

COVID-19: Force Majeure and Other Potential Legal Issues Regarding Contractual Performance

MARCH 2020

This publication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It should not be relied upon as legal advice as facts and circumstances may vary. The sharing of this information will not establish a client relationship with the recipient unless Cravath is or has been formally engaged to provide legal services.

COVID-19 Outbreak

- **The emergence and rapid spread of COVID-19 has resulted in significant global, federal and local action**
 - WHO declared the outbreak a “pandemic” on March 11
 - The federal government has issued foreign travel restrictions
 - States and local governments have declared states of emergency and imposed event and gathering restrictions, business closures and mandatory quarantines
 - The President declared a national emergency on March 13

- **The effects of the outbreak—and government efforts to curtail the spread of the virus—are being felt across the global economy**
 - Federal Reserve cut interest rates to 0% - 0.25%
 - U.S. Treasury announced approval of \$10 billion Federal Reserve commercial paper funding facility with purpose of assisting American businesses to manage short-term liquidity issues
 - Federal government is considering a \$2 trillion stimulus package

What does COVID-19 mean for business?

- **Potential effects of the outbreak, which are already being felt across the global economy, include:**
 - Interruption of supply chains
 - Stagnated or halted production
 - Business closings
 - Diminished labor force/employment issues
 - Significantly reduced cash flows and greater liquidity concerns
- **These global disruptions may pose challenges to fulfilling existing contractual obligations, including contracts that have long-term or ongoing supply implications**

Force Majeure: Overview

- **Force majeure clauses are likely to be relevant to companies facing difficulties complying with contractual requirements as a result of COVID-19 circumstances**
 - A force majeure clause is a contractual provision that excuses contractual performance due to an event that is outside the control of the contracting parties
 - Force majeure clauses often specify what events will constitute “force majeure”, such as acts of God, war, disaster, strikes, national health emergency, etc.
 - A force majeure clause may be used as an affirmative defense in the event a party is unable to perform under a contract due to a “force majeure” event
- **Whether COVID-19 constitutes a “force majeure” is often a contract-specific question that will be governed by the law of the relevant jurisdiction**
 - Courts interpreting force majeure clauses may consider whether the clause specifically identifies “disease”, “pandemic”, “epidemic” or “quarantine” as potential triggering events
 - The applicability of a force majeure clause will depend on a case-by-case examination of the contract and relevant commercial circumstances
- **Force majeure clauses may be construed narrowly by courts**

Force Majeure: Practical Tips

▪ Review your contracts

- Do they have a force majeure clause?
- Does that clause enumerate any category of event that could reasonably include COVID-19, like “disease”, “epidemic”, “pandemic” or “quarantine”?

▪ Check the governing law

- It is important to understand the law of the governing jurisdiction with respect to the interpretation and application of force majeure clauses
- Many courts, including in New York, construe these clauses narrowly
- Some courts require that the event was unforeseeable such that the parties could not have accounted for it when drafting the contract or mitigated the effects of the event
- Whether the economic downturn that results from the outbreak constitutes a force majeure event will depend on the relevant law and contract language

▪ Reserve your rights

- Force majeure clauses will often contain a notice provision requiring that the party seeking to excuse performance alert the other party
- Ensure compliance with these notice requirements—and any other contract-specific requirement or requirement imposed by the relevant case law—to ensure that you are reserving your rights to assert force majeure as a defense

Other Potentially Relevant Contractual Clauses

▪ Industry Standards

- Obligations to perform to such standards may no longer make sense if the impact of the virus is such that it reduces performance across the industry
 - Pay attention to provisions that require parties to exercise “commercially reasonable efforts” or act in accordance with standards that are customary for a certain industry (particularly if that industry has been significantly affected by COVID-19)

▪ Restrictions on Alternative Delivery

- Certain contracts may mandate that all work be conducted at specific facilities
 - If that facility is closed as a result of the pandemic, parties could argue for an exception to that requirement
 - Though conducting the same work at a different facility could act as a workaround, doing so may raise a host of additional issues (e.g., intellectual property, data security, employment, tax)

▪ Termination Rights

- Parties may be able to terminate if performance becomes illegal, impossible, unreasonable or otherwise constrained

Other Potential Legal Defenses to Nonperformance

- In addition to contractual clauses, parties may be able to rely on common law defenses to excuse performance due to the COVID-19 pandemic
- Check the law of the governing jurisdiction to determine which of these defenses are available and how they are construed in the jurisdiction
- Like force majeure clauses, these defenses are generally enforced narrowly by courts. Whether they apply will be determined based on a case-specific inquiry
- **Impossibility**
 - Impossibility may excuse nonperformance where performance is objectively impossible due to the intervention of an unforeseeable circumstance or action
- **Impracticability**
 - Impracticability may excuse nonperformance where an unanticipated circumstance has made performance so different from what was reasonably expected that the party would suffer extreme, unreasonable and unforeseeable hardship
 - Impracticability falls short of objective impossibility
- **Frustration of Purpose**
 - Frustration of purpose may excuse nonperformance where an unanticipated event has foreclosed the “purpose” of the contract
 - That is, even if the party performed its obligations, performance would not fulfill the purpose of the contract

Summary

- **There is growing reason to believe it may become difficult to honor certain contractual obligations due to the increased spread and impact of COVID-19**
- **Companies need to be diligent and proactive in reviewing their contracts to identify what defenses may be available and what notice and reporting obligations they may have under those contracts**
 - Engaging in this work on the front-end can help preserve such defenses, to the extent they are available
 - Parties should be mindful that contract counterparties are likely conducting a similar analysis and that available defenses may limit their ability to recover damages for nonperformance

CRAVATH

Worldwide Plaza

825 Eighth Avenue
New York, NY 10019-7475
+1-212-474-1000 Phone
+1-212-474-3700 Fax

CityPoint

One Ropemaker Street
London EC2Y 9HR England
+44-20-7453-1000 Phone
+44-20-7860-1150 Fax