Alert

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Force Majeure from the Trenches: Cancelling Contracts in the Midst of a Global Pandemic

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Eight weeks ago, coronavirus was an obscure term of modest significance to nearly everyone detached from the narrow band of doctors and scientists who study such things. Today, coronavirus or, more correctly, COVID-19, is not only at the top of each news cycle, it often is the news cycle. Schools have closed. Businesses have closed. Borders have closed. Wall Street has closed … down … a lot. Additional closures and restrictions seem likely.

As the situation progressed, legal commentators opined *en masse* about the effect COVID-19 might have on the ability of contracting parties to perform their bargained-for obligations — would the virus be considered a force majeure event such that contractual performance could be excused? Yet, piece after piece on the subject proved time and again that the authors were unwilling or unable to answer their own central question.

Force majeure events are rare. They are unforeseeable. They are "acts of God." If they occurred often, each triggering event would be addressed in contracts with greater frequency and particularity. Only now are we beginning even to scratch the surface of the legal issues spawned by COVID-19.

Evaluating Force Majeure Starts with Three Questions

Whether you are a contracting party looking to cancel your contract or to resist cancellation, three fundamental considerations will likely guide your analysis: (1) what does the contract say; (2) what does applicable law say; and (3) how, specifically, has COVID-19 impacted the performance of the contract? Let's take each in turn.

As with most issues arising in contract, this evaluation starts with the contract. Do you have a force majeure clause and what does it say? (Not all contracts have a force majeure clause and, as touched on below, common law arguments may still exist if a force majeure clause is absent). Notwithstanding that the general principle undergirding substantially all force majeure clauses is the same — to allow contracting parties to unwind or, sometimes, modify a contract in the event something unforeseeable by the parties at the time of contracting disrupts performance — it will likely come as no surprise that the language of these clauses is often negotiated and can vary considerably from contract to contract. For instance, some clauses may allow force majeure to be invoked if performance is "inadvisable" or "impracticable;" whereas others may hold the parties to a higher standard such as "illegal" or "impossible." Along the same lines, some contracts may specifically identify triggering events such as "earthquake," "flood," and yes, "pandemic;" whereas others speak more generally to "acts of God," "government authorities" or "natural disasters." This matters because courts generally interpret force majeure clauses narrowly, meaning, in order to cancel, a force majeure event must generally be deemed to fall within the direct scope of the clause's language.

Similarly, the law applicable to the contract is critical. Just as contract language can vary considerably, so can courts' stance on how to interpret that language. New York courts, for instance, are widely regarded as taking a restrictive view of the events that can trigger a cancellation due to force majeure, often refusing to look behind the list of events the contracting parties specifically enumerated, if any. Other jurisdictions are more liberal, reading contracts narrowly but affording the parties sufficient room to maneuver where an intervening event was truly unforeseeable and materially alters performance. This matters because pandemic is an unusual basis to invoke force majeure. Parties forced to litigate the issue may find *some* precedent involving the SARS outbreak and other isolated events but, for the most part, the legal pathway to cancellation due to COVID-19 is not well worn. As touched on below, the evaluation becomes even

more complex if it involves questions of international law. For instance, nations with a civil law system (EU, China) address force majeure differently — often more forgivingly — than nations with a common law system (USA, UK).

Lastly, contracting parties must consider how, specifically, COVID-19 has impacted or will impact their performance. For instance, if the contract allows for cancellation when performance becomes "impossible," the contracting parties must ask themselves honestly: is performance truly *impossible*, or merely impracticable? Remember, courts will generally read force majeure clauses narrowly. As a result, parties should not assume that performance will be excused if such performance is technically possible but results in a financial hardship to the party seeking to cancel. Financial hardship — even bankruptcy — may not excuse performance.

Additional Duties: Notice and Mitigation

A desire to cancel coupled with a good faith belief that you can cancel does not a cancellation make. You evaluated the three factors above and believe they fall in your favor — now what? Force majeure cancellations are generally accompanied by a duty to give notice and a duty to mitigate damages. Both should be taken seriously.

Contracts will sometimes, but not always, spell out the parties' notice requirements. If the contract speaks to the manner or timeframe in which notice must be given, it should be strictly adhered to. More than one supposed declaration of force majeure has been deemed ineffective due to insufficient notice. If the contract is not specific about notice, it is still prudent in nearly all situations to give notice promptly, in writing, and in sufficient detail for the counterparty to understand the contractual basis for the cancellation and way(s) in which COVID-19 has affected performance so the counterparty can evaluate its own rights and obligations — i.e., so the counterparty cannot claim undue prejudice. Remember, a declaration of force majeure is generally a bell that cannot be unrung, so the nature, timing, and substance of any communication on the subject should be thoughtful. This is not the time to shoot from the hip, no matter how adverse the parties perceive the situation to be.

Once notice is given, the law generally implies a duty to mitigate damages. What this means, practically speaking, may vary considerably from circumstance to circumstance depending on the nature of the contract and the disruption to performance. Assume the contract relates to an event that must be cancelled due to travel restrictions. The parties might ask themselves: Can the event be postponed or rescheduled at a time when travel restrictions would be less likely to be in effect? Or, assume the contract is for services that cannot be performed in full due to quarantine, the parties might ask: Can there be partial performance now, with total performance to follow when the quarantine is lifted? The point is, the relationship between the contracting parties does not simply cease in its entirety because force majeure has been declared.

Final Considerations

Although the concepts discussed above will likely form the backbone of any force majeure analysis, they are not the be-all and end-all. Whether a party is considering cancellation or faced with the prospect of resisting, contracting parties should consider the following non-exclusive list of additional concepts.

Renegotiation

The olive branch before the spear. Have you attempted to renegotiate as a precursor to declaring force majeure? Because a declaration of force majeure is often a bell that cannot be unrung, contracting parties may want to determine whether the terms of a contract can be renegotiated for mutual benefit before a cancellation is made.

Remedies/Enforcement

If you cancel the contract and your counterparty resists, how and where will the dispute take place? Is there an arbitration clause and does it inure to your adversary's benefit? Is the law of a restrictive forum (or liberal forum) applicable? And are there potentially any penalties for non-performance that may be invoked by the counterparty?

Insurance

Will a cancellation trigger coverage under a party's business interruption, events, general liability, or other insurance? Have you dusted off and reviewed your coverage and discussed it with your broker, insurer, and/or counsel?

Alternate Supply Streams

Have you considered whether the goods and/or services at issue in your contract can be provided by other persons or entities in the event of a cancellation in order to reduce the impact on you and, if applicable, your business?

Civil Law vs. Common Law

Have you evaluated whether your contract, or a dispute regarding cancellation, will be evaluated under civil law or common law? Civil law often implies concepts of force majeure in contracts, even if they are not stated outright in the document. Common law generally does not. Common law, by contrast, recognizes doctrines such as "impossibility," impracticability," and "frustration of purpose," which can be used to cancel a contract in the absence of express force majeure language. But successfully invoking these doctrines can be quite difficult, even by comparison to invoking force majeure.

Conclusion

The global proliferation of COVID-19 will undoubtedly result in contracting parties declaring force majeure in numbers seldom seen in the history of established contract law. Notwithstanding that pandemics have rarely been used as a basis for such declarations, it seems at least plausible — if not likely — that a great many of these declarations will withstand judicial scrutiny, if challenged. Indeed, the only modern precedent we have for a pandemic of this projected scope would appear to be the Spanish flu of 1918. Yet, that pandemic arose at a time when globalization — and, by extension, multinational contracts — had reached a mere fraction of the level we see today. Likewise, governmental steps to disrupt the spread of the virus were less decisive.

So, Spanish flu is, at best, in imperfect analog to COVID-19. With businesses and borders closing to both people and goods, and quarantines on the rise, contractual obligations will be disrupted and performance will often become impossible. That is not speculation; it is fact. It is already happening. Because the circumstances that give rise to a colorable declaration of force majeure are fact-specific, all parties whose contracts may be affected by COVID-19 — those who may seek to invoke force majeure and those who would be likely to oppose it — would be wise to evaluate the risk **now**, rather than being caught flat-footed in a commercial landscape that is changing by the hour.