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Pandemic prompts urgent review of overlooked contractual clause

By: Barry Bridges March 26, 2020

While a contract's use of 'pandemic' will be helpful to a party hoping to invoke force majeure in the current crisis, more vague terms such as 'act of God' will invite disputes, says James H. Hahn of Providence.

With the jolt of the coronavirus crisis still unfolding across the country, corporate lawyers in Rhode Island are observing an uptick in queries related to a boilerplate provision common to many commercial contracts that perhaps heretofore gleaned little attention: the "force majeure" clause.

According to Brian J. Lamoureux of Johnston's Pannone, Lopes, Devereaux & O'Gara, recent search trends from Google reveal that a substantial number of companies may be beginning to ponder the enforceability of their contractual obligations in a landscape in which material shortages are popping up in some sectors, and supply chains are being upended in others.

"For many years, no one had been searching 'force majeure,' and now all of a sudden there is a major spike to the extent that Google can't even scale it," Lamoureux said. "To see that was an 'uh-oh' moment for me, and it's only going to be a matter of time before we're navigating the issue in our practice."

As for the critical question of whether the pandemic will constitute a condition that could excuse a party from upholding its end of an agreement, business lawyers are unequivocally saying "it depends."

"Whether the mere existence of a pandemic will reach the level of force majeure will depend on the exact language used in the contract, including the intentions of the parties if the language is unclear," said James H. Hahn of Partridge, Snow & Hahn in Providence.

He explained that while a contract's use of "pandemic" will be helpful to a party hoping to invoke force majeure in the current crisis, more vague terms such as "act of God" will invite disputes.

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With the last pandemic in this country in 1918, Lamoureux pointed out that there are no published court opinions on the question and agreed that the first step is to examine the language of the parties' contract.

"Beyond explicit terms, there may be qualifying phrases such as 'including, but not limited to,' which could give some leeway. But would that include pandemics? Locusts? I think we are going to see a lot of litigation on the

meanings of these clauses, and that makes my heart jump as a lawyer," he said.

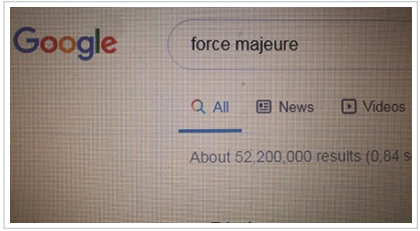
'Act of God'

Adam J. Gwaltney of Nixon Peabody reported that his firm has recently been dealing with the force majeure questions related to Chinese companies trying to cope with newly imposed tariffs.

"After SARS and MERS, a lot of law firms have looked to refine the force majeure clauses, especially considering that courts have historically defined these provisions very narrowly. If a term is not specifically mentioned, you are less likely to succeed," the Providence lawyer said.

Gwaltney often works with cross-border agreements, with each jurisdiction treating them differently. For instance, China has issued thousands of "force majeure certificates," which may be enforceable there but not in the United States. If a U.S. company brings suit in China, there is a higher chance it will lose.

"Where you are trying to enforce will impact how successful you will be," Gwaltney said.



Duffy & Sweeney's Stacey P. Nakasian said contracts between companies in the United States do not typically include epidemic/pandemic/quarantine language. However, she said the linchpin of the issue is that the triggering event is one that the parties did not anticipate and is beyond their control, meaning that a pandemic such as the coronavirus could possibly fall under more general terms, such as an "act of God."

Daniel J. Procaccini of Adler, Pollock & Sheehan said with catchall phrases a court might look to whether COVID-19 was reasonably foreseeable at the time the contract was made.

"December 2019 and February 2020 could be totally different situations," he said.

As for the broad "act of God" language, Gwaltney explained that courts read the phrase in context, with the extent of relief it offers likely depending on other contractual provisions. For instance, if enumerated events triggering the force majeure clause are along the lines of floods or hurricanes, an "act of God" may be deemed to be weather-related.

"Although there is some thought now that courts may be more liberal considering the scope of this pandemic, it's of course too early to tell," Gwaltney said.

Procaccini said that force majeure clauses, like any other contractual provision, are interpreted narrowly because they are excusing performance under an otherwise valid contract, so the bar to invoke it is high.

"But while a court will look to the specific surrounding language, an attorney might be able to make a good argument that 'act of God' refers to occurrences other than those specifically enumerated," the Providence lawyer said.

Litigation arising from force majeure clauses is almost inevitable and, in some cases, advisable, Procaccini said, as many businesses will be under pressure to maintain their resources and examining the enforceability of contractual obligations would be a step in that direction.

Government lockdowns

But the analysis does not end with the question of whether COVID-19 is a force majeure event.

"The question is whether it is the cause of the inability to perform," Nakasian said. "I think we are going to see a lot of lawsuits surrounding causation, preparedness and response, which really goes to the idea of mitigation. I expect to see some pretty creative arguments surrounding causation."

On the question of what a party seeking excusal did to mitigate the risk getting in the way of performance, Lamoureux argued that a good practice is for a company to keep all records of efforts to identify alternatives.

"If a judge finds that you did your best under the circumstances, you will have a better argument," Lamoureux said. "On the other hand, if you sat there twiddling your thumbs and did not take Herculean or otherwise admirable steps to try to solve the problem, a court is not going to look kindly on you."

Government action could also be a basis for excusing performance.

"If there is a force majeure provision, whether government action falls under the clause will depend on the language," Nakasian said. "The contract may talk about strikes or work stoppages, or have a catchall such as 'unforeseen circumstances,' and arguably government action could fall under that."

Hahn added that government orders are often within the list of defined force majeure events, and it may be that a shutdown order could justify the defense of impossibility, depending on the facts.

Procaccini noted gray areas on that front, such as whether a government's "strong guidance" is enough or whether a formal order would be required to act under the clause.

But even if the contract does not specifically address government action, a party may be able to depend on the common law principles of impossibility or impracticability, according to Nakasian.

Hahn emphasized that the ultimate inquiry for the purposes of accepting or rejecting a defense of impossibility is whether the intervening changes in circumstances were so unforeseeable that the risk of increased difficulty or expense should not be properly borne by the non-performing party.

"The mere fact that performance of a contract becomes more difficult or expensive than originally anticipated is not usually sufficient grounds to set it aside," he said.

Lamoureux said that winning the argument that performance should be excused under a force majeure provision is an uphill battle, noting that prevailing parties "typically have either very on-point contracts or extreme facts."

"The clause does not serve as a get-out-of-contractual-obligations-free card," he said.

'Negotiation to be had'

Hahn said that a widespread pandemic may not offer a reasonable excuse under some contracts, and that care should be taken in invoking force majeure as it could potentially lead to a claim of anticipatory breach.

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"It is important to analyze fully the terms of the contract, the negotiating leverage of the parties, and who benefits from termination before adopting any course of action," he said.

Gwaltney added that in every case he would advise clients that the first step is to have conversations with the other party.

"With the scope of this pandemic, I truly feel there's a negotiation to be had. If there is no middle ground, look at the force majeure language and make sure it covers your situation," he said.

Although he foresees some increase in litigation, Gwaltney said he is not convinced it will be widespread, as companies have an interest in maintaining strong business relationships. He also concurred that there are

ramifications if a party is unsuccessful in invoking the clause, because it would essentially be an admission of non-performance and a breach of the contract.

Going forward, Lamoureux said, lawyers will be more likely to explicitly use words such as "pandemic" in commercial contracts. He witnessed a similar trend in the insurance industry after the SARS outbreak, with companies inserting coverage exclusions for "viruses" and "bacteria."

He offered one practical tip: giving timely notice is essential.

"If you want to invoke the clause, you can't do that soon enough," Lamoureux said.

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