a way that affects contractual commitments.

7. Consider the effect of a *force majeure* declaration in one commercial contract across other agreements and legal obligations. For instance, some financial agreements include representations regarding, or covenants to provide notice of, material events that could lead to litigation or anticipated loss outside of the ordinary course of business. Such events may also constitute an event of default in related agreements.

A proper assessment of the impact of the coronavirus outbreak requires a fact-specific analysis of a company's business and contractual relationships. Concerned company executives should review with their in-house and outside counsel the rights and obligations provided in the company's commercial contracts and other relevant agreements, and under applicable law.

Please contact us if you have any questions.

Jennifer Ancona Semko
Partner, Washington, DC
jennifer.semko
@bakermckenzie.com

Mark Goodman
Partner, San Francisco
mark.goodman
@bakermckenzie.com

Mark McCrone
Associate, Washington, DC
mark.mccrone
@bakermckenzie.com

Marisa Bakker
Associate, Washington, DC
marisa.bakker
@bakermckenzie.com

Maria McMahon
Associate, Washington, DC
maria.mcmahon
@bakermckenzie.com