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Client Update - Coronavirus (COVID-19) and Force Majeure Contract Clauses

An unforeseeable circumstance, such as the recent outbreak of the coronavirus, which prevents a party from fulfilling its contractual obligations, may fall within the definition of "*Force Majeure*" in certain contracts.

Force majeure clauses are specific to each contract and operate as a risk allocation mechanism in order to govern situations which are beyond the control of the parties, such as the outbreak of war, or natural disasters. Whether the COVID-19 outbreak constitutes a *force majeure* event depends on the specific wording and scope of the provision in each contract. For example, if the force majeure clause:

- expressly specifies epidemics, diseases or public health emergencies, then COVID-19 likely qualifies as a *force majeure* event;

- covers "acts of government," then travel bans may be covered.

The party seeking to invoke *force majeure* usually must show a causal connection between the event, i.e., the outbreak of COVID-19, which made it effectively impossible to perform its contractual duties. The clause may also operate to excuse or suspend performance of a particular contractual duty.

Can COVID-19 Excuse Performance Under a contract containing a "general" *Force Majeure* Provision?

Historically, courts have read *force majeure* provisions narrowly. For example, in 2015, a U.S. Court of Appeals held that the Chinese government's decision to flood the market with cheap solar panels was insufficient to trigger a *force majeure* provision in a take-or-pay supply contract. The effect of that decision was a multibillion-dollar liability to the plaintiff. Courts have also rejected the application of *force majeure* provisions to

unexpected business interruption caused by the September 11 terrorist attacks, sudden changes in market conditions, union strikes and unseasonable weather.

As the term "*force majeure*" does not have a recognized meaning under English law, the courts in the UK will look to how the parties have defined the term "*force majeure*" within the agreement itself in order to determine its effect.

In the UAE, Article 273 of the Civil Code expressly provides that if an event of *force majeure* makes the performance of a contract impossible, then all contractual obligations shall cease, and the contract shall automatically be cancelled. In such an event, the parties shall be restored to the positions in which they were prior to entering into the agreement; if that is not possible, then damages may be awarded by way of compensation to a party that has suffered a loss as a result of the inability to unwind the contract.

Although the UAE Civil Code does refer to *force majeure* in Article 273, it does not, however, provide a definition as to what constitutes an event of force majeure. Under UAE civil law, parties to a contract are generally free to agree upon the terms which will govern their relationship, so long as such terms are not in conflict with a mandatory provision of UAE laws. Courts in the UAE will, therefore, look to how the parties have defined the term "*force majeure*" within a contract in order to determine its scope and application.

To determine whether a force majeure clause applies to a specific contract, whether under US, UK or UAE law, we advise a detailed analysis be performed of the following factors:

- **Express references to epidemics**: *Force majeure* clauses are generally not uniform and should be read along with other contractual terms, such as termination rights under the agreement. For example, several clauses written after the SARS, MERS and Ebola outbreaks of recent years expressly cite global epidemics as examples of *force majeure*. Many clauses drafted prior to the SARS, MERS and Ebola outbreaks, however, do not contain such a provision.

- **Catchall provisions**: Even in the absence of express citation of epidemics, many contracts include a "catchall" with some enumerated qualifying examples. If the effects of COVID-19 are considered to be "unforeseeable," then they may fall within a *force majeure* catchall.

- **Prior statements/representations**: Invoking a *force majeure* clause may contradict, or otherwise be inconsistent with, a party's prior statement and/or representation to a counterparty, which may impact the willingness of such counterparty to agree that a *force*

majeure event has actually occurred. Prior statements may be seen as admissions or waivers of rights in some circumstances.

- **Other provisions**: The remaining provisions of the contract may address the fulfillment of each party's contractual duties in the event of unexpected circumstances. For example, a "take or pay" supply contract is in and of itself designed to allocate risk of unforeseen events. Such a contract may be interpreted differently than, for example, an output contract.

- **Disclosure, legal or securities concerns**: Making representations about the outbreak of COVID-19 may give rise to other legal concerns such as disclosure or other securities requirements of statements of material litigation for public companies, statements about financial performance, impact on financing from lenders and communications with unions or other contractors, depending on the jurisdiction and particular business situation.

- **Notice requirements**: Many contracts require that any party which seeks to assert *force majeure* as a basis for suspending performance must promptly provide notice to its counterparty. Failure to do so may result in a waiver defense or other consequences. Other contracts state that the continuation of a *force majeure* event for a certain period of time (*e.g.*, 90 to 180 days) may give rise to a right of termination. In still other cases, *force majeure* may give rise only to a suspension of the required performance. Even without an express requirement, delay in providing notice could give rise to equitable principles such as laches or good faith and fair dealing claims in certain cases.

Frustration of a Contract's Purpose

If a particular contract does not contain a *force majeure* clause, then a party still may be excused from its contractual duties under the narrower doctrine of frustration of the contract purpose. Generally, in order to invoke this doctrine, the event must: (1) be not reasonably foreseeable, and (2) radically change the contract terms from what the parties had agreed to. Merely escaping a bad bargain is not enough.

Material Change Clauses

Some contracts include clauses which deal with a change in circumstances resulting from a reasonably expected event which materially alters that contract's terms. Thus, the contract itself may allocate risk based upon reasonably expected changes which impact a party's performance under the agreement. For example, certain contract terms may have

been updated after the prior SARS outbreak. Attention should be given to how the contract's other clauses may address the parties' allocation of risk for material changes which impact performance.

Insurance Coverage

The losses arising out of a party's inability to fulfill its contractual obligations due to the outbreak of COVID-19 may in certain circumstances give rise to an insurance claim. Coverage, however, will depend upon the policy's specific terms and conditions, and careful attention should be given to the policy's specific notice provision.

In summary, a fact-specific analysis of each contract, insurance policy, and/or business relationship must be undertaken in order to assess the impact of COVID-19 on your company's business.

As an arbitrator with more than 14 years of experience deciding *Force Majeure* cases, Dr. John Maalouf has substantial expertise in navigating the uncertainties associated with invoking *Force Majeure* clauses in cases involving an epidemic or pandemic, including the SARS, MERS and Ebola outbreaks. In addition, Dr. Maalouf has 27 years of experience as an attorney arbitrating and litigating such *Force Majeure* cases.

For further information regarding the subject matter discussed herein, please contact Dr. John J. Maalouf at the following:

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