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PERSPECTIVE

Contractual considerations in the coronavirus climate

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The COVID-19 outbreak has impacted the manufacturing, transportation and supply chains underpinning countless aspects of trade and commerce on a global basis. Additionally, the shelter-in-place orders have caused nonessential businesses to shut down, resulting in many of them being unable to meet their contractual obligations.

Force Majeure

Whether coronavirus can be considered a force majeure depends on the wording of the provision. Unless illness-related triggers are specified in the definition, parties are left relying on the typical catchall provisions, such as "act of God" and "unforeseeable events beyond the reasonable control of the parties." Although the courts have provided little guidance on what falls into these provisions, traditionally, "act of God" has been used to refer to natural disasters. The burden of proof will fall on the party attempting to rely on the clause, and it is a high burden to meet. The party must show direct causation between the event and the resulting nonperformance.

One particular piece of language that can provide relief in the coronavirus climate, if it is indeed contained in the force majeure clause at issue, is "government action" or "government regulation." Although it may be difficult to prove that the pandemic itself caused the nonperformance, the travel bans and shelter-in-place orders have provided a unique argument for the nonperformance of contracts for certain parties. It is important to note, however, that traditionally, the courts tend to exempt obligations to make payments from the protection of the force majeure clause.

Common Law Defenses

Other possible arguments with respect to a party's nonperformance are the common law defenses of impracticability/ impossibility and frustration of purpose, which vary across different jurisdictions. The defense of impracticability/impossibility applies where performance is not practical and can only be accomplished with excessive and unreasonable cost. Frustration of purpose excuses performance if the principal purpose for entering into the agreement has been frustrated by a change in circumstances, so much so that without it, the transaction would essentially be pointless. The standard of proof for these claims tends to be higher than that for a force majeure claim, and the probability of success upon litigation is unpredictable.

As in an argument for force majeure, one must try to secure alternative sources for their performance (whether it be personnel, materials, etc.), although if doing so is at prohibitive costs, this could bolster the argument for impracticability. For a claim of frustration, the parties cannot claim the defense merely because they would not have entered into the contract had they known how events would unfold. But, for instance, if an event planning company booked a venue for a large event, which is now prohibited by regulations that forbid gatherings, one could argue that the coronavirus has rendered that particular business transaction pointless. Although these are challenging claims to win, just as in relying on force majeure, coronavirus may provide a unique argument for these common law defenses due to the government actions such as the travel ban and shelter- in-place orders that have caused many businesses to shut down, making them unable to perform their contractual obligations.

A primary factor in arguing these claims is the foreseeability of the event causing the nonperformance. One the one hand, outbreaks such as coronavirus are arguably foreseeable, with epidemics occurring every several years, such as SARS and Zika. On the other hand, coronavirus is not your typical virus. The government response to the outbreak, including travel bans and shelter-in-place orders, has been extraordinary compared to other epidemics, which lends itself to an argument of unforeseeability. The extent and reach of the virus and the responses thereto could not have been identified in advance such that the risks associated with it could have been adequately allocated between the parties.

Other Contractual Considerations

In addition to considering defenses for nonperformance, affected parties should review and analyze the totality of the material agreements impacting their business and the interplay of the provisions therein. Representations, warranties and covenants should be reviewed to determine whether any breaches have occurred due to the financial condition of the business. There may be notice requirements to be complied with. For instance, financing agreements may contain notification obligations requiring the borrower to notify the lender of certain anticipated events, such as material losses or litigation, and other contracts may specify interruption of business as an event of default.

We have learned many lessons in this new climate, which will impact the way we do business now and going forward. Force majeure provisions should be closely reviewed and negotiated and should include illness triggers, such as pandemics, epidemics and public health emergencies. All agreements should be properly analyzed – whether or not a party desires to claim force majeure — and reviewed with an eye toward lockdowns and supply shortages. For instance, parties to supply agreements should review the ordering processes, any available transition services and termination/renewal provisions to determine what leverage they may provide. If applicable, self-help remedies can be negotiated into contracts in order to avoid business interruption.

This is a time to be proactive. Parties should analyze their insurance coverage and reach out to their contracting counterparties to discuss the condition of their business and forecasting. Both parties should negotiate business continuity plans and then amend current agreements to adopt such plans, enabling enforcement going forward. To the extent not in place, businesses should incorporate mitigation/response plans internally. And all parties should stay on top of government regulations in order to avoid liability traps in a myriad of areas, including labor and employment. It is always advisable to attempt to work out these disputes before they land in front of a judge, so communication with your lenders, landlords and other contracting counterparties is encouraged. Your business may be better served by coming to the table and being prepared to negotiate a mutually agreeable outcome. ■

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