

Coronavirus, Force Majeure and Impact on Commercial Contracts

By Frank Mugisha , Cavendish University

Introduction

Looking at the supply chain disruption caused by the Covid-19 pandemic¹, it is likely that performances under many contracts will be delayed, interrupted, or even cancelled.

Counterparties (especially suppliers) to such contracts may seek to delay and/or avoid performance (or non-performance liability) of their contractual obligations and/or terminate contracts, either because Covid-19 has legitimately prevented them from performing their contractual obligations, or because they are seeking to use it as an excuse to extricate themselves from an unfavorable deal. Further, companies may not be able to perform their obligations under their customer agreements because of their suppliers' non-performance and may in turn seek to delay and/or avoid performance (or liability for non-performance) of their contractual obligations and/or terminate contracts. Parties may also cite Covid-19 as a basis for renegotiation of price or other key contractual provisions (e.g. volume of materials exported from or imported into affected areas due to shifts in supply and demand). In this context, it is important to determine if Covid-19 and the presidential/Government directives (guidelines) will be considered as a '**force majeure**' event.²

The force majeure

The law relating to Force Majeure (a French phrase that means a 'superior force') is embodied under the contracts Act of 2010 and Sections 32 and 56 of the Indian Contract Act, 1872. It is a contractual provision agreed upon between parties. The occurrence of a force majeure event

¹ On 11 March 2020, the World Health Organisation announced its assessment that COVID-19 can be characterized as a pandemic. If your clause specifically refers to pandemics (or work stoppages, lay-offs or actions of government) as events of force majeure, then your clause may be activated by the outbreak of COVID-19 and subsequent events. (<https://www.arthurcox.com/knowledge/covid-19-practical-considerations-force-majeure-clauses-in-contracts/>)

² <https://www.bloomberqint.com/coronavirus-outbreak/covid-19-coronavirus-force-majeure-and-impact-on-commercial-contracts>

protects a party from liability for its failure to perform a contractual obligation. Typically, force majeure events include an Act of God or natural disasters, war or war-like situations, labour unrest or strikes, epidemics, pandemics, etc. The intention of a force majeure clause is to save the performing party from consequences of something over which it has no control. Force Majeure is an exception to what would otherwise amount to a breach of contract. Whether a contractual obligation can be avoided on the grounds of force majeure is a factual determination based on the specific terms of the contract³. The courts would examine, whether in each case, impact of Covid-19 pandemic prevented the party from performing its contractual obligation. Indian courts have generally recognised this concept and have enforced it where appropriate.

The law has been laid down in the seminal decision of the Supreme Court in the case of *Satyabrata Ghose vs Mugneeram Bangur & Co*⁴. The entire jurisprudence on the subject has been well summarised by Justice R.F. Nariman of the Supreme Court in a recent decision in the case of *Energy Watchdog vs CERC*⁵.

Force majeure related language used in most contracts varies widely and, therefore, it is important to review these clauses carefully. Some contracts list specific examples of force majeure events that automatically meet the standard upon the happening of such event, while others rely on generic language usually included in such force majeure clause.

A force majeure clause cannot be implied under law, it must be expressly provided for under the contract and protection afforded will depend on the language of the clause. In the event of a dispute as to the scope of the clause, the courts are likely to apply the usual principles of contractual interpretation⁶

Can A Force Majeure Clause Be Successfully Invoked In Light Of Covid-19 Being Declared A Pandemic?⁷

³ *Kel Kim Corp. v. Cent. Mkts., Inc.*, 70 N.Y.2d 900, 902 (1987)

⁴ (AIR 1954 SC 44).

⁵ *Energy Watchdog vs CERC* (2017) 14 SCC 80

⁶ Ibid

⁷ <https://www.bloomberquint.com/coronavirus-outbreak/covid-19-coronavirus-force-majeure-and-impact-on-commercial-contracts>

A Covid-19 pandemic could make it more difficult for parties to perform their contractual obligations. There are two possible instances, which may suggest that a force majeure clause covers a pandemic:

- (a) If the contractual definition of a force majeure event expressly includes a pandemic. Inclusion of pandemic to the list of force majeure events will provide clarity as to whether Covid-19 outbreak would trigger a force majeure clause in a contract; or
- (b) If the force majeure clause covers extraordinary events or circumstances beyond the reasonable control of the parties. Such general, catch-all wording may be invoked if it is determined that the factual circumstances caused by the pandemic are beyond reasonable control of the affected party.

Having said that whether a party can be excused from a contract on account of Covid-19 being declared a pandemic is a fact-specific determination that depends on the nature of the party's obligations and the specific terms of the contract.

Also **relying on the force majeure provisions**, force majeure event must not have been foreseen by the parties. For example, a party seeking to rely on widely drafted and non-specific force majeure clause entered into since the outbreak in China came to light, may find it difficult to convince a judge that the parties did not foresee the risk of COVID-19 impacting the contract. Additionally, a counter party may try to argue that the Covid-19 outbreak is not unforeseeable, in light of the SARS outbreak in 2002⁸.

There must be a genuine failure or likely failure to perform and it must be established that COVID-19 caused the failure to perform i.e. the simple fact of COVID-19 existing will not be enough to be able to rely upon the force majeure provision, if the impact of the outbreak did not actually cause the party's failure to perform the obligations. (Bear in mind that the onus of proving that the event has prevented performance in manner outlined in the clause lies on the party seeking to avail of the force majeure clause.)⁹

⁸ <https://www.arthurcox.com/knowledge/covid-19-practical-considerations-force-majeure-clauses-in-contracts/>

⁹ Ibid

In considering the applicability of force majeure, courts look to whether: (1) the event qualifies as force majeure under the contract; (2) the risk of nonperformance was foreseeable and able to be mitigated; and (3) performance is truly impossible.

The court's inquiry largely focuses on whether the event giving rise to nonperformance is specifically listed as a qualifying force majeure in the clause at issue.¹⁰ Even if a party can surmount this requirement, it cannot invoke force majeure if: (1) it could have foreseen and mitigated the potential nonperformance¹¹, and (2) performance is merely impracticable or economically difficult rather than truly impossible¹² (unless the specific jurisdiction or contract at issue specifies a different standard)¹³. Recent COVID-19 developments may impact whether the outbreak and/or its effects constitute force majeure.

While courts will likely reject a force majeure claim if the parties' agreement does not contain a force majeure clause¹⁴ parties seeking to excuse nonperformance may still avail themselves of the common law doctrines of impossibility or, in some jurisdictions, impracticability. These doctrines may excuse nonperformance where a party establishes that: (1) an unexpected

¹⁰ 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.”); *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”).

¹¹ Lord, *supra* note 7, § 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).

¹² 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”); see Lord, *supra* note 7, § 77:31 (“Nonperformance dictated by economic hardship is not enough to fall within a *force majeure* provision.”); *Bateman et al.*, *supra* note 6, § 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.”).

¹³ *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”).

¹⁴ *Gen. Elec. Co. v. Metals Res. Grp. Ltd.*, 293 A.D.2d 417 (1st Dep’t 2002) (“The parties’ integrated agreement contained no force majeure provision, much less one specifying the occurrence that defendant would now have treated as a force majeure, and, accordingly, there is no basis for a force majeure defense.”).

intervening event occurred; (2) the parties' agreement assumed such an event would not occur; and (3) the unexpected event made contractual performance impossible or impracticable¹⁵.

A party's nonperformance will not be excused under these principles where the event preventing performance was expected or was a foreseeable risk at the time of the contract's execution¹⁶. Even if the event was unforeseeable, courts will still assess whether the "nonoccurrence" of the event at issue was a "basic assumption . . . on which the contract was made¹⁷." It is, for example, assumed that the subject of the contract will not be destroyed. It is not, however, considered a "basic assumption" that existing market conditions or the financial situation of the parties will not be disturbed¹⁸. As a result, mere market shifts or financial inability to perform generally do not constitute unforeseen events the nonoccurrence of which was a "basic assumption" of the contract.

As a general principle, a party assumes the risk of its own subjective incapacity to perform its contractual duties unless the contract envisions otherwise¹⁹. As a result, courts apply an objective assessment of whether the performance sought to be excused is impossible or impractical—whether the performance is beyond a party's subjectively-viewed capacity is irrelevant to this analysis²⁰. Some jurisdictions, including New York, excuse performance only where it is truly impossible, rather than merely impracticable, which generally requires a showing that destruction of the subject matter of the contract or the means of contractual performance make the satisfaction of obligations impossible²¹. Other jurisdictions, including California, excuse performance where it is impracticable, such that it would require excessive or unreasonable

¹⁵ Restatement (Second) of Contracts § 261 (Am. Law Inst. 1981) (addressing the impracticability of performance). According to the Restatement (Second) of Contracts, "extreme impracticability of performance may properly be regarded as having the same effect as strict impossibility of performance," and performance is impossible when "it can only be done at an excessive and unreasonable cost, for which the parties had not bargained." 17A Am. Jur. 2d *Contracts* § 643 (2020).

¹⁶ *Korea Life Ins. Co., Ltd. v. Morgan Guar. Trust Co. of N.Y.*, 269 F. Supp. 2d 424, 447 (S.D.N.Y. 2003)

¹⁷ Restatement (Second) of Contracts § 261 (1981)

¹⁸ *Ibid*

¹⁹ *id.* cmt. e ("[T]he rationale [behind impracticability and impossibility] is that a party generally assumes the risk of his own inability to perform his duty.")

²⁰ *See id.* (describing the objective standard of the doctrine as, "if the performance remains practicable and it is merely beyond the party's capacity to render it, he is ordinarily not discharged")

²¹ *Kel Kim Corp.*, 70 N.Y.2d at 902

expense²². We expect that the COVID-19 pandemic will require courts to address calls to liberalize the doctrines of impossibility and impracticality.

The party claiming force majeure is usually under a duty to show that it has taken all reasonable endeavors to avoid or mitigate the event and its effects. This is a subjective standard and will be interpreted on a case-to-case basis. The force majeure event or circumstance must be causative to the contractual breach and a party claim

The language of the force majeure clause will determine the remedies available to the parties. Some contracts may provide for immediate termination of the contract upon the happening of the force majeure event. Others may provide that the contract will be put on hold until the force majeure event is resolved. Some contracts may provide for limitations in time after which either party may terminate the agreement with written notice to the other (i.e. if non-performance caused by the event is prolonged or permanent). Others may require the contract to remain in effect until the force majeure event is resolved. Some contracts will only allow for certain obligations to be suspended²³.

Practical considerations

- **Attempt to resolve the issue:** Parties should in the first instance discuss the matter and try to find a practical and reasonable solution. Given the global nature of this crisis, very few people will be unaffected so it will be worthwhile trying to reach a compromise, such as suspending obligations or reducing the level of those obligations until such time as they can be resumed in full. Record decisions reached and audit all mitigating actions.²⁴
- **Follow the procedure in the contract:** A force majeure clause generally sets out the steps that must be followed if a party wishes to claim force majeure. This usually involves giving the other party written notice within a certain period of time. It is

²² *Habitat Trust for Wildlife, Inc. v. City of Rancho Cucamonga*, 175 Cal. App. 4th 1306, 1336 (Cal. Ct. App. 2009).

²³ <https://www.bloomberquint.com/coronavirus-outbreak/covid-19-coronavirus-force-majeure-and-impact-on-commercial-contracts>

²⁴ Leslie Scism, *U.S. Businesses Gear Up for Legal Disputes with Insurers Over Coronavirus Claims*, Wall St. J. (Mar. 6, 2020 10:00AM), <https://www.wsj.com/articles/u-s-businesses-gear-up-for-legal-disputes-with-insurers-over-coronavirus-claims-11583465668>.

important to follow these steps precisely to ensure there is no inadvertent breach of contract. The wording of the specific provisions should be carefully analysed. Identify other express obligations which mandate specific actions such as business continuity and disaster recovery plans.

- **Monitor developments:** Depending on the wording of the force majeure clause, redesignations by the WHO or new directions issued by the Uganda government may affect whether or not COVID-19 falls within the scope of force majeure. These should be closely monitored as they may either bring COVID-19 within the scope of the clause, or may result in the force majeure event being brought to an end, in which case a party will need to follow the contractual provisions relating to resumption of obligations.
- **Insurance coverage:** Consider whether there is any insurance coverage in place that may cover losses arising out of COVID-19. Business interruption insurance may be relevant here, but the policy will need to be carefully assessed to determine if losses arising out of COVID-19 will be covered. As a result of the 2002 SARS outbreak, many policies may now exclude losses arising out of outbreaks of disease, epidemics or pandemics.

Risk Management Measures to Be Considered In the Context of Non-Performance/Breach of Contract

Companies may consider the following curative actions in connection with their commercial contracts:²⁵

- Key contracts should be analysed to assess the parties' rights and obligations, including with respect to termination, force majeure, governing law and dispute resolution.
- Copies of critical correspondence and other communications should be maintained if disputes arise later. This can be particularly important in establishing that the company has done all that was reasonably possible to mitigate the losses
- Detailed review of supply chains should be conducted to understand geographic scope of operations, dependencies and business risks and legal rights.

²⁵ <https://www.mwe.com/insights/force-majeure-and-covid-19-frequently-asked-questions/>

- Legal views should be obtained on whether the force majeure clause in key contracts is open-ended or exhaustive in relation to the list of force majeure events and whether the Covid-19 outbreak is covered or excluded.

The COVID 19 continuing to cause panic in the world, we recommend that parties in commercial contracts consider the following

Review your contract to determine whether the contract includes a force majeure provisions. Force majeure provisions are express and not implied in contracts.

Establish that the inability to perform an obligation under contract is due to the consequences of COVID 19 and not a different reason. Notice periods for relief entitlement may be specifically reviewed.

review the definition of force mar....in the contract to determine whether there any express event incorporating events such as COVID19 and if not, whether the general language is sufficient to include COVID19 and its consequences.

Establish and consider the steps a business may need to put in place to avoid or at try to reduce the effects of COVID 19 as far as the ability to continue to perform contracts is concerned.

Establish what the consequences of a successful claim for force majeure are.