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Alerts

COVID-19, Broken Supply Chains, and Force Majeure

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Insights for Insurers

The coronavirus (COVID-19) pandemic—alone or coupled with government orders limiting activities—has impacted the ability of many businesses to maintain operations and to fulfill contractual obligations. Over the past few days, the World Health Organization declared COVID-19 a pandemic and the governors of several States—including New York, California, and Illinois—have declared states of emergency and/or imposed unprecedented travel, movement, and gathering restrictions, and limited or prohibited for a period of time various activities.

First tier priorities for businesses include the health and well-being of their employees and customers. Business survival, continuity, and minimizing losses in revenue and profit also figure prominently in company priorities. The direct and indirect impacts of the virus are wreaking havoc on supply chains. It is hardly surprising, therefore, that many companies are examining contacts to see the remedies that may be available in the event their suppliers do not perform as well as the consequences and remedies available in the event of their own inability to perform.

Many commercial contracts contain *force majeure* ("FM") clauses that may excuse non-performance of contractual obligations when performance is rendered impossible or impracticable due to an event beyond the party's control. Historically, these clauses were boilerplate and not the subject of considerable thought or negotiation at least in some industries. More recently, parties have paid greater attention to the inclusion and content of FM clauses. In the wake of COVID-19, however, companies are likely to give enhanced consideration to the content and negotiation of FM clauses in the future.

The Impact of *Force Majeure* Clauses in Contracts

It seems that the term "*force majeure*" or "superior force" has been spoken more in recent days than in the preceding decades. We have received numerous inquiries regarding supply chain issues and FM clauses and thought it was an appropriate time to provide an overview.

Whether and how a FM clause impacts a company in the context of COVID-19 and/or resulting governmental orders, of course, depends upon the language of the *force majeure* provision, the facts, and the state law that applies to the contract. The answer to the question usually requires a multi-prong analysis. Here are some of the basics.

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- Is there a FM clause? The initial issue is whether the contract contains a FM provision. Many do not.
- Does the FM clause apply? FM clauses are generally interpreted narrowly such that, for an event to qualify as a *force majeure*, it must be specified in or at least be within the scope of the FM clause. Clauses that specify pandemics, epidemics, viral outbreaks, government orders, or states of emergency are more likely to be triggered than those that do not. If not specifically stated, the event must be deemed to at least fall within a category of a force majeure. One phrase commonly found in FM clauses is an "act of God." Whether COVID-19 constitutes an act of God appears to be an open issue.
- Was the event foreseeable? In some jurisdictions, a party seeking to invoke a FM clause often must show it could not have foreseen the potential non-performance. Even if we are focused on the same event—the pandemic—the answer to the foreseeability question may differ depending upon the language of the contract and the time the contract was executed. The outcome may hinge on whether the contract was entered into days ago as opposed to months or years ago.
- Was performance impossible or impracticable? Depending upon the jurisdiction, a party seeking to invoke a FM clause may have to show that its performance was made impossible by the *force majeure*. In other jurisdictions, it is sufficient to show the event made performance impracticable or economically difficult rather than truly impossible.
- Could the party have performed otherwise? A party may have to demonstrate that it could have performed but for the triggering event. In other words, a party generally is not excused from performance by a *force majeure* when it was unable to perform because, for instance, it otherwise lacked the equipment, personnel, or parts to perform.
- Did the party mitigate non-performance? A party must usually show that, notwithstanding the triggering event, its failure to perform could not have been avoided or overcome through alternative means. A party generally has an obligation to mitigate its non-performance. Securing alternate supply streams in the event a supplier's operations are impacted, planning for how employees may continue working remotely, or attempting to transfer functions to other locations potentially may be ways to mitigate.
- Did the aggrieved party mitigate? Mitigation runs both ways. The party seeking to hold the non-performing party liable generally has a duty to mitigate damages itself, by attempting to obtain an alternative supplier or by otherwise limiting its damages.
- Did the aggrieved party comply with the FM clause? The party invoking *force majeure* generally must show that it complied with the provisions in the contract. For example, it is common for a FM provision to require that the party provide notice that it cannot perform to the other party.
- What are the consequences? Many times, the *force majeure* provision sets forth the consequences of a FM under the contract. Some contracts provide that performance is excused completely, while others excuse performance only partially. Still others provide that a *force majeure* merely delays the time when performance is required.

Predicting how any given FM clause will be interpreted in connection with the COVID-19 pandemic is further complicated by the variety of different emergency orders and prohibitions issued by various governmental entities. All circumstances are not the same.

Regardless, we can anticipate that some parties will seek strict enforcement of FM clauses, while others may attempt to rely upon the old adage that "hard cases make bad law." It will be interesting to see whether some courts are willing to interpret FM provision more liberally in view of the scope of COVID-19. As Hinshaw's Chicago-based partner Scott Seaman stated in a March 20, 2020 *Corporate Counsel* article:

"The impact of the coronavirus could make the courts swing more liberal when interpreting force majeure provisions . . . And, in my opinion, the courts should not allow events to distort contract law right now." Seaman called the dynamics very interesting. "In terms of how it will play out in the courts, we'll see. But the parties are lining up."

Indeed, we have previously reported on wrongheaded calls by legislatures and some members of Congress for insurers to pay COVID-19-related losses not covered by policies.

Another interesting dynamic will be how governmental relief, subsidies, and stimulus packages may mitigate damages or otherwise impact developments.