



## FORCE MAJEURE AND OTHER CONTRACTUAL ISSUES RELATED TO COVID-19

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As the COVID-19 pandemic causes issues all over the world, businesses are facing significant pressures. Oil and gas markets are being heavily hit; dairies are being forced to spill raw milk because of broken supply chains.<sup>1</sup> A business owner may find it impossible to obtain a product or part or to deliver goods or services. In these cases, businesses will need to assess their contracts.

Contractually, force majeure clauses are the center of attention now. There are other potential defenses to performance under an agreement, including impossibility or impracticability. Following is a cursory discussion of these concepts.

### Force Majeure

An example of a typical force majeure clause follows:

Force Majeure. Whenever a period of time is prescribed in this Agreement for the taking of any action (other than monetary obligations) by a party, no party shall be liable or responsible for, and there shall be excluded from the computation of such period of time, any delays due to force majeure, which means acts of God, strikes, lockouts, material or labor restrictions by any governmental authority, riots, floods, washouts, sinkholes, explosions, earthquakes, fire, storms, acts of the public enemy, wars, insurrections, and *any other cause not reasonably within the control of the parties*<sup>2</sup> and which by the exercise of due diligence the parties are unable, wholly or in part, to prevent or overcome. In such cases, the parties shall negotiate in good faith with the goal and intent of preserving this Agreement and the respective rights and obligations of the parties.

A force majeure clause is intended to excuse non-performance of obligations under certain circumstances if the cause of the non-performance is beyond the reasonable control of a party. The party seeking to excuse its performance has the burden of proof.

Interpretation of a force majeure clause is based solely on contract law principles in most cases and the interpretation will be governed by the law of the state that applies to the contract. Force majeure clauses differ from agreement to agreement and there is not "set" language, meaning each agreement must be assessed. Issues to consider include:

- Does the force majeure clause specifically include or exclude the event? Most existing force majeure clauses do not list occurrences such as a "disease," "pandemic" or "contagion" as a force majeure event. Many force majeure clauses, do however, contain language providing that an event is a force majeure if it was due to a cause not reasonably within the control of the parties and/or not foreseeable. Force majeure clauses may also list as a qualifying event "government regulation" or "governmental action that makes it impracticable" to perform. If so, one could argue that a shelter in place order essentially shuttering a business might qualify as a force majeure event.

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<sup>1</sup> <https://www.cnbc.com/video/2020/04/14/dairy-farmers-are-dumping-milk-as-the-coronavirus-disrupts-the-supply-chain.html>; <https://money.usnews.com/investing/stock-market-news/articles/2020-03-10/how-coronavirus-is-affecting-the-global-supply-chain>.

<sup>2</sup> The italicized language is generally referred to as the "catch all" clause.





- Does the force majeure clause contemplate that the event be unforeseeable or beyond a party's control?
- Does the force majeure clause include a 'catch-all' clause?
- Does the agreement have notice, response, or other timing provisions? A party may have a force majeure clause but waive the right to use it if the party fails to follow the agreement's notice provisions.
- Has the party seeking to use the force majeure defense exercised reasonable diligence in attempting performance or taken efforts to mitigate the impact?
- What law governs the agreement?
- What obligations are excused under the force majeure clause? In the example provided, performance is excused except for monetary obligations.
- What are the specific governmental orders in place for your location?

In Texas, the general rule is that a force majeure event must be something that was not foreseeable, unless the event is listed as a specific force majeure event. As one court explained:

A force majeure clause does not relieve a contracting party of the obligation to perform, unless the disabling event was unforeseeable at the time the parties made the contract. An economic downturn in the market for a product is not such an unforeseeable occurrence that would justify application of the force majeure provision, and a contractual obligation cannot be avoided simply because performance has become more economically burdensome than a party anticipated.<sup>3</sup>

In the case, the contract had a force majeure clause with a catch all clause that the defendant argued applied because a downturn in the market prevented it from obtaining the necessary financing to drill required wells. A market downturn was not a specific listed force majeure event, meaning the interpretation relied on the catch all clause which the court determined required that the event be unforeseeable. According to the court, a downturn in a market is not unforeseeable.

It remains to be determined if a "shelter in place" order or travel ban related to COVID-19 will suffice for a governmental regulation of a business preventing performance. As well, other language in a force majeure clause may provide the basis for a legal argument, e.g., language related to a public emergency. Parties in a position to make a force majeure argument should consider doing so and work with counsel to make that determination and provide any required notice. Counsel can also review the entire agreement to evaluate if there are other issues the business needs to be aware of.

### Other Potential Defenses

In addition to force majeure, parties affected by COVID-19 may have other potential defenses, including impossibility and/or commercial impracticability. Under the Restatement (Second) of Contracts,<sup>4</sup> the impossibility defense generally applies when an unexpected event makes performance of a contract impracticable or impossible. The defense usually applies only in limited circumstances, such as the person necessary for performance dies or becomes incapacitated, the specific thing necessary for performance is destroyed or deteriorates, or a

<sup>3</sup> TEC OLMOS, LLC v. ConocoPhillips Company, 555 S.W.3d 176 (Tex. App.—Houston [1st Dist.] 2018).

<sup>4</sup> See Restatement (Second) of Contracts §§ 261, 262, 263.





change in the law makes performance illegal. Each determination is fact specific. Again, it is unclear whether a shelter in place order will be accepted as a change in law making performance impossible or illegal, but it is worth taking advantage of the possibility if your business is not able to meet contractual obligations due to COVID-19. The other party to the contract may argue, however, that economic hardship or increased costs of performance is not enough to permit an impossibility defense.

The Uniform Commercial Code (“**UCC**”) also has a specific defense of impracticability in certain situations. For sellers, Section 2.615 of the UCC provides that delay in delivery or non-delivery in whole or part by a seller will not be a breach of duty under a contract for sale if performance was made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order.<sup>5</sup> If the cause affects only a part of the seller’s capacity to perform, the seller must allocate production and deliveries among his or her customers but may, at his or her option, include regular customers not then under contract as well as his or her own requirements for further manufacture. The law further states that the seller may allocate in any manner that is fair and reasonable. Note that the law also requires that the seller notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required, of the estimated quota to be made available for the buyer.

There is also a UCC provision that may apply to leases of goods disrupted by COVID-19. Subject to substituted performance set forth in Section 2A.404, Section 2A.405(1) states that delays in delivery by a lessor or a supplier who is not otherwise in default are not a breach if performance was made impracticable by (1) the occurrence of a contingency, the non-occurrence of which was a basic assumption on which the contract was made, or (2) by good faith compliance with a governmental order or regulation. As with the provisions relating to a seller, the lessor or supplier must allocate production or deliveries to the extent possible and provide reasonable notice.

### Considerations

Businesses have a full plate dealing with COVID. An important step in assessing the condition of a business is to understand the contractual obligations in place. Owners need to review all agreements to determine if a force majeure clause is in place and work with counsel to evaluate the strength of that potential defense and others such as a UCC impracticability defense. And time is of the essence, particularly if an agreement has provisions requiring notice or other actions in a certain time frame.

It may also be useful to evaluate contract forms to see what changes would be beneficial in the future. Do you need a force majeure clause in your agreements, and if so, what should be the scope of the clause? If you are the one providing the goods, the clause may be useful versus if you are the party purchasing the goods, in which case you probably need a contract with narrowly drawn escape clauses.

If a business has a large number of agreements, it might consider assigning one person to work with counsel on the assessment of force majeure and other defenses. Additionally, a business will want to make sure that any emails, memos, other documents and any communications are consistent with the legal arguments the business intends to make.

Owners also need to make sure that their documentation is in good order for any potential litigation. Counsel can assist in determining what legal and/or factual issues will need to be addressed and what associated documents need to be gathered. Action should include documenting what mitigation steps have been taken to try to minimize the damage.

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<sup>5</sup> Tex. Bus. & Com. Code § 2.615(1).



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