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Force Majeure in the Wake of the Coronavirus (COVID-19)

Force majeure clauses are contract provisions that excuse a party's nonperformance when "acts of God" or other extraordinary events prevent a party from fulfilling its contractual obligations.¹ These clauses are currently gaining attention due to the coronavirus outbreak (COVID-19), which has significantly impacted the global economy and businesses' ability to manufacture, distribute and sell their products.² Due to the risks that COVID-19 poses to ongoing business operations, companies should proactively consider the potential impacts a global pandemic could have on their operations, take steps to mitigate their operational risk, and assess the availability of insurance coverage in the event that risk materializes. Taking these proactive measures will decrease the likelihood of force majeure disputes in the future; it will also help any party asserting a claim of force majeure to establish that it took reasonable steps to avoid contractual interruption.

Basic Principles of Force Majeure Clauses

Courts look to several elements when considering the applicability of a force majeure clause: (1) whether the event qualifies as force majeure under the contract, (2) whether the risk of nonperformance was foreseeable and able to be mitigated and (3) whether performance is truly impossible.

The primary focus is on whether the clause encompasses the type of event a contractual party claims is causing its nonperformance.³ Force majeure clauses are generally interpreted narrowly; therefore, for an event to qualify as force majeure it must be outlined in the clause at issue.⁴ Even when a potential force majeure event is encompassed by the relevant clause, however, a party is 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.⁵ Furthermore, depending on the relevant contractual language and governing law, a party generally will be required to establish that performance is truly impossible rather than merely impracticable.⁶ In many force majeure cases, nonperformance will not be excused if it is merely financially or economically more difficult to satisfy contractual obligations.⁷ Some jurisdictions, however, may only require that performance be impracticable, and some contracts may set a different standard (e.g., performance is "inadvisable").⁸ As a result, companies should closely scrutinize both the language of their force majeure clauses and the applicable law when considering their obligations and potential nonperformance risks.

Impact of COVID-19 on Force Majeure Clauses

The coming weeks and months will bring many assertions of force majeure in response to quarantines, business closures and travel restrictions. Whether such assertions of force majeure will be successful will be heavily dependent on the facts relevant to the particular contracts and businesses at issue.

It is virtually certain that economic and business impacts of the type seen already in China, Korea, Italy and Japan will spread to other jurisdictions. In response to this, companies—wherever their operations—should be taking proactive steps to ensure continuity of operations sufficient to meet existing contractual obligations and be evaluating whether their counterparties are also taking steps such that they will not have the need to invoke force majeure.

Taking affirmative steps now is especially important given the ability that companies currently have to foresee and attempt to mitigate any potential operational impacts in advance of the outbreak spreading to any new locality. Ideally, businesses will be able to plan accordingly to avoid any disruptions in their operations if the virus continues to spread.

Examples of steps companies might actively consider taking now (and seek to ensure that counterparties are taking) include: securing alternate supply streams in the event a supplier's operations are impacted; planning for how employees can continue working remotely, or how functions can be transferred to other locations, in the event of quarantines and business closures; and mitigating the impact of restricted travel both around the globe and within countries. Even if such steps are not successful in avoiding the need to declare a force majeure, a company's attempt to mitigate its risk in advance will be highly relevant to a court's determination of whether reasonable steps were taken to continue to satisfy contractual obligations, and whether performance was truly impossible. Affirmative measures to help ensure a company is prepared for the possibility of business interruption resulting from COVID-19 include a careful review of insurance policies that may cover such an event.

Business Interruption Insurance

Business interruption insurance is intended to cover losses resulting from interruptions to a business's operations, and generally covers lost revenue, fixed expenses such as rent and utility, or expenses from operating from a temporary location.⁹ While these policies most frequently relate to physical property damage, businesses should nevertheless assess their coverage to determine whether they might be covered for losses due to business interruptions resulting from COVID-19.

Several companies were able to recoup losses through business interruption insurance for various operational disruptions after the global outbreak of Severe Acute Respiratory Syndrome (SARS) in 2002-2003.¹⁰ In turn, however, many insurers have now excluded viral or bacterial outbreaks from standard business interruption policies.¹¹ As a result, it is critical for companies to proactively assess the specific

terms and conditions of their governing insurance policies to determine whether interruptions from COVID-19 would be covered. In connection with that assessment, companies should review their policies' insurer notice requirements to ensure their scrupulous compliance with those provisions in the event coverage is ultimately sought. Taking these proactive steps will help companies be prepared for any financial or legal implications that may result from the continued spread of COVID-19.

We intend to closely monitor the legal and business implications associated with the global fallout from the COVID-19 outbreak, and will continue to report developments.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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- ¹ TRACY BATEMAN ET AL., 77A CORPUS JURIS SECUNDUM, SALES § 370 (describing a force majeure clause as a provision that “may have the effect of excluding nonperformance arising out of certain causes as unforeseeable or beyond the parties’ reasonable control or specified by the contract”); MARIE K. PESANDO, AMERICAN JURISPRUDENCE 2d, ACT OF GOD § 13.
- ² *Coronavirus Deals Blow to Global Business*, WALL ST. J. (Feb. 28, 2020 5:11PM), <https://www.wsj.com/articles/coronavirus-deals-blow-to-global-business-11582919791>.
- 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.”).
- ⁴ See, e.g., *Kel Kim Corp. v. Cent. Mkts., Inc.*, 70 N.Y.2d 900, 902 (1987) (holding that force majeure defense is narrow and excuses nonperformance “only if the force majeure clause specifically includes the event that actually prevents a party’s performance”).
- ⁵ See LORD, *supra* note 3, § 77:31 (noting that a party seeking the benefits of a force majeure clause must show that performance is impossible “in spite of skill, diligence, and good faith” to continue to perform).
- ⁶ See *In re Cablevision Consumer Litig.*, 864 F. Supp. 2d 258, 264 (E.D.N.Y. 2012) (noting that, under New York law, force majeure clauses are “construed narrowly and will generally only excuse a party’s nonperformance that has been rendered impossible by an unforeseen event”).
- ⁷ See LORD, *supra* note 3, § 77:31 (“Nonperformance dictated by economic hardship is not enough to fall within a *force majeure* provision.”); BATEMAN et al., *supra* note 1, § 370 (“Inability to sell at a profit is not the contemplation of the law [of] a force majeure event excusing performance and a party is not entitled to declare a force majeure because the costs of contract compliance are higher than it would have liked or anticipated.”).
- ⁸ See, e.g., *Facto v. Pantagis*, 390 N.J. Super. 227, 231 (2007) (“A *force majeure* clause, such as contained in the [defendant’s] contract, provides a means by which the parties may anticipate in advance a condition that will make performance impracticable.”); *OWBR LLC v. Clear Channel Comms., Inc.*, 266 F. Supp. 2d 1214, 1216 (D. Haw. 2003) (noting that the force majeure clause excused nonperformance where it was “inadvisable, illegal, or impossible”).
- ⁹ *Covering Losses with Business Interruption Insurance*, INSURANCE INFORMATION INSTITUTE (last visited Mar. 1, 2020), <https://www.iii.org/article/covering-losses-with-business-interruption-insurance>; Jing Yang, *Why Many Businesses will be on*

the Hook for Coronavirus Losses, WALL ST. J. (Feb. 21, 2020 6:00AM), <https://www.wsj.com/articles/why-many-businesses-will-be-on-the-hook-for-coronavirus-losses-11582282802>.

¹⁰ Yang, *supra* note 9.

¹¹ Noor Zainab et al., *Many Global Firms, Excluded from Epidemic Insurance, Face Heavy Coronavirus Costs*, REUTERS (Jan. 29, 2020 6:30AM), <https://www.reuters.com/article/us-china-health-insurance/many-global-firms-excluded-from-epidemic-insurance-face-heavy-coronavirus-costs-idUSKBN1ZS1CU>; Yang, *supra* note 9 (“Now insurers across the board exclude epidemics in standard business-interruption policies, which mainly cover property damage from events such as fire, terrorism and natural catastrophes.”)