

A U.S. litigator's perspective on *force majeure*

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The COVID-19 (“coronavirus”) illness that has swept into at least 140 countries worldwide and infected more than 200,000 people was officially designated a pandemic by the World Health Organization (WHO). In addition to the humanitarian and public health dimensions of the outbreak, governments have begun implementing drastic measures to mitigate the spread of the virus, including quarantines, closure of bars and restaurants, bans on mass gatherings, and strict travel restrictions.

As a result, companies have begun to cancel or postpone high-volume events including major concerts, festivals, sporting events, and conferences on a global scale. In light of such action, affected parties need to assess whether the COVID-19 pandemic, and related mitigation efforts, are sufficient to trigger *force majeure* provisions in their contracts, which would allow the invoking party to suspend, defer, or be released from its duties to perform without incurring liability.

***Force majeure* clause: the basics**

A *force majeure* clause is a contractual provision that excuses a party's performance under a contract when circumstances arise beyond that party's control, making performance inadvisable, commercially impracticable, illegal, or impossible.¹ Although *force majeure* was historically equated with an “act of God” such as natural disasters, earthquakes or floods, the term has since been expanded to encompass other events, including strikes, market shifts, terrorist attacks, computer hacking, and government actions.

In California, the primary test for *force majeure* is determining whether the particular event impeding performance “could not have been prevented by the exercise of prudence, diligence and care.”² In considering the applicability of this test, courts have focused on (1) whether the event qualifies as *force majeure* under the contractual language; (2) whether the risk of nonperformance was foreseeable and able to be mitigated; (3) causation between the *force*

¹ See Cal. Civ. Code § 1511; see also TRACY BATEMAN ET AL., 77 A CORPUS JURIS SECUNDUM, SALES § 370; MARIE K. PESANDO, AMERICAN JURISPRUDENCE 2D ACT OF GOD § 13.

² *Horsemen's Benevolent & Protective Ass'n v. Valley Racing Ass'n*, 4 Cal. App. 4th 1538, 1564-65 (Cal. Ct. App. 1992)(quoting *Pacific Vegetable Oil Corp. v. C.S.T., Ltd.*, 29 Cal. 2d 228, 238 (Cal. 1946)).

majeure event and the resultant non-performance; and (4) whether performance is truly impossible.

Reverting to first principles, the threshold question is whether the plain language of a *force majeure* clause encompasses the type of event a contracting party claims is causing its nonperformance.³ All clauses are not created equal. Some contracts 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. Other *force majeure* clauses include catch-all language that broadly excuses performance based on significant events outside the parties' control.

It is worth noting that parties are under an obligation to mitigate any foreseeable risk of nonperformance, and cannot invoke *force majeure* where the potential nonperformance was foreseeable and could have been prevented or otherwise mitigated.⁴ Many contracts also require that a party seeking to enforce a *force majeure* provision in order to suspend or terminate performance must provide notice. Failure to provide notice according to the specifications noted in the contract may result in waiver of the clause.

Importantly, even when a potential *force majeure* event is encompassed by the relevant clause, impracticability or inconvenience in performance is insufficient; there must be extreme and unreasonable difficulty, expense, injury or loss that frustrates a party's reasonable efforts to perform.⁵ Some courts have held that a *force majeure* clause may be triggered when performance is not "impossible," as long as it is found to be "prohibitively difficult." For example, in 1989 when Hurricane Hugo damaged oil facilities, a court excused an oil supplier's delay due to "post-hurricane congestion" in oil production and shipments under a *force majeure* clause in the original contract.⁶

Specific applications of *force majeure* clauses

Typically, courts will assess the applicability of a *force majeure* provision based on the particular facts at issue on a case-by-case basis.⁷ The following examples from various jurisdictions provide illustrations of what constitutes a *force majeure* event:

³ See RICHARD A. LORD, 30 WILLISTON ON CONTRACTS § 77:31 (4th Ed.) ("What types of events constitute *force majeure* depend on the specific language included in the clause itself."); see also *Watson Labs., Inc. v. Rhone-Poulenc Rorer, Inc.*, 178 F. Supp. 2d 1099, 1109–10 (C.D. Cal. 2001) quoting *Perlman v. Pioneer Limited Partnership*, 918 F.2d 1244, 1248 (5th Cir. 1990) ("The language in the force majeure clause ... is unambiguous and its terms were specifically bargained for by both parties. Therefore, the [common law] 'doctrine' of force majeure should not supersede the specific terms bargained for in the contract.").

⁴ See *Hay Haulers Dairy Employees & Helpers Union*, 45 Cal.2d, *supra* note 4; see also 6 CORBIN ON CONTRACTS, § 1342, at 328.

⁵ See *Oosten v. Hay Haulers Dairy Employees & Helpers Union*, 45 Cal.2d 784, 291 P.2d 17, 20–21 (1955); see also *Butler v. Nepple*, 54 Cal.2d 589, 6 Cal. Rptr. 767, 772-73, 354 P.2d 239, 244-45 (1960) (affirming *Oosten* rule that party must take reasonable steps to ensure performance); accord, *San Mateo Community College District v. Half Moon Bay Ltd. Partnership*, 65 Cal.App.4th 401, 409–13 (1st Dist.1998).

⁶ *Toyomenka Pac. Petroleum v. Hess Oil Virgin Is. Corp.*, 771 F. Supp. 63, 66-67 (S.D.N.Y. 1991).

⁷ *Nissho-Iwai Co., Ltd. V. Occidental Crude Sales, Inc.*, 729 F.2d 1530, 1540 (5th Cir. 1984) ("the California law of force majeure requires us to apply a reasonable control limitation to each specified event, regardless of what generalized contract interpretation rules would suggest."); *Valley Racing*, 4 Cal. App. 4th at 1565, *supra* note 2.

- In *SNB Farms, Inc. v. Swift & Co.*, the court found in favor of three hog farms that claimed an outbreak of Porcine Reproductive and Respiratory Syndrome affected hog production and triggered the *force majeure* provisions included in their contracts.⁸
- In *Bush v. Protravel International, Inc.*, the court held that measures taken by the New York State and City governments, including their declaration of a State of Emergency in the wake of the September 11, 2001 terrorist attacks, strongly supported the claim that performance of the contract had been rendered impossible for a period of time.⁹
- In *Rexing Quality Eggs v. Rembrandt Enterprises, Inc.*, a federal court in Indiana applying Iowa law held that failing consumer demand did not constitute a *force majeure* event.¹⁰
- In *Virginia Power Energy Mktg., Inc. v. Apache Corp.*, two hurricanes merging to cause damage to a gas pipeline and prevent delivery constituted a *force majeure* event.¹¹
- When the global financial crisis of 2008 made it impossible for a party to build a restaurant because it needed its limited funds to meet debt obligations, a New York appeals court refused to excuse performance despite a broad *force majeure* clause, reasoning that “financial hardship” is not grounds for invoking *force majeure*.¹²

Of note, even if an event is found to trigger a *force majeure* clause, the focus remains on whether the party invoking the clause could have performed “but for” the event. In *Classic Maritime Inc. v. Limbungan Makmur SDN BHD*, a ship owner entered into a long-term contract with Limbungan, a charterer, for the carriage of iron ore pellets from Brazil to Malaysia.¹³ Following the burst of the Fundão dam in Brazil on November 5, 2015, Limbungan claimed that the burst constituted a *force majeure* event that prevented it from supplying the promised shipments. The court held that because Limbungan could not prove that “but for” the dam burst it would have performed its obligation under the contract, it was not entitled to invoke *force majeure* and avoid liability.

COVID-19 as a basis for invoking *force majeure*

In analyzing whether a court or arbitration panel will find whether COVID-19 excuses performance, it is imperative to scrutinize the specific language of the *force majeure* clause, as well as the applicable law in the governing jurisdiction. Some clauses may specifically mention disease or illness, while others may generally reference causes beyond the parties’ reasonable control, or “acts of God.” Unless the contract specifically mentions pandemic, viral outbreak or illnesses, there will likely be a dispute over whether the coronavirus’ impact on the parties’

⁸ No. C01-2077, 2003 WL 22232881, at *10 (N.D. Iowa Feb. 7, 2003).

⁹ 746 N.Y.S.2d 790, 795, 797 (N.Y. Civ. Ct. 2002).

¹⁰ *Rexing Quality Eggs v. Rembrandt Enterprises, Inc.*, 360 F. Supp. 3d 817, 822 (S.D. Ind. 2018).

¹¹ 297 S.W.3d 397, 405 (Tex. App. 2009).

¹² *Route 6 Outparcels v. Ruby Tuesday*, 931 N.Y.S.2d 436, 438 (App. Div. 3d Dep’t 2011) (“Defendant made a calculated choice to allocate funds to the payment of its debts rather than to perform under the subject lease. Economic factors are an inherent part of all sophisticated business transactions and, as such, while not predictable, are never completely unforeseeable; indeed, ‘financial hardship is not grounds for avoiding performance under a contract.’”); *but see In re Old Carco*, 452 B.R. 100, 119–20 (Bankr. S.D.N.Y. 2011) (excusing performance after 2008 financial crisis under *force majeure* clause that explicitly included “change to economic conditions” as a *force majeure*).

¹³ 646 F. Supp. 2d 364, 366-67 (S.D.N.Y. 2009).

performance constituted an “act of God,” or whether it was sufficiently foreseeable that it should have been more specifically written into the contract.

While the question of whether a pandemic constitutes a *force majeure* event turns on the language of the provisions and applicable law, there is not extensive published case law in the United States involving disease outbreak similar to COVID-19. In the relatively small number of judicial opinions that have analyzed whether a certain disease outbreak constituted a *force majeure* event, courts have maintained focus on the actual language of the clause, as well as the extent to which the outbreak was an unforeseeable event precipitating a dramatic change in market conditions and rendering performance truly impossible.¹⁴ Here, the fact that at least 140 countries have reported COVID-19 cases to the World Health Organization distinguishes it from other epidemics and weighs in favor of this pandemic being considered a *force majeure* event. Of note, this is only the sixth time that the WHO has declared a disease outbreak to be a Public Health Emergency of International Concern (PHEIC) since being vested with that authority in 2005, two years after the SARS outbreak.

However, even if the COVID-19 outbreak itself is not considered a *force majeure* event because it does not make performance essentially impossible, the quarantines, travel restrictions or other related limitations on normal business imposed by governments may constitute a valid “Governmental Entities” act excusing performance.¹⁵

Given the current crisis, courts in the United States may be more willing to find that both the outbreak and governmental responses were unforeseeable events or beyond the control of either party, making it more probable that *force majeure* invocation would prevail to suspend, defer, or release a party from contractual obligations at least for a period of time.

Frustration of purpose and impossibility in the absence of a *force majeure* clause

Even if a contract does not contain an applicable *force majeure* clause, an affected party may still seek to avoid performance by arguing frustration of contract due to COVID-19. A contract is frustrated when there is a “change in circumstances” that alters the nature of the contractual rights and/or obligations in a way that the parties could not have reasonably contemplated at the time they executed the contract.¹⁶

¹⁴ See *Rembrandt Enterprises v. Dahmes Stainless*, No. 15-cv-4248, 2017 WL 3929308, at *2, *12 (N.D. Iowa Sept. 7, 2017) (“In the spring of 2015, an epidemic of Avian Flu hit the Midwestern United States. The outbreak was notorious and engendered a large amount of media coverage and government intervention;” the flu devastated a poultry farmer’s egg production operations and he was forced to shutter plans to build a new location; farmer sought to cancel its order of a commercial dryer for that cancelled location, as a result of the purported force majeure; the court refused, reasoning that the effects of the avian flu did not affect the ability of the supplier to build and deliver the dryer).

¹⁵ See, e.g., *Harriscom Svenska, AB v. Harris Corp.*, 3 F.3d 576, 580 (2d Cir. 1993) (holding *force majeure* clause which included “governmental interference” excused performance when the government forbade shipping orders to Iran); *Duane Reade v. Stoneybrook Realty, LLC*, 882 N.Y.S.2d 8, 9 (App. Div. 1st Dep’t 2009) (A New York appellate court applied a *force majeure* clause that included “governmental prohibition” to excuse performance interrupted by a judicial restraining order. The court reasoned that a judicial order, though not specifically enumerated, fit into the category of governmental prohibition.).

¹⁶ *FPI Development, Inc. v. Nakashima*, 231 Cal. App. 3d 367, 398 (Ct. App. 1991) (citing Restatement (Second) of Contract (citing Restatement (Second) of Contracts § 266 (2)).

The change in circumstances must be attributable to an external event that is not caused by the party relying on it. Accordingly, if COVID-19 fundamentally changes the principal purpose of the contract in a way that renders performance drastically different from what would have been originally contemplated, the contract may be considered frustrated and the defaulting party may be excused from performing.¹⁷ However, unlike some *force majeure* clauses, it is not possible to simply suspend the performance of a frustrated contract; instead the contract is voided.¹⁸

In a situation where there is no applicable *force majeure* clause and no mutually understood contractual purpose, if performance is impossible, the excuse of impossibility may apply.¹⁹ An assessment of this defense is heavily dependent on specific facts developed, and the invoking party must be able to show that the event causing impossibility was unforeseeable.²⁰

Insurance recovery and COVID-19

Another option for recovery in light of COVID-19 is business interruption coverage as part of property insurance. Business interruption insurance is intended to cover losses resulting from interruptions to a business's operations, and is typically provided if there is a direct physical loss such as a fire, flood or earthquake. In the case of COVID-19, a direct physical loss may not be readily apparent. However, if access to a property is impaired by order of a civil or military authority in connection with an insured peril, such as President Trump's recent ban on travel from Europe to the U.S., or the Center for Disease Control's recent recommendation to cancel or postpone events for more than 50 people for eight weeks, there is a higher potential for recovery.

Standard business interruption coverage typically includes an endorsement excluding bacteria/viruses and/or epidemics. However, in response to past epidemics, specialty insurance was developed to respond. For example, in October 2014, in response to the Ebola epidemic, specialty brokers in conjunction with the Ark Specialty Program of Lloyds of London offered a new type of coverage called "Pandemic Disease Business Interruption Insurance" to cover loss of income arising from government mandated closure of healthcare facilities and diminished revenue in the aftermath of a quarantine.²¹ Also, some exclusions are limited to bacteria (as opposed to bacteria and virus), so it is vital to check the policy language given that COVID-19 is a virus and may not be covered by a bacteria exclusion. Accordingly, as with *force majeure* provisions, companies should analyze language included in their business interruption insurance policy, with particular attention given to notice requirements, in order to make sure they are in compliance should it be necessary to request recovery due to COVID-19.

¹⁷ See *Dahmes Stainless, Inc* No. 15-cv-4248 at *9, *supra* note 15 (The court reasoned that a jury might find that both parties fully understood the purpose of the contract – to expand the egg production operations to meet new orders – and that the new equipment would be worthless due to cancellation of order due to the flu.).

¹⁸ See *Johnson v. Atkins*, 53 Cal. App. 2d 430, 433, 127 P.2d 1027, 1029 (1942).

¹⁹ See *Emelianenko v. Affliction Clothing*, 2011 WL 13176615, at *27 (C.D. Ca., 2011) ("The common law force majeure defense is similar to the defense of impossibility.").

²⁰ See *D & A Structural Contractors v. Unger*, 25 Misc.3d 1211(A). 901 N.Y.S.2d 898 (N.Y. Sup. Ct. 2009).

²¹ Stephanie Goldberg, "NAS offers coverage for Ebola-related business closures," *Business Insurance*, Oct. 17, 2014, <https://www.businessinsurance.com/article/20141017/NEWS06/141019880/NAS-offers-coverage-for-Ebola-related-business-closures> (last visited Mar. 1, 2020).

Looking ahead: evaluating plans to assert your rights under *force majeure*

As the COVID-19 pandemic continues to evolve, companies should evaluate how the outbreak may affect their ability to enforce and/or excuse contractual performance, and take proactive steps to mitigate risk associated with invoking *force majeure* provisions. Whether you're thinking about making a claim or worried about receiving one, here's our 10-point, jargon-free checklist on what to do:

Check your contract's governing law²²

- The level of deference to the language of the underlying agreement will differ depending on the jurisdiction applying its law. Some jurisdictions impose overriding *force majeure*-type provisions which apply no matter what the contract does or doesn't say. Some jurisdictions, such as California, require the court to consider parol evidence when interpreting the language of the agreement.²³

Find the *force majeure* clause

- It could be buried somewhere unexpected or headed "exceptions," "unforeseen events," or "acts of God."

Establish the events it covers

- A non-exhaustive list is obviously better than an exhaustive one. In both cases, look closely at how *force majeure* events are defined and decide whether COVID-19 or related events fits the definition.
- Most clauses referring to epidemics and pandemics won't define them or identify who decides whether an outbreak has reached this threshold. However, there is less of a hurdle now that COVID-19 is classified as a global pandemic. Some governments have officially certified coronavirus as a *force majeure* event in their jurisdiction.
- If pandemics aren't mentioned, the clause could still be triggered where it covers labor and supply shortages (which COVID-19 will cause) or broadly defines events as exceptional, beyond one party's control, unavoidable, and not attributable to the other party (but check carefully that all these conditions are fulfilled).
- If there is no *force majeure*-type clause or the event is not covered by the contract wording, consider relying on provisions such as those dealing with material adverse change, price adjustment, liability limitations and exclusions, extensions of time, variations, or changes in law (for example, laws prohibiting employees or transport from working, which slow down the supply chain).

Evaluate the causal links between COVID-19 and non-performance

- A *force majeure* clause usually requires performance of contractual obligations to be "prevented," "impeded," "hindered," or "delayed." "Prevent" requires that the obstacle to perform is insurmountable, for example that it is no longer physically possible or legally permissible to perform the contract. "Impede," "hinder," and "delay" can be construed more broadly and do not require the affected party to prove impossibility to perform.

²² The original version of this checklist was created by Hogan Lovells attorneys Zachary Tan, Mark Crossley and Angus Rankin in the United Kingdom and posted here: <https://www.hoganlovells.com/en/publications/coronavirus-as-a-contractual-force-majeure-event-a-simple-checklist>

²³ See *Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal.2d 33, 37 (1968).

- To rely on the clause, the event must be the only one affecting contractual performance (unless clearly stated otherwise). In other words, "but for" the COVID-19 pandemic or related events, a party must have been willing and able to perform.

Understand the effects from noticing a *force majeure* event

- Depending on how long performance is affected, the contract may provide for the right to suspend, seek an extension of time, or for either party to terminate. Are you prepared for one or more of these consequences?
- If a dispute were to result from the claim, is your dispute resolution mechanism robust or are there drafting gaps that could be exploited and lead to satellite claims, for example over governing law, arbitration, or venue? Would court orders or arbitral awards be enforceable in the relevant jurisdiction? If not, friendly negotiations between senior company representatives, mediation, or settlement may be more productive.

Comply strictly with contractual notice requirements

- Ask yourself:
 - Is an initial notice of the *force majeure* event required?
 - Must you supply supporting details and evidence of the event and its effects?
 - By when, and in what form, should notices and supporting documents be served?
- It may be hard to pinpoint exactly when COVID-19 will start to affect your contract. If unsure, consider notifying *force majeure* at the earliest opportunity, followed by further periodic notices or updates regarding the continuing disruption, so your claim is not time-barred.

Document evidence which supports your claim

- Properly record and store evidence of all communications with your counterparties about the disruption and its effects, including order or service cancellations.
- You must mitigate the effects of a *force majeure* event, so document reasonable steps taken to do so.

Respond quickly to *force majeure* notices

- If there is a time limit for responding to a notice, failure may constitute acceptance of the counterparty's *force majeure* claim.
- Review subcontracts and supply contracts in case you too need to claim *force majeure*. If this will require *force majeure* event notices from counterparties, engage them early to manage the risk of late or premature notices.

Prepare for the *force majeure* event ending

- Agree with your counterparty on a date when obligations will resume after the event and its effects have ended, especially if the contract is unclear.
- To avoid breaching your contractual obligations once the event is over, request a further extension of time for performing your obligations. The supply chain will need time and resources to resume operations or clear backlogs, so negotiate and agree a realistic extension.

- As the effects of coronavirus are felt at different times, *force majeure* notices could continue to be issued after it is downgraded from a pandemic. At this stage, return to the contract wording to check if coronavirus is covered and the location of the *force majeure* event is mentioned. For example, would your clause be triggered if there were still an epidemic at the place of delivery, but not the place of manufacture?

Learn lessons for future disruptions

- Assess your supply chain contracts so you know which counterparties are most likely to be affected by coronavirus (if they haven't already) and by future *force majeure* events. Engage with them early to plan how the situation will be managed.
- Do the *force majeure* clauses in your existing and future contracts clearly and expressly allocate *force majeure* risk? Depending on your relationships with counterparties, think about amending existing contracts to prepare for similar future outbreaks.
- If you do not have the bargaining power to secure a favorable *force majeure* clause, seek other protections such as a robust price adjustment mechanism. If even they are not possible, would business disruption insurance be appropriate?

We will continue to monitor the situation and provide updates as necessary. If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

Christopher J. Cox

Partner, Silicon Valley

Email: chris.cox@hoganlovells.com

Phone: +1 650 463 4078

Joseph T. Spoerl

Associate, Silicon Valley

Email: joseph.spoerl@hoganlovells.com

Phone: +1 650 463 4159

www.hoganlovells.com

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