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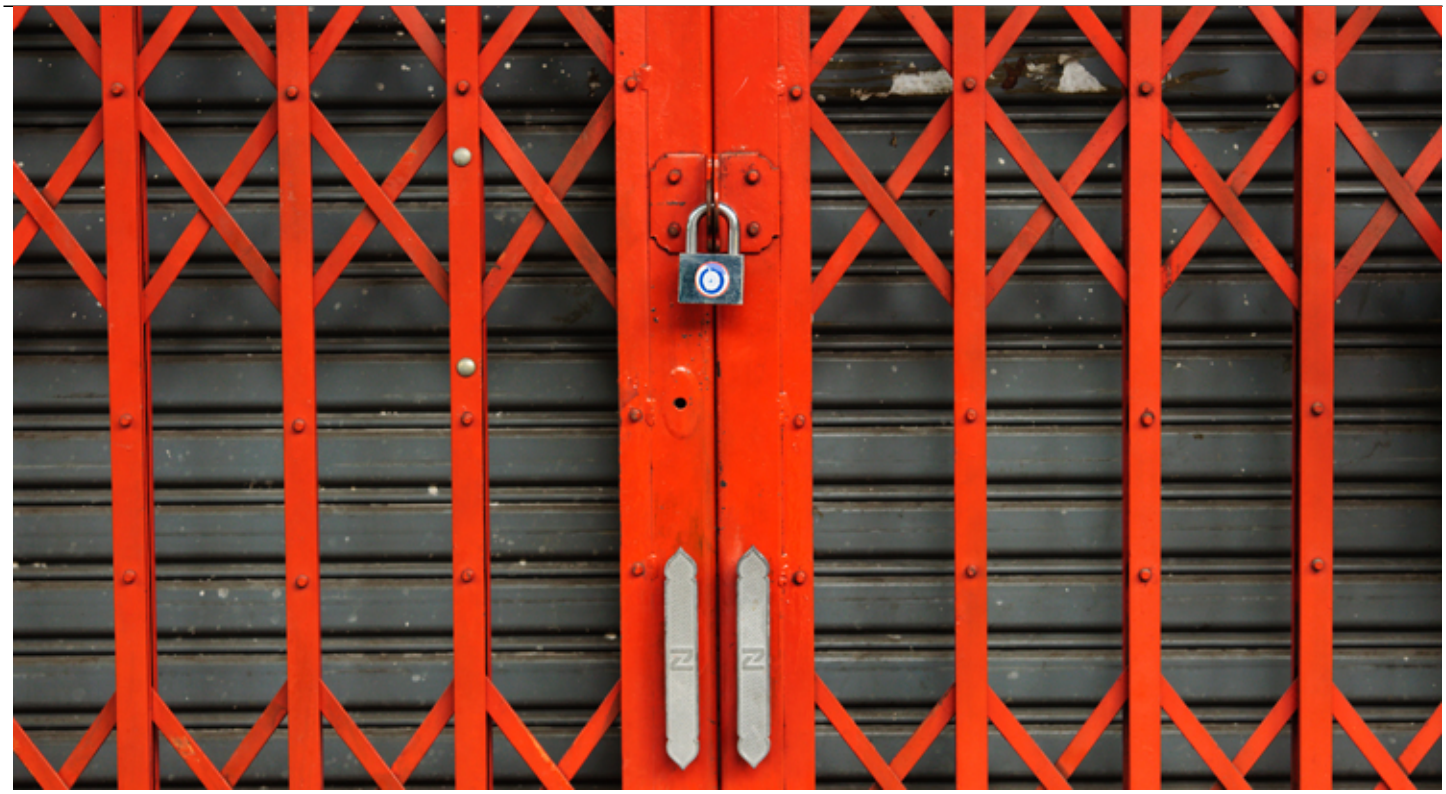
May the Force Majeure Be With You: The Anatomy and Effect of Force Majeure Clauses

Litigation and Dispute Resolution



Companies are facing disruptions to their supply chains, whether it's due to vendors that are no longer providing services or customers who seemingly vanish. This is reality in the realm of COVID-19.

But who is responsible when the supply chain fails due to a pandemic? What should a company do when its vendors stop working when their employees stay home? And how can a company avoid making payments pursuant to its contracts when its revenue stream has suddenly dried up?

With the COVID-19 pandemic, an oft-forgotten body of contract law — impossibility, impracticability, and frustration of purpose — has taken a front seat. Similarly, an oft-forgotten contract clause, the "force majeure" clause, is suddenly on the forefront of everyone's mind.

In the first part of this two-part series, we explored the common law and the Uniform Commercial Code on impossibility and frustration of purpose. In the second part of this two-part series, we'll explore the anatomy and effect of force majeure clauses, explained below.

The anatomy and effect of force majeure clauses

Force majeure, translated literally, means "superior force." It is often used synonymously with "act of God," but those two terms are not the same. An "act of God" usually refers to a natural disaster, such as a flood or tornado. However, force majeure events can result from an "act of man," such as a war or strike. As such, a more fulsome translation is that force majeure means an unanticipated and overwhelming act of god or man.

Force majeure clauses in contracts address the allocation of risk between the contracting parties if

the contract cannot be performed, or fully performed, due to a force majeure event. It is the contractual clause version of the impossibility, impracticability, and frustration of purpose common law principles discussed in Part One of this series.

So, what exactly is a force majeure clause? A classic example of a force majeure clause, as set forth in Corbin on Contracts, is as follows:

> *"Neither party shall be liable for its failure to perform hereunder if said performance is made impracticable due to any occurrence beyond its reasonable control, including acts of God, fires, floods, wars, sabotage, accidents, labor disputes or shortages, governmental laws, ordinances, rules and regulations."*

This example is rather short, containing less than 50 words. But force majeure clauses come in a variety of lengths and go into various levels of detail. By way of example, the International Chamber of Commerce model force majeure clause is over 750 words long.

These are the key components of a force majeure clause, which are further explained below:

1. It can be drafted to be mutual or one-way.
2. It usually has a list of events that trigger the clause.
3. The force majeure clause may require notice, may require certain information in the notice, or may simply be silent as to notice.
4. A force majeure clause often specifies the effect of a force majeure event.

1. Mutual or one-way force majeure clauses

Force majeure clauses can be drafted to benefit one party to a contract, or they can be drafted to benefit both sides of a contract. The example from *Corbin on Contracts*, above, is a mutual force majeure clause. It can benefit either party when there is a force majeure event, such as a pandemic.

However, not all force majeure clauses are mutual. Many are written excusing only one of the contracting parties from performance in the event of a force majeure event. For example, the above clause could instead have been written:

> *"Party A shall not be liable for its failure to perform hereunder if said performance is made impracticable due to any occurrence beyond its reasonable control, including acts of God, fires, floods, wars, sabotage, accidents, labor disputes or shortages, governmental laws, ordinances, rules and regulations."*

Thus, only one party is excused.

2. Events that trigger the force majeure clause

Usually, there must be an event that triggers the force majeure clause. Many force majeure clauses specifically reference force majeure events to include occurrences such as "epidemics" and "quarantine restrictions."

Many other force majeure clauses, like the *Corbin on Contracts*, do not. However, as long as the force majeure events are written in a broad manner with terms like “including” and “act of God,” there is a strong likelihood that courts will consider the COVID-19 pandemic to be a force majeure event, regardless of whether the specific word “epidemic” or “pandemic” is contained in the language of the clause.

However, it should be noted that the qualifying event is usually tied to the inability of a party to perform the contract. In other words, it is not an epidemic itself that triggers the clause, but rather something caused by the epidemic that makes the performance of the contract impracticable or impossible. As such, force majeure clauses typically require that the force majeure event be something beyond the control of the performing party.

For example, a supplier of goods to be manufactured in a state or country with stay-at-home orders that prevent the manufacture or transport of the goods may likely be able to invoke a standard force majeure clause based upon the COVID-19 pandemic. That same supplier would not likely succeed in invoking a force majeure clause, however, if the inability to manufacture the goods was caused by the manufacturer’s decision to use a new cleaning agent on its manufacturing equipment that unexpectedly seized up the machines.

3. Notice requirements

Many force majeure clauses have a notice requirement. The notice requirement means that in order to invoke the clause, a party must provide written notice to the other parties, often estimating the duration of the delay in performance.

The Porcine Reproductive and Respiratory Syndrome (PRRS) outbreak provides an interesting comparison study to today’s COVID-19 events. Owing to PRRS, hog suppliers found themselves unable to supply the hogs they contractually agreed to supply. The hog buyer sued the suppliers for failing to deliver the promised hogs.

Although the parties agreed that PRRS was a force majeure event, as most suppliers did not provide written notice of this force majeure event, those suppliers could not invoke the clause as a defense. The lesson is that even in a force majeure scenario, you cannot count on the extreme nature of the circumstances excusing your lack of performance.

You must follow your contract to the letter: If it requires notice, provide notice. Even if a force majeure clause does not have a notice requirement, prudence still dictates that the non-performing party provide notice. Indeed, this is often required in contracts involving the sale of goods.

4. Effect of a force majeure clause

Force majeure clauses can do more than simply excuse a party from performing under a contract. Some force majeure clauses eliminate damages for breach of the contract. Other clauses cancel the contract. Many clauses require that a force majeure event does not excuse performance under the contract, but simply extends the obligation until after the event is over.

As to the latter situation, for example, a supplier may not be obligated to supply materials during the force majeure event (e.g., the COVID-19 pandemic) if it is unable to obtain the materials. Once the materials become available, however, it must resume shipment. Conclusion In these challenging

times, it behooves corporate counsel to become familiar with the force majeure provisions in their key contracts. It is important to understand:

- Whether the clause is mutual or one-way;
- What events trigger the force majeure;
- How the notice requirement works; and
- The effect of the exercise of the clause on each party's respective obligations.

Corporate counsel should be particularly mindful about properly providing notice of a force majeure event or verifying whether the other party properly provided notice. Likewise, corporate counsel should explore the possibilities for alternative or delayed performance by their company or the other contracting party. And corporate counsel should not lose sight of the common law and UCC rules governing impossibility, impracticability, and frustration of purpose discussed in Part One of this series.

With companies grappling with the pernicious effects of COVID-19, force majeure clauses have temporarily become one of the most important clauses in contracts.

For more advice and information on the coronavirus pandemic, visit ACC's Coronavirus Response Resource Page.

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