Updates
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COVID-19 and Force Majeure: Time to Review Your Commercial Contracts

Parties to commercial contracts that may be affected by COVID-19 are now examining their force majeure provisions, as well as all other risk allocation provisions, to determine which party bears the cost of delay or impossibility of performance. The specific language of these provisions, as a reflection of the parties' intent, is crucial to the outcome of any dispute, as is the specific law governing the contract. It is also helpful to understand the focal points of analyses generally performed by courts or arbitration panels which adjudicate force majeure cases.

In litigating matters involving declarations of force majeure, we have had several cases that proceeded through trial or hearing at arbitration. One of these matters was a 2016 arbitration over a 15-year rail transportation contract between two railroads and a utility to transport coal from Wyoming and Montana mines to the utility's coal-fired plants in Ohio. We represented one of the railroads. Largely because of the impact of fracking and the decline in the price of natural gas, the coal-fired plants served by the contract became economically obsolete early in the contract term. When the U.S. Environmental Protection Agency (EPA) enacted new mercury emission standards for coal-fired plants at the end of 2011, the utility made the decision to shutter its plants rather than to spend the hundreds of millions of dollars necessary to retrofit the plants to comply with the new standards.

By shuttering its plants, the utility effectively repudiated the rail contract and made clear it would not meet the annual minimum coal shipment requirements. Facing 15 years' worth of liquidated damages under the contract, the utility declared force majeure on account of the new mercury emissions standards. The arbitration panel rejected the defense because the new government regulation did not mandate shutdown of coal-fired plants. Rather, compliance with the standards was technologically possible and thus performance of the contract by the utility was not actually prevented. The panel determined the utility made an economic decision, and such a decision did not constitute force majeure without express language shifting to the railroads the risk of changes in economic circumstances, including as a result of changed government regulations. It is also worth noting that the language of the force majeure provision included a mitigation clause which required "commercially reasonable" efforts. The utility contended this meant that it was not required to make an expenditure of hundreds of millions of dollars in technology upgrades. However, the panel determined that clause would be invoked only after the occurrence of a true force majeure event.

The force majeure provision at issue in this arbitration reflected the more traditional and generic notion of a force majeure event, as one which cannot be anticipated or controlled such as a natural disaster, a terrorist attack, or similar unforeseen and extraordinary event.[1] Many, but not all force majeure provisions also list government orders or actions as force majeure events, although even such provisions vary, sometimes significantly, in their precise wording. Where an event constituting force majeure (as defined in the particular contract) exists, the party declaring force majeure may be, again depending on contract language and circumstances, temporarily or fully excused from some or all its contractual obligations.

A global pandemic such as COVID-19 would seem likely to qualify as an event which is unforeseeable and beyond the parties' control, but the inquiry does not stop with the nature of the event. Rather, the key is the specific impact on the contracting parties, and in particular, whether performance is truly prevented versus made more difficult or expensive. Absent express contractual language, changes in market conditions or economic hardship are likely to be insufficient to establish force majeure, even if they are the result of some unforeseen or uncontrollable event. For example, in the month following the September 11, 2001, terror attacks, and because of likely low attendance due to attendees' travel concerns, Clear Channel Communications Inc. canceled a

convention to be held at the Outrigger Wailea Resort in Hawaii. Clear Channel's declaration of force majeure was rejected by the court. While the terrorist attack itself was an unforeseen and uncontrollable event, Clear Channel could have held the convention and performed the contract, and its economic decision not to do so did not qualify as force majeure.

Presumably, the same analysis would apply if a party were to cancel voluntarily an event which it feasibly could hold, notwithstanding COVID-19, but which would have little to no attendance on account of fears of the virus. On the other hand, if the event were to be held in a state or locality which had issued a government order prohibiting public gatherings of a certain size, that should qualify as a circumstance beyond the party's control which prevents performance.

Applying this distinction in the landlord/tenant context, a government order directing the shutdown of a retail property may well absolve a landlord from being held liable for breach of its obligations, for example, to provide access to the demised premises. In this event, the landlord may even be entitled to continue to receive rent from tenants if the contract requires payment of rent even if there is a force majeure. Such provisions are common in commercial leases, which place the economic risk of such events on tenants. If the landlord chooses voluntarily to close the retail property, tenants would have a compelling argument that there has been a breach by landlord, there has been no force majeure, and tenants would be relieved of their rent obligations.

To the extent that performance of specific contract obligations is not actually prevented by COVID-19 or government orders to address COVID-19, the specific contract language may nonetheless provide a basis for relief if the standard set forth in the force majeure provision is something less than a true "prevent" standard. The "prevent" standard, pursuant to which performance must be actually foreclosed, is the most common standard used by contracting parties. Under this standard, the ability to perform the contract, even at great expense, means that the excuse of force majeure is unavailable, and courts have even found that extreme economic impact caused by an event does not constitute force majeure if the party is physically able to perform. On the other hand, parties to commercial contracts are becoming more sophisticated in their approach to force majeure, specifically incorporating in their force majeure provision events or impairment standards which excuse performance when it merely would be overly expensive or unprofitable. With events such as natural disasters becoming more commonplace, and now with the experience of COVID-19, parties may well give greater thought to force majeure provisions and risk allocation in their contracts going forward, but for now need to examine the language in their existing contracts and fashion arguments from lessons learned in recently litigated cases.

Individuals drafting contracts, including those involving force majeure clauses, should consult with trusted counsel.

Endnotes

[1] Although not likely relevant to cases arising from COVID-19, it is worth noting that the historical prerequisite of unforeseeability no longer applies universally. Parties may expressly agree that a force majeure event under the contract may be foreseeable or unforeseeable, and courts in some states also decline to read an unforeseeability requirement into a force majeure provision that is silent on the question.

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