

# Applicability of Force Majeure and Related Doctrines in Response to COVID-19

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COVID-19 has begun to impact virtually every aspect of global commerce. Governments are imposing increasingly stringent restrictions to fight the virus, and consumers and workers have begun to cancel plans and avoid public spaces on a mass scale. One recurring issue businesses will face through all of this is whether, in the face of unprecedented disruption, they still need to meet their contractual obligations or whether their performance is suspended or excused. Most contracts contain a force majeure clause that relieves one or both sides of their obligations if they are unable to perform due to some massive and unforeseen event beyond their control (classic examples include fires, earthquakes, floods or wars) and which may apply to failures to perform resulting from COVID-19. Other doctrines, such as frustration of purpose or impracticability of performance, may also apply under US law, and still other avenues may be available for contracts governed by certain foreign law.

While every contract will be different, and the law can vary significantly between jurisdictions, this user's guide outlines the basic steps and analytic process businesses can use to approach their particular problem.

## Step 1: Remember that lives are at stake

Many people have died from COVID-19, and many more will, both from the virus and the secondary effects of the pandemic. The health and safety of everyone should be the first and most important factor guiding every business decision right now.

## Step 2: Read your force majeure clause

While obvious, this step is critical because the general rule is that a force majeure clause must include the event in question in order to excuse (or, in some cases, merely suspend) performance. Many force majeure provisions include reference to an "action" or "order" from the government. While these will provide a clear contractual basis to excuse performance in the event of a quarantine, travel restriction or some other mandate, a party unfortunately needs to wait until the order comes down. Given that federal, state and local agencies are issuing new directives almost daily in response to rapidly shifting conditions, there will be significant uncertainty about when exactly force majeure will kick in. For example:

- **Scenario A:** A band has entered into a contract with a venue to put on a concert. The venue has a capacity of 1,000 seats. The state where the venue is located orders all venues of 500 seats or more to close for the next 30 days. The concert is scheduled for 60 days from when the state issues the order. If the force majeure clause in the contract only refers to "government orders," it may not apply yet given the timing.

Some force majeure clauses also contain references to "epidemics," "pandemics" or "quarantines." These provide a more general and flexible basis for invoking a force majeure clause and extend to situations that are not clearly covered by an explicit directive from the government.

Finally, some force majeure clauses are highly generalized and only refer to "any Act of God or other circumstance beyond the control of the parties." Others include specific examples ("fires, floods, earthquakes, tsunamis, wars, terrorist attacks, strikes, civil unrest...") and then conclude with a catch-all phrase like "or any other circumstance beyond the control of the parties which they cannot overcome through reasonable and diligent efforts." Whether this kind of language captures COVID-19 related disruptions likely will vary significantly from jurisdiction to jurisdiction. The laws of some states will broadly interpret these terms with an eye toward the entire contract, its purpose and the expectations of the parties, but others read these narrowly and only construe them as including those events that are substantially similar to whatever specific examples do appear.<sup>1</sup> Depending on the local rules of contract interpretation, these seemingly broad and generalized terms may either

clearly include COVID-19 or may prove to be narrower than anticipated. Also note that most force majeure clauses do not excuse payment obligations, which includes payment of rent, operating expenses and loan payments.

You should also review carefully whether performance is excused or suspended or evaluate what is excused or suspended. Some contracts, for instance, carve out the obligation to pay money, and there may be some take-or-pay commitments that are not covered.

If, because of some combination of your specific situation, the words of the contract and the relevant law, COVID-19 clearly doesn't qualify as force majeure, that is not the end of the line. Performance by one or both sides may still be excused under other legal doctrines like frustration of purpose. And for contracts that are governed by the laws of a civil law jurisdiction, other doctrines like hardship or changed circumstances may apply. These doctrines are discussed further below.

## Step 3: Determine if performance is actually impossible or merely impractical

Impossibility includes legal impossibility – while it might be physically possible to do what the contract calls for, the government has taken some action that would make doing so illegal. Generally speaking, force majeure requires actual impossibility and not merely extreme difficulty. Two increasingly common scenarios illustrate this point:

- **Scenario B:** A band has entered into a contract with a venue to put on a concert. The state where the venue is located orders the venue to close as part of a mandatory general quarantine order. It is now legally impossible for the venue to fulfill its obligations under the contract. Almost any standard force majeure clause will excuse the venue from hosting the performance.
- **Scenario C:** A band has entered into a contract with a venue to put on a concert. The state where the venue is located issues nonmandatory guidance strongly encouraging all its residents to cancel nonessential travel and to avoid large gatherings and public places to the extent possible. As a result, the market for tickets dries up, and the band is only able to sell 10% of the seats available.

Because the state's guidelines were not mandatory, it is still physically and legally possible for the band to perform. A boilerplate force majeure clause will arguably not apply to this situation.

The key thing to remember is that simply because it is extremely unprofitable or exceptionally difficult to perform under a contract does not mean that it is actually impossible – and force majeure likely only applies to the latter situation.

## Step 3.5: Check your force majeure language again

Some force majeure clauses will contain language that encompasses situations where performance remains possible. For instance, suppose in Scenario C above, the relevant provision contained this language:

“or if due to any of the foregoing [fires, floods, earthquakes, hurricanes, tsunamis, famines, tornadoes, epidemics, quarantines, wars, rebellions, invasions, civil unrest, strikes or governmental action] Band is, in spite of its good faith and diligent efforts, unable to sell more than one-third of the seats available.”

Now, due to the specific language of the clause, a situation which normally would not excuse performance under force majeure (i.e., extreme economic impracticability) now will. While the background or default rules for force majeure require actual impossibility, parties are always free to contract and assign risks as they see fit, including by drafting custom force majeure provisions that encompass situations that would not meet the traditional test.

Nonstandard inclusions are particularly important for businesses that are grappling with one highly visible second order impact of COVID-19: volatility in the financial markets. The general rule is that even the kind of extreme financial downturns we have seen in recent days do not qualify as force majeure events. For example, in the aftermath of the 2008 financial crises, courts consistently concluded that market forces do not count as

force majeure.<sup>2</sup> While there were exceptions to this, it was generally because the specific force majeure clause contained nonstandard language (such as a reference to a “change in economic conditions”) that might apply to financial turmoil.

## Step 4: Determine if mitigation or substitution is possible

A force majeure event will generally only excuse performance if the party cannot overcome or avoid it through reasonable and diligent efforts. Again, here are a few increasingly common scenarios to illustrate this point:

- **Scenario D:** A supply chain link makes widgets, which a manufacturer buys as one of several parts that are combined into a final product. The supply chain link buys alpha parts from Wuhan Parts. Alpha parts are a crucial component of the widget assembly process.

Due to quarantines imposed by the Chinese government, the labor force of Wuhan Parts is unable to come to work, and in turn, Wuhan Parts is unable to supply alpha parts to the supply chain link (who in turn, cannot make enough widgets to satisfy its obligations to the manufacturer). Alpha parts are highly sophisticated and custom designed products that are not available from other sources. The supply chain link cannot overcome the problems posed by the quarantine, and its performance to the manufacturer is excused under force majeure.

- **Scenario E-1:** Same as Scenario D, except now, the supply chain link can obtain beta parts from an American company. Beta parts are both inferior in quality and more expensive than alpha parts. However, they are good enough that the resulting widgets still satisfy the manufacturer’s specifications. Because the supply chain link can overcome the obstacle through diligent efforts, its performance is not excused by force majeure.
- **Scenario E-2:** Same as Scenario E-1, except now, beta parts are so much more expensive than alpha parts that the supply chain link is now taking a small loss on its widget deliveries. Whether force majeure applies likely depends on the specific language of the contract. If it refers to “diligent and commercially reasonable efforts,” then performance is likely excused since it is probably not commercially reasonable for the supply chain link to take a loss on every widget it delivers. However, if the contract only refers to “diligent” efforts, force majeure may not apply.
- **Scenario F-1:** A consulting firm has been hired by a client to provide management consulting. The contract clearly envisions that the consulting firm will be physically on-site at the client’s offices and contains numerous terms reflecting this.

All the consulting firm’s relevant personnel are EU citizens, who, due to the recent ban on travel to the United States, are unable to be physically present at the client’s site. However, the consulting firm can gather all the data it needs to produce its recommendations remotely (via email, videoconference, etc.). The consulting firm can overcome the obstacle through reasonable efforts so force majeure does not apply.

- **Scenario F-2:** A consulting firm has been hired by a client to conduct environmental testing and analysis on a proposed development site. All the key scientists and engineers of the consulting firm are EU citizens, who, due to the recent ban on travel to the United States, are unable to travel to the relevant site to conduct the tests. Force majeure likely<sup>3</sup> applies.

A corollary of the rule of the duty to mitigate or find substitutions is that if there are obligations that remain possible to perform under the agreement, the party invoking force majeure likely still needs to fulfill them. Another doctrine such as frustration of purpose might still excuse performance if performing the remaining obligations is an entirely empty or futile gesture.

## Step 5: Give notice of force majeure

Most force majeure clauses require the side seeking to avoid performance to give notice or otherwise inform its counterparty that it will not be able to satisfy its obligations under the contract. Companies should resist the urge

to issue a rote or terse notice and should instead lay out in some detail exactly why they cannot perform and why they have not been able to find some way over, around or through the problem. If the other side ever does sue over the contract, the force majeure notice will be a crucial piece of evidence that the court will closely scrutinize. Telling a convincing and thorough story up front will go a long way in any eventual dispute.

## Step 6: Think about other doctrines

Even if force majeure does not apply, a party may be excused from performing under other legal doctrines, depending on the governing law of the contract. These include frustration of purpose or commercial impracticability, and in civil law jurisdictions, doctrines like hardship and changed circumstances.

**Frustration of purpose:** A party does not need to fulfill their obligations under a contract if, due to some wholly unforeseen event that was beyond what was bargained for or anticipated, the underlying purpose of the contract cannot be achieved.

One important nuance to bear in mind here is that courts will rarely accept the argument that “making a profit” is the “purpose” of a contract for the purpose of applying this doctrine, otherwise any unprofitable contract could be avoided. To illustrate this point, we can look at Scenario C. While force majeure likely does not excuse the band’s performance, they also probably cannot get out of their obligations by arguing the purpose of the contract has been frustrated. The reason is that the underlying purpose of the contract is not to make money or to sell tickets: the purpose is to *hold a concert at the venue*, and it is still entirely possible to do that.

Contrast this with what seems like a very similar fact pattern:

- **Scenario G-1:** A trade association enters into a contract with a hotel to hold a conference. Due to travel restrictions imposed by governments fighting to contain COVID-19, over 90% of the trade association members that had planned to attend the conference cannot do so, including the keynote speaker.

The trade association will probably not be excused from performing under a standard force majeure clause, since it is still physically and legally possible to hold the conference. But unlike the band, the trade association can probably invoke the doctrine of frustration of purpose. The difference is that the fundamental purpose of this contract was to hold a conference – that is, the purpose was to bring large numbers of the trade association’s members to one place to talk and network. Due to unforeseen circumstances completely beyond the trade association’s control, it is no longer possible to do that in any meaningful way, and the underlying purpose of the contract has been frustrated.

Now consider a slight variation:

- **Scenario G-2:** A trade association enters into a contract with a hotel to block off rooms for the trade association’s membership to use during a conference. Due to travel restrictions imposed by governments fighting to contain COVID-19, over 90% of the trade association members that had planned to attend the conference cannot do so, obviating the need for rooms.

The hotel would argue (likely successfully) that the purpose of the contract was to make lodging available, and it is still entirely possible to hold the rooms open for use. However, this could go in the trade association’s favor if, for instance, the recitals of the contract contained language stating that the purpose was to accommodate or house the trade association’s members.

Note that a lot of the case law on frustration of purpose also delves into whether the particular obstacle was anticipated by the parties or within the risks contemplated and allocated under the agreement. This is highly unlikely to be an issue here given the unprecedented impacts of COVID-19.

**Commercial impracticability:** The Restatement (2d) of Contracts § 261 provides the basic formulation for the defense of commercial impracticability:

Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the nonoccurrence 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.

As the Comments to the Restatement illustrate, commercial impracticability is almost synonymous with force majeure; the fact that a contract suddenly becomes a money-losing proposition for one side is not enough. Instead, some massive and supervening factor such as a fire or war must outright prevent the performance of one side's obligations.

The advantage of impracticability as a doctrine is that it might, especially in jurisdictions that follow the Restatement, serve to compensate for an unfavorable force majeure clause. Suppose for instance your force majeure clause does not list epidemics as a performance excusing event, and you are in a jurisdiction that narrowly construes catch-all phrases so that you might not be able to claim the protection of force majeure. While the contract may not excuse performance, the same facts, applied to commercial impracticability, might be able to function as an affirmative defense.

**Civil law:** In civil law jurisdictions (e.g., France, Switzerland, the Netherlands or Germany), doctrines such as hardship, unforeseeability and fundamental change in circumstances may require parties to discuss rebalancing or adjusting their contracts and may empower the courts or arbitral tribunals to do so if the parties are unable to agree. These doctrines are rooted in the duty of good faith and tend to apply to long-term contracts. Notably, they do not require a showing of impossibility; rather, they require proof that performance would be extremely onerous or the equilibrium between the parties has fundamentally changed.

#### Notes

1. *Compare, TEC Olmos LLC v. ConocoPhillips Co.*, 555 S.W. 3d 176, 194 (Tx. Ct. App. 2018) ("reviewing courts cannot myopically scrutinize the contract's single force majeure provision to identify a qualifying event; instead, they view the entire contract to determine whether the parties intended the disruptive event to be within the body of risk assigned to a party or if, instead, it may excuse performance through the force majeure provision"); *with Kel Kim Corp. v. Central Markets*, 70 N.Y. 2d 900, 902-03 (N.Y. Ct. App. 1987) ("the Contractual [force majeure] provision does not specifically include plaintiff's inability to procure and maintain insurance. Nor does this inability fall within the catchall 'or other similar causes beyond the control of such party.' The principle of interpretation applicable to such clauses is that the general words are not to be given expansive meaning; they are confined to things of the same kind or nature as the particular matters mentioned").
2. *Great Lakes Gas Transmission Ltd. P'ship v. Essar Steel Minn., LLC*, 871 F. Supp. 843, 852-53 (D. Minn. 2012) (collecting cases on the 2008 financial crisis and force majeure).
3. "Likely" because it may be possible for the consulting firm to hire American scientists to conduct the tests or gather the relevant data. Whether this is a reasonable response likely depends on the specifics of the consulting contract, and in particular, whether the consulting firm was hired for the specific expertise or knowledge of its own employees or to conduct more commodified work.

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