

Force Majeure/Commercial Impracticability and COVID-19 Does the pandemic crisis excuse contractual performance?

Like the term "Requirements Contract" dominated the restructuring of automotive industry contracts in the 2000s, "Force Majeure" is likely to be the hot term in the next two years. Force majeure is French for "superior force." Force majeure provisions are written differently but they all address the circumstances under which the parties to a contract may be excused from performing their contractual obligations. This arises when events occur that neither contracting party could foresee or control and that made the party's performance impossible. A force majeure provision is one of these "boiler plate" contractual provisions that most contracting parties have never put much thought into. Generally, force majeure events are limited to only the very most significant of events. Said another way there is a very high standard for force majeure. For example, merely having unexpected, even very significant, price increases of raw materials would probably not be a force majeure event.

While force majeure (or the comparable UCC concept of commercial impracticability) apply generally, parties may address the concept in their contracts and specifically provide what may or may not constitute a force majeure event and what the parties' responsibilities would be if a force majeure event occurs. Here is an example of a force majeure provision taken from General Motors' standard terms and conditions (2014 version):

"Force Majeure . . . unable to produce, sell or deliver . . . as a result of an event or an occurrence beyond the reasonable control of such party, without such party's fault or negligence . . ., including, if applicable, actions by any governmental authority (whether valid or invalid), fires, floods, windstorms, explosions, riots, natural disasters, wars and sabotage; . . ."

Generally, force majeure does not excuse performance merely because a party's performance under a contract is difficult or more expensive than anticipated – only when it is reasonably impossible or, as described in the UCC, "commercially impractical."

There can be little question but that the Coronavirus pandemic and all its associated health care and governmental mandates would qualify as an event of force majeure or would support a defense of commercial impracticability to contracting parties whose performance is directly affected, absent a contract provision providing otherwise. But an analysis is required to determine if and to what extent performance would be excused.

First, one must examine any relevant provisions in the contract in question. Not all contracts have a force majeure provision. If not, the general law of force majeure would apply, or if it is a contract for the sale of goods, the UCC law of commercial impracticability. Typically, a party whose work force cannot report for work or who lacks access to other resources necessary to perform the contract as a direct result of the Coronavirus and associated government actions, will be entitled to relief from performance, which failure might otherwise constitute a breach.

Again this conclusion is only the start of your journey with force majeure. In the coming months we expect substantial commercial disagreements regarding the practical implementation of force majeure concepts, including whether the duration of the force majeure event justifies termination of the contract. Many force majeure provisions and the UCC specify when a party may terminate a contract if the other party's performance is delayed due to a force majeure. Under the UCC, this right arises "where the prospective deficiency substantially impairs the value of the whole contract."

Similarly, we anticipate disputes over whether an "excused" party has adequately mitigated the effects of the force majeure conditions. Allocation of production will create substantial friction, and even more so as the economy reengages. While a customer may accept that its supplier's performance was excused, it might still demand a burdensome allocation of the supplier's start-up production, to the detriment of the supplier's other contracts. Each contract dispute will arise out of unique facts and contract language. The following considerations are likely to be important to most such situations.

1. What is the length or extent of relief to which the contracting party is entitled and what is the risk of contract termination?
2. To what extent, and to whom, should limited assets be allocated during the force majeure event and during recovery? In certain industries, contracting parties have, through one provision or another, promised most favored nation status to a customer, potentially more than one customer. These parties will demand that all resources be assigned to it.
3. What reasonable measures are required of a party excused from performance to mitigate the impact of their non-performance?

Each of these questions will come to bear on eventual disputes in supply chains.

What can contracting parties do now to prepare?

1. **Examine your contracts.** If they have force majeure provisions, understand what your contractual obligations are to each contract partner, and the extent to which these obligations may be excused or supplemented.
2. **Communicate, communicate, communicate.** Involve your contract partners in regular communications regarding the status of their production and your force majeure limitations. Surprise is a precursor to dispute. In many contracts, the force majeure provision requires prompt or immediate notification of the contract partner with ongoing updates, and failure to comply might limit the protection available. Additionally, by communicating you engage your client in mitigation and allocation discussions. Might some of those contract partners (or perhaps all of them) have unrealistic expectations? Absolutely. But knowing them now and having them articulate them now is better than finding out later.
3. **Track expenses, costs and events associated with any force majeure event.** What recovery will look like is still very much unknown. How the obvious costs of the coronavirus disruption will be allocated among industry members is unknown. There is likely to be substantial government assistance and action. You need to be able to demonstrate the impact of the coronavirus on your business. In the same regard, you want to be able to demonstrate to your customers the extent, timing, and ramifications of force majeure on your business. So track your production timeline events also.
4. **Begin planning now.** At some point the coronavirus will begin to dissipate but the economy will not return to normal on a specific date. Rather, the impact of the virus will have different impacts in different global regions. Different economies will get back up and running at different paces and supplies and raw materials will become available at uneven levels. You will be obligated to show your customers not only when you will be back to full production but how you will allocate your limited resources until you are. So put mechanisms in place now when you have idle resources to prepare for that crush of activity later.

Bodman's attorneys are available to assist you as businesses adjust to this difficult time, please contact any of our team listed below.

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