Now that President Trump has declared a “national emergency” and the Centers for Disease Control & Prevention has issued guidance regarding avoiding gatherings of 10 or more people, the disruption to business is clearly upon us. The outbreak of the novel coronavirus (known as COVID-19) has impacted global manufacturing, transportation and supply chains, both local and cross-border. Over the past several months, we have been advising clients on numerous legal issues relating to the outbreak, such as contractual remedies available to enforce or limit supply agreements, proper disclosure by public companies of the impact of the outbreak, and reporting and other obligations under credit and other financing agreements. We’ve also been diligently working with companies on addressing supply chain risks associated with the pandemic in relation to commercial agreements being negotiated today. If you have not already done so, now is the time to review your supply agreements (both as a seller and as a buyer) to determine what rights and obligations you have, and what should be your next steps to enforce such rights.

Reviewing the agreements should include:

- Identifying applicable provisions that may be affected by the pandemic;
- Identifying notice obligations triggered by the outbreak;
- Identifying alternative sources of supply or means of performance;
- Reviewing consequences of nonperformance or breach; and
- Managing required communications (and managing expectations) with the counterparty.

The most apparent provision that comes to mind is part of the “boilerplate” legalese stuck in the back of many contracts that addresses “force majeure”. However, other provisions that may come into play include representations and warranties, covenants, conditions, termination rights, and operational clauses like lead times, forecasts, time is of the essence, etc. The pandemic may also have potential consequences for financing agreements and disclosure obligations for public companies and government contractors.

**Force Majeure**

Simply put, force majeure is a doctrine to excuse performance or delays in performance. It allows the party claiming force majeure to avoid liability for certain events. In the United States, England and other common law jurisdictions, force majeure clauses are creatures of contract. Analogous common law concepts can also be found in the doctrine of impracticality under §2-615 of the Uniform Commercial Code (UCC) as well as Article 79 of the United Nations Convention for the International Sale of Goods (UNCISG) for transactions involving the sales of goods between parties in different member states to the UNCISG convention. By contrast, in most civil law countries (Italy and France for example), force majeure is written into applicable law.

Because force majeure clauses are creatures of contract, there is no uniform definition and the precise wording and choice of law greatly impact interpretation. Generally speaking, however, a force majeure clause covers events that are neither anticipated nor within a party’s reasonable control including acts of god (e.g. floods, earthquakes), acts of government and other acts beyond a party’s reasonable control. In many instances, force majeure clauses include labor disputes, strikes and inability to obtain materials. Until recently, only a limited number of force majeure clauses referred to pandemics or epidemics. That is why President Trump’s declaration of a national emergency, an act of the Federal government, is useful in limiting arguments as to whether the...
pandemic counts as an “act of god”. For further information regarding the concept of Force Majeure in the context of a government order, see Force Majeure and Acts of Government.

In most agreements, a notice may need to be given within a defined time period of an event of force majeure.

Failure to timely give the notice may result in a waiver of the nonperforming party’s failure to perform its obligations under the agreement. Similarly, many force majeure clauses allow a party to terminate if the force majeure event continues beyond a certain period.

Frustration and Hardship

If the agreement is silent as to force majeure and neither the UCC nor the UNCISG provide any help, then the concepts of frustration or impossibility may also excuse performance. However, these concepts are very fact specific, vary significantly across jurisdictions, and the ability to claim "frustration" and/or "impossibility" is generally limited. Impossibility generally requires a showing that the contract or the means of performance have been affected to make performance objectively impossible. Frustration or commercial impracticability generally requires a showing that the main purpose of the agreement has been so frustrated such that it is radically different from what was contemplated by the parties at the time when the contract was originally entered into.

Insurance

In addition to considering whether force majeure may excuse non-performance of the agreement, companies should carefully review and consider whether there is insurance which may cover losses arising out of one party’s inability to perform its obligations resulting from the pandemic and/or resulting governmental orders. Coverage will depend on the types of policies and specific language of the policies carried by the company. It is important to thoroughly review the policies and timely notify the carrier of any loss or potential loss.

Other Agreements

An event of force majeure can excuse non-performance of the contract at issue. However, such an event may have cascading implications for the parties. Companies should carefully review their financing agreements and other material contracts to determine whether an event of force majeure in one agreement may require a disclosure under the company’s financing agreement. For example, most credit agreements require notice of material events (e.g. those having a Material Adverse Effect) or litigation which may get triggered by a force majeure event. Similarly, some credit facilities contain specific provisions regarding material suppliers or have certain financial covenants that may get triggered by an inability to sell resulting from a force majeure event. Even if not contractually required, it may be wise to communicate with lenders and update them on the business to maintain good lines of communication and avoid any unpleasant surprises.

Take Aways

1. Do Not Overreact: Although this is a scary and unprecedented moment in time, it is important that companies not panic and overreact. Epidemics and other supply chain disruptions are occurring with some regularity. Companies should have disaster and continuity plans in place to address these types of situations.

2. Triage Agreements and Obligations: Setting aside the health and welfare of the Company’s employees and the public, the Company should conduct an assessment of its material contracts and obligations and prioritize the most mission critical vendors and customers.

3. Review Critical Agreements: Once the mission critical agreements have been identified, they need to be reviewed to determine whether there are force majeure or other material clauses that may excuse non-performance. Is the force majeure clause broadly worded? Does it require notice? Are there termination rights associated with it?

4. Timely Provide Notice of Force Majeure: Regardless whether the agreement requires notice, it is always good to provide notice to the counterparty and other vendors that may be impacted by the force majeure event. Managing communications and updating the other parties to the agreement will go a long way to minimizing disruption and maintaining a positive contracting experience.
5. Mitigate the Consequences: In this event, finding alternative suppliers or vendors may be difficult. Nevertheless, it is important that companies investigate whether alternatives exist. At a minimum, if the force majeure does not excuse the other party’s performance, mitigating damages is a requirement in order to recover for breach.

Conclusion

Assessing the impact of the COVID-19 outbreak on a Company’s contractual relationships requires a fact-specific analysis of the agreement and the situation. Companies should review with their counsel, their rights and obligations under their various agreements. Companies also need to review and consider notice obligations, insurance coverage and required disclosure in light of the coronavirus outbreak.

For more information on force majeure and its impact on supply chain agreements please contact your Quarles & Brady attorney or:

Ed Broecker: (317) 399-2828 / ed.broecker@quarles.com
Juan-Carlos Espinoza-Forlenza: (608) 283-2446 / jespinoza@quarles.com
Daniel Janssen: (414) 277-5733 / daniel.janssen@quarles.com
David Muth: (414) 277-5621 / david.muth@quarles.com

© 2020 Quarles & Brady LLP. Published with permission.