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CRAVATH, SWAINE & MOORE LLP

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

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# COVID-19 Outbreak

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- **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

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# What does COVID-19 mean for business?

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- **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**

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# Force Majeure: Overview

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- **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**

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# Force Majeure: Practical Tips

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## ▪ 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

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# Other Potentially Relevant Contractual Clauses

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## ▪ 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

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# Other Potential Legal Defenses to Nonperformance

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- **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

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# Summary

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- **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

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**Please feel free to contact us if we can provide further information on these matters**

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