



PROGRAM MATERIALS

Program #3098

March 31, 2020

Coronavirus and Contract Performance: Force Majeure and Related Doctrines

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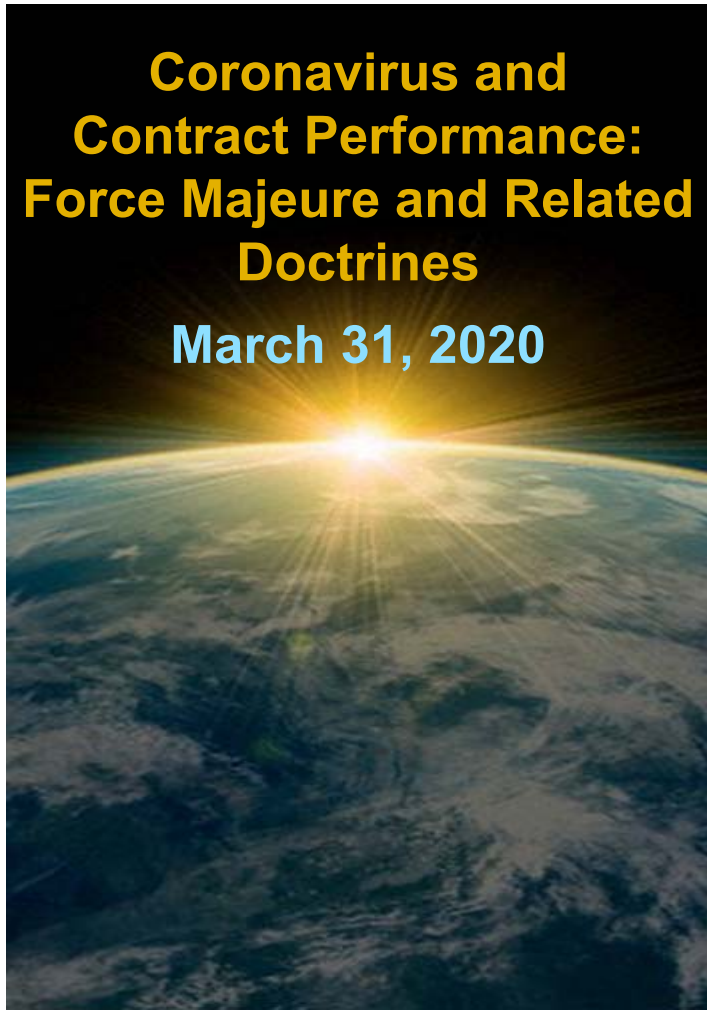


Coronavirus and Contract Performance *Force Majeure and Related Doctrines*

March 31, 2020

**Coronavirus and
Contract Performance:
Force Majeure and Related
Doctrines**

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**Coronavirus and
Contract Performance:
Force Majeure and Related
Doctrines**

March 31, 2020



Agenda

- **Market and Social Disruption**
- **Sources of “Force Majeure”**
 - **Contract Provisions**
 - **Statutory or Codified Rights**
 - **Common Law Doctrines**
- **China Council for the Promotion of International Trade Force Majeure Certificate**
- **Case Studies**

Market and Social Disruption

- At the beginning of the month, commentators were predicting that peak disruptions might occur mid-March
- Now, “stay at home” orders exist in more than 50 state and local jurisdictions



- Disruptions can be **direct**
 - Government declarations and measures
 - Supply chain shortages
 - Local and regional outbreaks or impacts affecting your own labor
- Disruptions can also be **indirect**
 - Downstream effects
 - Reduced demand
 - Disproportionate price increases

Market and Social Disruption

- Certain industries (travel, medical) may face unique challenges
- Almost every industry, whether goods or services, might anticipate suffering some disruptions relating to either demand or supply



- What happens if I ***no longer can perform*** on a contract?
- What happens if I ***no longer need or do not want performance*** I would otherwise be paying for?
- What if I'm in the middle, ***between a customer and a vendor?***

Will COVID-19 provide a basis to excuse contract performance?

**FORCE
MAJEURE!**



Top 12 things you can do to better guard against contract performance risks

1. Assess and document COVID-19's impact on your ability to perform obligations under your contracts
2. Retain counsel, or ask in-house counsel, to review relevant contracts force majeure provisions
3. Consider revising your "standard" contracts to include a detailed force majeure clauses that anticipate labor and supply shortages related to "disease," "epidemic," or "act of God"
4. Consider drafting notice letters now if you anticipate delayed or disrupted performance
5. Consider amending current contracts to explicitly outline notice requirements and "triggering" events
6. Keep detailed centralized records related to (potential) non-performance

Top 12 things you can do to better guard against contract performance risks

7. For contracts under PRC law, even if CCPIT issues a certificate the applying party must still show that there has been an objective circumstance that was unforeseeable, unavoidable and insurmountable such that it rendered performance impossible.
8. Attempts to use force majeure opportunistically will not work, and appearance is reality
9. Monitor relevant government and regulatory announcements, notices and policies
10. Determine the “best” governing law at the outset of contract (re)negotiations
11. Negotiate with the other party reach an agreement on possible waivers, substitute performance, and extensions
12. The more “indirect” the link between alleged breach and any circumstances surrounding COVID-19, the more likely an unseemly fight over causation may break out.

What is “*Force Majeure*?”

- Typically refers to a contract clause excusing performance based upon circumstances beyond the party’s control.
- Often, however, Courts will also use the term force majeure to refer to any of about a half-dozen laws and doctrines that might excuse a party’s performance under a contract.



Sources of “*Force Majeure*”

- **Contract provisions**
- **Statutory or codified rights**
 - Uniform Commercial Code (UCC) § 2-615
 - Contracts for the International Sale of Goods (CISG) Art. 79
- **Common Law Doctrines**
 - Impossibility
 - Commercial Impracticality
 - Frustration of Purpose
 - Other phrasing, such as mutual mistake, or change of circumstances, may express similar concepts
- **China Council for the Promotion of International Trade Force Majeure Certificate**



Force Majeure – Contract Provisions



- **Recognize that certain industries have quite specific and typical force majeure provisions, or well-developed caselaw around them**
- **Our comments today are meant to apply across as broad a range of situations as possible, knowing that in any particular industry practice or instance, the specific contract terms will control**
- **Force majeure clauses can be very general boilerplate, or very detailed with long lists of examples**

Force Majeure – Contract Provisions

A common general provision:

Neither party shall be liable for any failure or delay in performance under this Agreement for causes beyond that party's reasonable control and occurring without that party's fault or negligence, including, but not limited to, acts of God, acts of government, flood, fire, civil unrest, acts of terror, strikes or other labor problems (other than those involving the party's employees, respectively). Dates by which performance obligations are scheduled to be met will be extended for a period of time equal to the time lost due to any delay so caused

Force Majeure – Common Contract Provision

What if the disruption is based on illnesses or perceived risk by your own employees?

Neither party shall be liable for any failure or delay in performance under this Agreement for causes beyond that party's reasonable control and occurring without that party's fault or negligence, including, but not limited to, acts of God, acts of government, flood, fire, civil unrest, acts of terror, strikes or **other labor problems (other than those involving that party's employees,** respectively). Dates by which performance obligations are scheduled to be met will be extended for a period of time equal to the time lost due to any delay so caused.

Force Majeure – Common Contract Provision

Who determines the **dates affected**?

Neither party shall be liable for any failure or delay in performance under this Agreement for causes beyond that party's reasonable control and occurring without that party's fault or negligence, including, but not limited to, acts of God, acts of government, flood, fire, civil unrest, acts of terror, strikes or other labor problems (other than those involving that party's employees, respectively). Dates by which performance obligations are scheduled to be met will be extended for a period of time **equal to the time** lost due to any delay so caused.

Force Majeure – Common Contract Provision

Is it even necessarily clear that there will be no allegations of a party's own **fault or negligence**?

Neither party shall be liable for any failure or delay in performance under this Agreement for causes beyond that party's **reasonable control and occurring without that party's fault or negligence**, including, but not limited to, acts of God, acts of government, flood, fire, civil unrest, acts of terror, strikes or other labor problems (other than those involving that party's employees, respectively). Dates by which performance obligations are scheduled to be met will be extended for a period of time equal to the time lost due to any delay so caused.

Force Majeure – Contract Provisions

Common specific force majeure provisions can be pages long, and might include:



- Unilateral language
- Specific “trigger” language
- Mitigation or “efforts” language
- Oral and written notice requirements
- Modified payment terms, reimbursement terms, or liquidated damages provisions
- Time periods on or after which other terms apply
- Extraordinarily lengthy and detailed lists of examples

Force Majeure – Contract Provisions

What issues arise relating to a potential COVID-19 disruption in more detailed provisions?



- Courts tend to apply the maxim *ejusdem generis*, sometimes even where the list expressly says “including but not limited to”
- Time periods may be very hard to determine
- Oral or written notice procedures tend to operate as forfeiture provisions
- Force majeure provisions (especially more detailed ones) risk superseding common law remedies

Force Majeure – Contract Provisions

- **Other species of force majeure provisions**
- **Many contracts have cancellation, termination, delayed performance or delayed payment provisions that incorporate “act of God” type concepts**
- **Look for “exclusive remedies” language in your contracts**



COVID-19 & Contract Performance Practice Tips



- 1. Assess and document COVID-19's impact on your ability to perform obligations under your contracts**
- 2. Retain counsel, or ask in-house counsel, to review relevant contracts' force majeure provisions**
- 3. Consider revising your "standard" contracts to include a detailed force majeure clauses that anticipate labor and supply shortages related to "disease," "epidemic," or similar language**

Force Majeure – Statutory or Codified Rights

UCC § 2-615 provides for excuse of performance in the sale of goods for “failure of presupposed conditions”

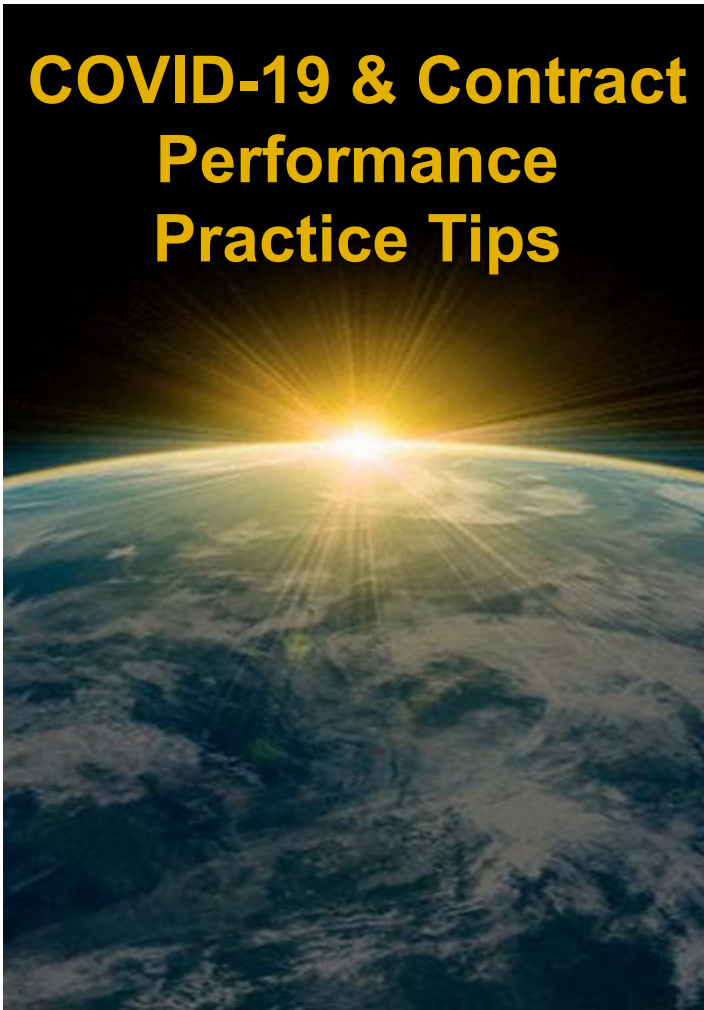
- Excuses seller’s performance where: performance as agreed has been made **impracticable** by the occurrence of a contingency the non-occurrence of which was a **basic assumption** on which the contract was made or by compliance in good faith with any **applicable foreign or domestic governmental regulation or order** whether or not it later proves to be invalid
- Requires allocation of performance among customers “in any manner which is fair and reasonable”
- Notification is required

Force Majeure – Statutory or Codified Rights

Contracts for the International Sale of Goods (CISG) Art 79 provides for excuse of performance

- Excuses performance for “impediment beyond [the party’s] **control**” if the party “could not reasonably be expected to have taken the impediment into **account**” or “to have **avoided** or **overcome** it or its consequences”
- Exceptions are made for third party performance
- Notice is required

COVID-19 & Contract Performance Practice Tips



4. **Consider drafting notice letters now if you anticipate delayed or disrupted performance**
 - Prompt Notice is critical, ***even if*** your force majeure clause does not have a notice provision
5. **Consider amending current contracts to explicitly outline notice requirements and “triggering” events**

Force Majeure – Common Law Doctrines

Impossibility & Impracticability

- Common law doctrine(s) permitting a very narrowly-defined excuse from performance
- Courts and commentators are clear excuse for impossibility or impracticability is a strict standard
- These doctrines are not available when one party to the contract assumed the risk



Force Majeure – Common Law Doctrines

- Some cases of *impossibility* are easy; supervening circumstances make performance objectively impossible
- In other cases, *impracticability* exists where one would suffer “*extreme, unreasonable, and unforeseeable hardship* due to an *unavoidable* event or occurrence”
 - More than mere change in degree of difficulty or expense
 - May not be available where the contract already addresses force majeure
 - Substitute performance may be an obstacle to this excuse



Force Majeure – Common Law Doctrines

Frustration of Purpose requires:

1. Supervening **event**;
2. A **mutual basic purpose** of the contract that
3. has been **frustrated** by the supervening event;
4. The event was **unforeseen** – that is not fairly within the risks assumed under the contract;
5. The event was **neither caused by** nor within the avoidance or **control** of the party; and
6. The event renders the value of **performance essentially worthless**



Force Majeure – Common Law Doctrines

Frustration of Purpose

- Doctrine can create fact issues as to how the parties define a “basic purpose” of the contract after the fact
- As COVID-19 grows more infamous, there is increasing risk that at least as to new contracts, the risks are not unforeseen
- As COVID-19 becomes more known, and steps to mitigate its spread develop, there may be unseemly fact issues as to “control” or “avoidance”



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6. Keep detailed centralized records related to (potential) non-performance, including:

- **Timing**
- **Loss**
- **Progression of Force Majeure Event**
- **Mitigation Efforts**
- **Negotiation Efforts**

Record, record, and record some more!

A Note (or two) On Stay At Home Orders and Contract Performance

“Illegal” Performance

- Often, the more literally “illegal” performance is, the more likely force majeure or another doctrine will apply
- Note, however, that some contracts have express “change of laws” provisions that may allocate risk
- Courts may look for opportunities for substitute performance that would avoid the illegality, and fact issues may develop regarding impracticability



A Note (or two) On Stay At Home Orders and Contract Performance

In Stay At Home Orders, what is prohibited?

- Numerous stay at home orders define “essential” businesses and services differently
- For business continuity, one would like to be “essential,” obviously
- Status as an “essential” service may be counterproductive to force majeure and impossibility arguments
- Impracticability and Frustration of Purpose arguments should still be available in all events
- Look carefully for “recommendations” couched as “orders” and seek clarification



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7. Carefully review Stay At Home Orders for yourself *and contract counterparties*

- **Duration**
- **What is required?**
- **What is recommended or permitted?**
- **Will your business be “essential” or otherwise exempted?**
- **Will your counterparties be “essential” or otherwise exempted?**

China Counsel for the Promotion of International Trade (CCPIT)



- Founded in 1952, CCPIT is a national foreign trade and investment promotion agency
- Jan. 30, 2020: announced that it would offer force majeure certificates to Chinese companies struggling to cope with the impact of the coronavirus outbreak.
- Feb. 2, 2020: issued the first certificate to a Zhejiang-based auto parts manufacturer within one day of its application.
- By Feb. 14, 2020: issued more than 1600 certificates.
- By March 11, 2020: issued 5,637 certificates covering contracts worth a combined Rmb503.5bn (\$72.47bn).

Force Majeure – PRC Law

- Articles 94, 96 and 117-118 of the PRC Contract Law (中华人民共和国合同法).
 - 94(1): a party may terminate if the purpose of the contract is rendered impossible
 - 96: a party who wants to terminate shall notify the other party. The contract is terminated when the notice reaches the other party. If the other party does not agree to the termination, it may seek confirmation of the validity of the contract from the court or arbitral tribunal.
 - 117: if a party delays & the event happens after the delayed performance, cannot be exempted from liability.
 - 118: a party unable to perform shall notify the other party promptly to reduce potential losses caused to the other party; and shall provide proof/certificate of force majeure within reasonable time.
- Article 180 of the PRC General Provisions of Civil Law (中华人民共和国民法总则)
- Articles 107 and 153 of the PRC General Principles of Civil Law (中华人民共和国民法通则)

<https://www.rzccpit.com/company/infomationdetails.html?id=041bd1e08b0e4bc6bc9da5742cde4b37>

Force Majeure – PRC Law

To obtain a force majeure certificate, a party must submit the following supporting documents to CCPIT online:

- Export sales contracts, cargo booking agreements, freight forwarding agreements, customs declarations, or any other relevant contracts
- Certificates and/or announcements issued by municipal governments or institutions
- Notices and/or certificates on delay or cancellation of sea, land or air freight
- Will accept electronic order forms or emails if there is no written contract

<https://www.rzccpit.com/company/infomationdetails.html?id=041bd1e08b0e4bc6bc9da5742cde4b37>

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8. **Even if CCPIT issues a certificate the applying party must still show that there has been an objective circumstance that was unforeseeable, unavoidable and insurmountable such that it rendered performance impossible.**

Also note:

- The sufficiency of a CCPIT force majeure certificate has not yet been tested before the courts in China.
- CCPIT has stated that a certificate is not sufficient to bar liability.

Case Studies

First, an “Easy One”

- **Contract contains a force majeure clause, and both parties agree it is triggered**



Case Study

SNB Farms, Inc. v. Swift & Co., Inc.,
2003 U.S. Dist. LEXIS 2063 (N.D. Iowa 2003)

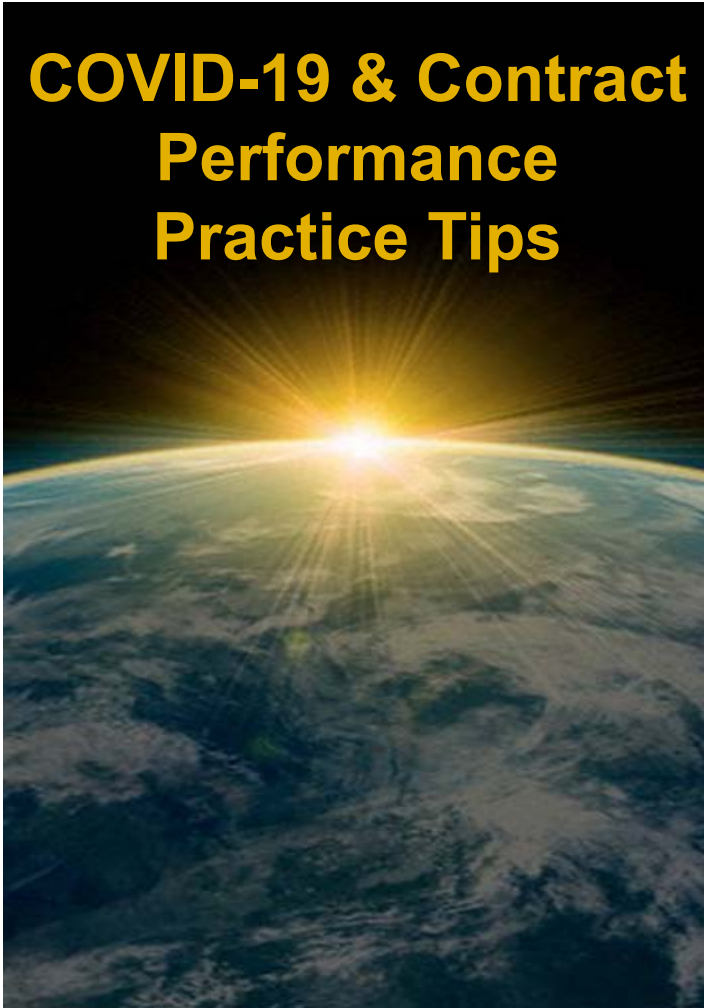
- **SNB Farms** and two other hog producers, contracted to sell **Swift** hogs for several years
- After an outbreak of PRRS, **SNB Farms** suffered hog production problems, and under-delivered
- Low prices prompted **Swift** to attempt to renegotiate the contract, and when **SNB Farms** refused, **Swift** terminated, citing the underproduction
- **SNB Farms** claimed to be excused in its under-performance by force majeure relating to the PRRS outbreak

Case Study

SNB Farms, Inc. v. Swift & Co., Inc.,
2003 U.S. Dist. LEXIS 2063 (N.D. Iowa 2003)

- Contract contained a force majeure clause, and all parties agreed the PRRS outbreak constituted force majeure
- Despite **Swift's** actual knowledge of the PRRS outbreak as it related to **SNB Farms**, **Swift** argued that the other two hog producers had not complied with the notice provisions of the contract for force majeure

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What might we learn from *SNB Farms*?

9. When your contracts do contain force majeure provisions, make sure you review them for notice provisions
10. Circumstances surrounding COVID-19 may (or may not) make it difficult to identify the “moment” of force majeure, and have a plan for your business; what circumstances would “trigger” providing notice of force majeure?

Case Study - Governmental Action

- **What happens if there is an unexpected governmental action?**
- **Or a government shuts the doors (mostly)?**



Case Study

Macromex SRL v. Globex Int'l, Inc.,
2008 U.S. Dist. LEXIS 31442 (S.D. N.Y. 2008)

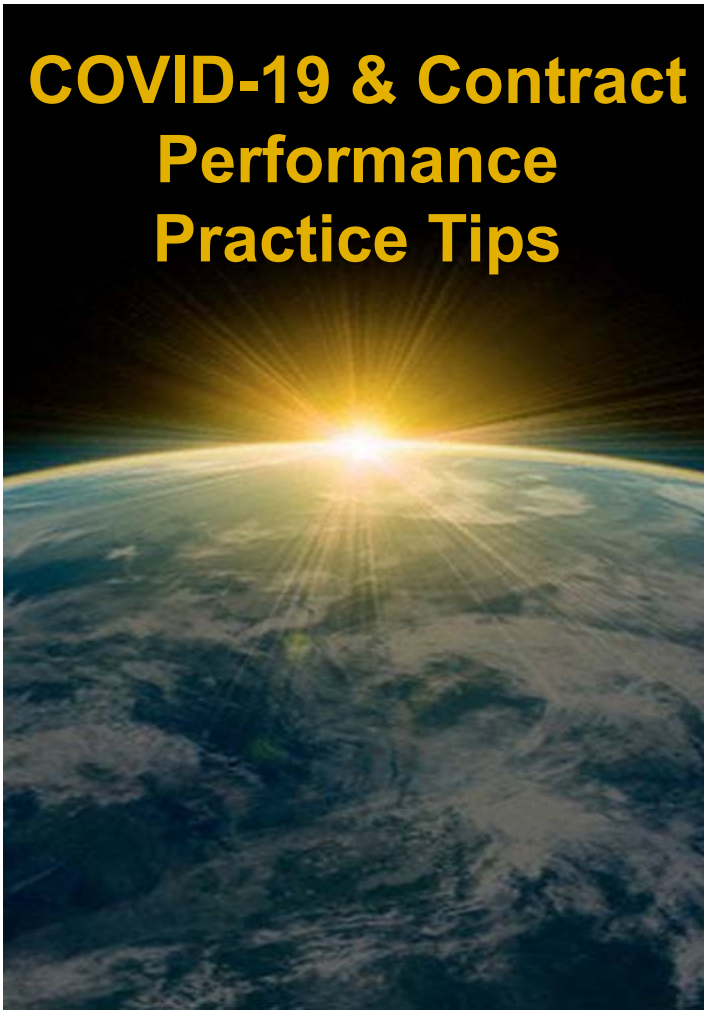
- **Globex**, a food product supplier, contracted to sell **Macromex** 112 containers of chicken parts, to be delivered in Romania
- Before complete delivery (but after shipment had been due), Romania declared, without notice, that no uncertified chicken could be imported into Romania
- **Globex** failed to make deliveries to **Macromex**, and claimed to be excused by the Romania's unexpected regulation

Case Study

Macromex SRL v. Globex Int'l, Inc.,
2008 U.S. Dist. LEXIS 31442 (S.D. N.Y. 2008)

- **Macromex** sued **Globex** for \$600,000 + attorneys fees
- Contract governed by Contracts for the International Sale of Goods (CISG) which contains force majeure principles

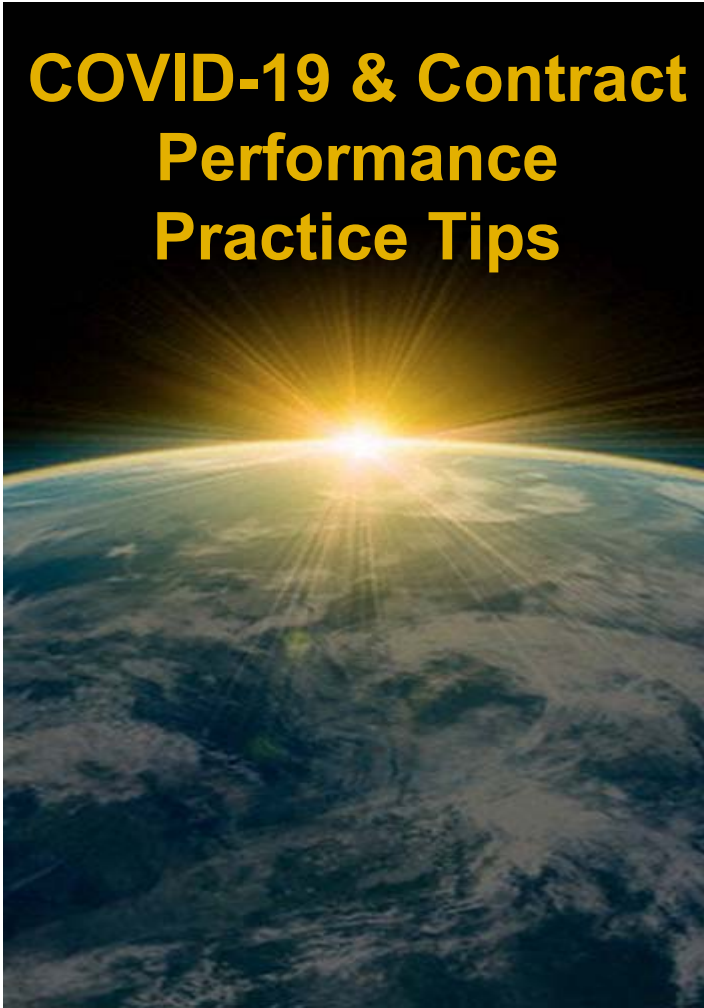
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What might we learn from *Macromex*?

- 11. Attempts to use force majeure opportunistically will not work, and appearance is reality**
 - Heightened risks presented by COVID-19 require more vigilance in ordinary contract performance
- 12. Monitor relevant government and regulatory announcements, notices and policies**
- 13. Determine the “best” governing law at the outset of contract (re)negotiations**

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14. Negotiate with the other party reach an agreement on possible waivers, substitute performance, and extensions

- Courts will work to find a manner of substitute performance that could have sufficed

Case Study – Supply Interruptions

- **What about supply interruptions and downstream effects?**
- **What happens when causation becomes unclear?**



Case Study

Rembrandt Enters. v. Dahmes Stainless, Inc., 2017 U.S. Dist. LEXIS 144636 (N.D. Iowa 2017)

- Egg producer, **Rembrandt**, planned an expansion project, and purchased and industrial egg dryer from **Dahmes Stainless** for the new facility
- Several of **Rembrandt's** facilities suffered an Avian Flu (HPAI) outbreak, causing destruction of 1 million hens and 50% reduction in egg production capacity
- **Rembrandt** lost several lucrative contracts due to the decreased capacity, cancelled the expansion, and provided notice claiming that **Rembrandt** was excused from buying the dryer

Case Study

Rembrandt Enters. v. Dahmes Stainless, Inc., 2017 U.S. Dist. LEXIS 144636 (N.D. Iowa 2017)

- Contract contained a force majeure clause, but it was (inadvertently?) one-sided and did not apply
- Court addressed excuse of performance under doctrine of Frustration of Purpose
 - Principal Purpose frustrated
 - Without **Rembrandt's** fault (causation)
 - By an unexpected failure of a basic assumption of the contract
- On the facts of *Rembrandt*, every element created a factual issue requiring trial.

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What might we learn from *Rembrandt*?

Frustration of purpose doctrine may result in contract fights far removed from any issue actually related to COVID-19

15. The more “indirect” the link between alleged breach and any circumstances surrounding COVID-19, the more likely an unseemly fight over causation may break out.

- Could one have predicted, prevented, or mitigated the outbreak?
- Was the outbreak really a pretext for other business decisions, business failings, or failure to find substitute performance?
- Should all of the risk have been spelled out in a better, bilateral force majeure clause?

Case Study – Labor Shortages

Can IV Packard Square LLC v. Packard Square LLC, No. 335512, 2018 Mich. App. LEXIS 157 (Ct. App. Jan. 23, 2018)

- **Packard Square** failed to substantially complete the project, despite having been given several extensions of construction deadlines
- **Packard Square** asserted two force majeure events: an electrician strike & a labor shortage.
- The contract required notice of force majeure events within two days. **Can IV** argued that notice was late.
- **Can IV** also argued that an electrician strike could not have delayed the project because electrical, plumbing, and mechanicals phase had not yet begun
- **Packard Square** failed to produce evidence to dispute this assertion

Case Study – Labor Shortages

Aquila, Inc. v. C.W. Mining, 545 F.3d 1258, (10th Cir. 2008)

Aquila, Inc. public utility sued *C.W. Mining* coal mining after *C.W. Mining* suffered a labor strike and geological problems. Their contract contained a force majeure provision requiring notice.

- *Aquila, Inc.* accepted *C.W. Mining's* partial deliveries and bought the remainder of its required coal elsewhere. *C.W. Mining* cancelled the contract entirely, citing the force majeure provision.
- The 10th Circuit determined that:
 - the labor dispute and resulting labor shortage did not excuse performance because evidence supported the finding that the mining company's **geological problems** were the primary and independent cause the inability to perform.
 - *Aquila, Inc.'s* acceptance of defective performance did not amount to a waiver of its right to sue for breach.
 - *C.W. Mining* did not give sufficient notice

Case Study – Decreased Demand

- Is depressed demand a force majeure?
- Is COVID-19 an “unforeseen contingency?”
- What should we do in ongoing contract negotiations, renewals, purchase orders, etc.?



Case Study

Rexing Quality Eggs v. Rembrandt Enters. Inc.,
360 F. Supp. 3d 817 (S.D. Indiana 2018)

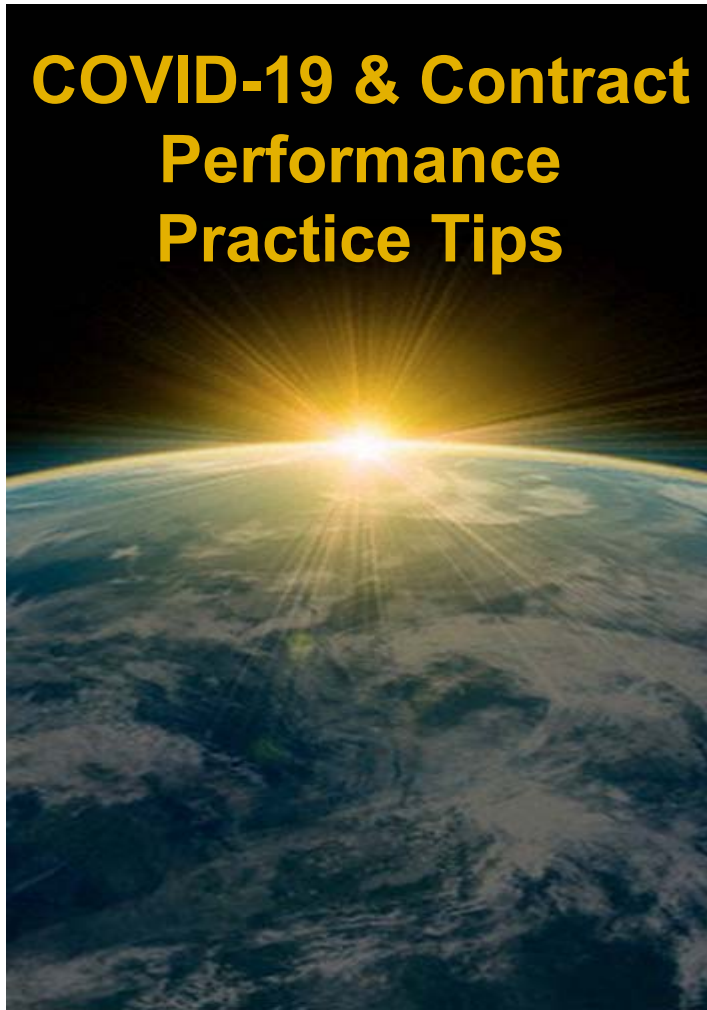
- Egg producer, **Rembrandt**, now selling to **Rexing**, an egg reseller, on a high volume contract
- **Rembrandt** suffered a MG bacterial outbreak, while **Rexing's** own buyers unexpectedly fell through, so it could not take the orders from **Rembrandt**
 - “[T]he cage free business isn’t what we were told it was going to be this time of year.”

Case Study

Rexing Quality Eggs v. Rembrandt Enters. Inc.,
360 F. Supp. 3d 817 (S.D. Indiana 2018)

- Contract contained a force majeure clause, and *Rexing* argued for frustration and “commercial impracticability” as well
- Court denied on all grounds
 - Mere drop in market demand is not an excuse
 - UCC 2-615 (the UCC version of commercial impracticality) did not apply absent “some unforeseen contingency” which alters the essential nature of performance

COVID-19 & Contract Performance Practice Tips



What might we learn from *Rexing*?

In some ways the *Rexing* result is obvious, but it begs important questions for us:

- 16. Against decades of jurisprudence reciting that market forces are not force majeure, how tightly must one prove the nexus between a market disruption and COVID-19?**
- 17. As contracts continue to be negotiated in the months ahead, under what “assumptions” are they being negotiated? What is the “mutual intent” of parties, now knowing that COVID-19 poses a risk? How long is COVID-19 an “unexpected contingency?”**

Top 12 things you can do to better guard against contract performance risks

1. BEFORE performance is interrupted (**right now**) assess and document COVID-19's impact on your ability to perform obligations under your contracts
2. Retain counsel, or ask in-house counsel, to review relevant contracts' force majeure provisions
3. Consider revising your "standard" contracts to include a detailed force majeure clauses that anticipate labor and supply shortages related to "disease," "epidemic," or "act of God"
4. Consider drafting notice letters now if you anticipate delayed or disrupted performance
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Additional Resources

Coronavirus Resource Center

<https://www.dorsey.com/newsresources/publications/client-alerts/2020/coronavirus-resources>

Federal Stimulus Act

<https://www.dorsey.com/newsresources/publications/client-alerts/2020/federal-stimulus-act>

Dorsey Partner Alissa Smith Discusses HIPAA Waivers Due to COVID-19

<https://www.dorsey.com/newsresources/news/media-mentions/2020/03/smith-covid19-hipaa>

LANDMARK CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY ACT: A Practical Guide

<https://www.dorsey.com/newsresources/publications/client-alerts/2020/03/landmark-coronavirus-aid>

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Questions?



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