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Negotiation and Enforcement of Force Majeure Clauses

Deborah Verdile
Senior Legal Editor
Practical Law
New York, NY USA

and

Lawrence Hsieh
Senior Legal Editor
Practical Law
New York, NY USA

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Introduction

This presentation discusses key issues related to the negotiation and enforcement of force majeure clauses, including:

- General risk allocation issues in contracts.
- The basics of force majeure provisions.
- How courts interpret force majeure provisions.
- Tips on drafting these provisions in new contracts.
- Circumstances where a contract lacks a force majeure provision.
- Steps to take when a force majeure event occurs.

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Introduction (cont'd)

- Extreme events (**force majeure events**), such as a hurricane, earthquake, flood, wildfire, or pandemic, can prevent a party from performing its contractual obligations and cause significant business interruptions.
- Force majeure events are typically defined by contract (in the **force majeure clause**), but general characteristics include:
  - **Parties' inability to control event**.
  - **Severity of event**.
  - **Unforeseeability of event**.
  - **Inevitability of event** (even if technically foreseeable).
  - **Difficulty to mitigate event** by contracting parties.

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Introduction (cont'd)

- Force majeure events can affect all transactions, for example:
  - Business-to-business (B2B) transactions.
  - Business-to-consumer (B2C) transactions.
  - Government contracts, including municipal contracts with vendors.
- For example, force majeure events can affect a vendor's:
  - Ability to produce goods and provide services to meet municipal contractual requirements.
  - Logistics providers' ability to deliver goods.

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General Risk Allocation Issues

Force Majeure Clauses as Risk Allocation

- A force majeure clause is a contractual risk allocation mechanism, which allocates the risk of which party bears the risk of a force majeure event.
- Examples of other contractual risk allocation provisions include:
  - Indemnification.
  - Risk of loss in sale of goods.
  - Representations and warranties.
  - Product warranties and service warranties.
  - Insurance.

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General Risk Allocation Principles Apply

- Courts (and the Uniform Commercial Code (UCC) for sale of goods contracts) generally respect the parties' freedom of contract to allocate risk.
- Absent contractual risk allocation, courts may look to:
  - Applicable statutes *(e.g.*, state's adopted version of the UCC for sale of goods transactions).
  - Common law case law precedent.
- Parties typically contractually allocate risk to:
  - Set out their agreement on risk allocation in advance.
  - Avoid the uncertainty of a court deciding the outcome.
  - Override unfavorable case law precedent or statutory requirements (if allowed).

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General Risk Allocation Principles Apply (cont'd)

If a contract does not have a force majeure clause and a force majeure event occurs:

- The parties generally must perform their contract obligations, with limited exceptions.
- The impacted party must rely on limited exceptions under the law that provide excuses for non-performance, including the common law doctrines of **impossibility, frustration of purpose,** and **non-UCC impracticability** and **UCC Section 2-615 commercial impracticability** (for sale of goods transactions).
- However, courts generally apply these exceptions only in narrow circumstances.

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Force Majeure Clauses – Mechanics

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Components of Force Majeure Clauses

Force majeure clauses generally contain the following:

- **Excuse from performance.** This is often at the beginning of the clause and excuses one (**unilateral provision**) or both parties (**mutual provision**) from performing the contract if a force majeure event occurs.
- **List of force majeure events.** This typically:
  - Includes either an **unrestricted** (**open-ended**) or **restricted** (**finite**) list of events (such as fires, hurricanes, tornadoes, wars, terrorist acts) that are considered force majeure events.
  - Unrestricted lists are characterized by language, such as "including without limitation," and **catch-all phrases** (such as "other events beyond the reasonable control of the impacted party" or "acts of God").

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Components of Force Majeure Clauses (cont'd)

- **Impacted party's obligations.** The clause may require the impacted party to:
  - Notify the other party of the event.
  - Mitigate the impacts of the event.
- **Other party's remedies.** The clause may specify the unaffected party's remedies, for example, its right to terminate the contract without liability if the force majeure event remains in effect after a specified number of days.
- **Exclusions**. Some force majeure clauses contain specific exclusions, such as:
  - Payment obligations.
  - Changes in macroeconomic circumstances.

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Sample Mutual Force Majeure Clause

No Party shall be liable for any loss or damage that arises directly or indirectly through or as a result of any delay in the fulfilment of or failure to fulfil its obligations in whole or in part (other than the payment of money as may be owed by a Party) under this Agreement where the delay or failure is due to Force Majeure. The obligations of the Party affected by the event of Force Majeure (the "**Affected Party**") shall be suspended, to the extent that those obligations are affected by the event of Force Majeure, from the date the Affected Party first gives notice in respect of that event of Force Majeure until cessation of that event of Force Majeure (or the consequences thereof).

"**Force Majeure**" shall mean any act, occurrence or omission (or other event), subsequent to the commencement of the Term hereof, which is beyond the reasonable control of the Affected Party including, but not limited to: fires, explosions, accidents, strikes, lockouts or labor disturbances, floods, droughts, earthquakes, epidemics, seizures of cargo, wars (whether or not declared), civil commotion, acts of God or the public enemy, action of any government, legislature, court or other Governmental Authority, action by any authority, representative or organization exercising or claiming to exercise powers of a government or Governmental Authority, compliance with Applicable Law, blockades, power failures or curtailments, inadequacy or shortages or curtailments or cessation of supplies of raw materials or other supplies, failure or breakdown of equipment of facilities, the invocation of Force Majeure by any party to an agreement under which any Party's operations are affected, and any declaration of Force Majeure by the facility producing the Goods, or any other event beyond the reasonable control of the Parties whether or not similar to the events or occurrences enumerated above.

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Sample Force Majeure Clause (cont'd)

Upon the occurrence of an event of Force Majeure, the Affected Party shall promptly give notice to the other Party hereto setting forth the details of the event of Force Majeure and an estimate of the likely duration of the Affected Party's inability to fulfil its obligations under this Agreement. The Affected Party shall use Commercially Reasonable Efforts to remove the said cause or causes and to resume, with the shortest possible delay, compliance with its obligations under this Agreement provided that the Affected Party shall not be required to settle any strike, lockout or labor dispute on terms not acceptable to it. When the said cause or causes have ceased to exist, the Affected Party shall promptly give notice to the other Party that such cause or causes have ceased to exist.

If an event of Force Majeure shall continue for more than three consecutive calendar months, then the other party shall have the right to terminate this Agreement.

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Force Majeure Clauses – Drafting Tips

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Drafting Tips

The party that is more likely to benefit from a force majeure clause (typically, the vendor in a sale of goods or services contract), generally drafts the force majeure clause to:

- Apply **broadly** (for example, include an unrestricted list of specified events plus catch-all language).
- Include **specified events** that are likely to affect it based on its location or recent events (such as wildfires, hurricanes, earthquakes, government action, or pandemics).
  - Listing a specific event can help a party be covered despite any **foreseeability** requirement. However, courts sometimes inquire into the foreseeability of a listed event.
  - You may therefore want to include language to overcome any foreseeability requirement, such as "**whether foreseeable or not**".

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Drafting Tips (cont'd)

- **Limit the other party's express contractual remedies** when performance is excused (for example, limit a customer's right to terminate or purchase goods from other sources).
- **Exclude payment** obligations.
- **Consider including standard of performance language** that requires the impacted party to only show performance is **substantially more onerous** (but not impossible) to excuse performance, for example, by using words, such as “hinder," "impair," or "impede" performance.

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Drafting Tips (cont'd)

The party that is less likely to benefit from a force majeure clause (typically, where it is the buyer of goods or customer of services) generally drafts the **force majeure clause**:

- **Narrowly** (such as by including a finite or restricted list with no catch-all language).
- To **limit the definition** of force majeure events to those events that are genuinely outside the impacted party's control and are not foreseeable.
- To include a requirement that the impacted party provide **notice** of the event and **mitigate** the effects of the event.
- To **expand its express contractual remedies** when performance is excused (such as the right to terminate if the event continues for a certain period or purchase goods from other sources).

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Drafting Tips (cont'd)

- To **exclude** the vendor's financial inability to perform, changes in cost or availability of materials, components, or services, or market conditions from the force majeure clause.
- To **not exclude payment obligations**. Most vendors will not agree to this, however.
- To include language that requires the vendor to show performance is **impossible** (and not just substantially more onerous) for non-performance to be excused, such as referring to events that "prevent" performance or make a party "unable" to perform.

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Drafting Tips – Special Issues

- Vendors sometimes include mutual clauses in their drafts:
  - If the customer has significant non-payment obligations, such as a buyer in a distribution agreement who has minimum resale obligations.
  - To facilitate adding the exception for the customer's payment obligations.
- Customers sometimes include mutual finite force majeure clauses in their drafts to preempt vendors, who typically insist on force majeure protection.
- Both parties should be aware that including a unilateral force majeure clause may mean that the party not covered by the clause may try to rely on UCC § 2-615 or common law defenses to escape its obligations if a force majeure event affects it.

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Drafting Tips – Special Issues (cont'd)

- Beware of unintended consequences, for example, courts may interpret "catch-all" language added to:
  - An unrestricted list to only include events of a similar nature or class as the listed events (thus narrowing the "unrestricted list").
  - A finite list to include events that may be dissimilar to the listed events (thus expanding the "finite" list).
- The parties can draft a catch-all phrase in the clause to demonstrate their intent by:
  - Referring to "other **similar** events beyond the reasonable control of the impacted party" if the parties intend to only cover only events similar to those listed.
  - Including the words "**whether similar or dissimilar**" after the catch-all phrase if the parties intend to cover dissimilar events.

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Drafting Tips – Special Issues (cont'd)

- Regarding "acts of God," consider likelihood that courts may not:
  - Assume that any risk dissimilar to the ones listed is an act of God.
  - Interpret risks the parties were aware of at the time of contract negotiations as acts of God.
  - Consider a specified risk an act of God if the parties entered into new contracts after a specified risk became well known (and therefore foreseeable), such as when interpreting new contracts entered after the onset of COVID-19.

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What If the Contract Does Not Have a Force Majeure Clause?

Other Defenses for Non-Performance

- If the contract is silent on force majeure, a court decides whether to excuse an impacted party's performance based on other principles, such as:
  - Impossibility.
  - Frustration of purpose.
  - Commercial impracticability under the Uniform Commercial Code (UCC) (for **sale of goods** contracts only).
  - Non-UCC impracticability.
- Courts generally interpret and apply these doctrines:
  - Narrowly.
  - On a fact-intensive, case-by-case basis (may lead to uncertainty relative to contractually negotiated force majeure provisions).

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Impossibility

- This excuses a party's contractual obligations if performance becomes:
  - **Objectively impossible.**
  - Because of an **unexpected supervening event.**
  - Beyond its control and without its fault.
- For a party to successfully use this defense, performance generally must be truly impossible, not just expensive or difficult to implement.

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Impossibility (cont'd)

Impossibility will generally discharge a party where, without its fault:

- In a contract requiring the promisor's personal performance, the promisor **dies or is incapacitated**.
- Performance is prevented by destruction of a contract's:
  - **Subject matter** (*e.g.*, in a contract where performance requires the continued existence of a specific thing, that thing perishes or is unavailable).
  - **Means of performance** (*Kel Kim Corp. v. Cent. Mkts., Inc.*, 519 N.E.2d 295, 296 (N.Y. 1987).
- Performance is later prohibited **by operation of law or other government action**.

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Frustration of Purpose

- This excuses performance when an unexpected **supervening event** destroys or removes the impacted party's main purpose for entering into the transaction (although performance remains possible).
- Frustration can excuse performance only if:
  - The principal purpose of the impacted party in entering into the agreement is **substantially frustrated** (*i.e.*, it **can no longer accomplish** its purpose for the transaction).
  - **Both parties knew** of the impacted party's principal purpose for entering into the contract.
  - An unexpected supervening event **caused** the frustration, that was not **the fault** of the impacted party.

  (See Restatement (Second) of Contracts § 265.)

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Impracticability Under the UCC

- UCC § 2-615 excuses performance in a **sale of goods** transaction if it becomes commercially impracticable because of either:
  - Unforeseen supervening circumstances.
  - Good faith compliance with applicable regulation or order.
- It applies when:
  - The seller **did not assume** the risk of the contingency.
  - The **non-occurrence** of the contingency was a **basic assumption** underlying the contract.

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Impracticability Under the UCC (cont'd)

- The occurrence of that contingency made performance **commercially impracticable**, which means it:
  - Materially changed the parties' contractual relationship.
  - Made performance **substantially** more difficult, complex, or challenging.
  - Resulted in the **excessive** and **unreasonable** increase in performance costs.
    - The seller may have to show it explored all reasonable means of fulfilling its contractual obligations, even if alternate means of performance are more expensive.

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Impracticability Under the UCC (cont'd)

- Under UCC § 2-615, if a company's ability to supply is only partially impacted, it must **allocate** its available inventory among its customers in a **fair and reasonable manner**.
- The UCC also requires the supplier to give **seasonable notice** to each of its customers. The notice must:
  - State that there is likely to be delay or non-delivery.
  - Include the estimated quantity to be made available if allocation is required.
- The buyer must respond to this notice within **30 days** or the contract lapses under UCC § 2-616. It has the option to:
  - Terminate the unexecuted portion of the contract.
  - Modify the contract (*e.g.,* by agreeing to its allocated deliveries).

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Non-UCC Impracticability

UCC Section 2-615 applies only to sale of goods transactions. Delayed, partial, or non-performance may also be excused by commercial impracticability under:

- Common law.
- A different statutory provision. For example, California Civil Code Section 1511 provides that, unless the parties have agreed otherwise, delayed performance or partial or entire non-performance is excused when caused by either:
  - An irresistible and superhuman cause.
  - The acts of public enemies of the US or California.

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Non-UCC Impracticability (cont'd)

The defense of impracticability can apply when:

- Something can only be done at a cost that is:
  - Excessive.
  - Unreasonable.
- Requiring performance is "commercially senseless." (*Natus Corp. v. United States*, 371 F.2d 450, 455 (Ct. Cl. 1967).)

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Non-UCC Impracticability (cont'd)

Section 261 of the Restatement (Second) of Contracts (Discharge by Supervening Impracticability) states that, unless the contract language or the circumstances indicate otherwise, a party's duty to perform under a contract is discharged when:

- The party's performance becomes impracticable.
- The impracticability is:
  - Not created by the party's own fault.
  - Created by the occurring of an event the non-occurrence of which was a basic assumption of the parties in making the contract.

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What to Do When a Force Majeure Event Occurs

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Initial Steps to Take

If a force majeure event occurs, you should consider the effects of the event on your municipality's contractual rights and obligations:

- Identify **affected contracts** under which your municipality and its business partners (such as suppliers, service providers, or customers) may be unable to meet their obligations due to, for example:
  - Damages from a natural disaster that may have occurred to plants or other facilities.
  - Government restrictions or lockdowns that may force the affected parties to close facilities or stop certain operations.
  - Worker shortages that may occur if workers are not coming to work due to injury or illness, fear of safety, or shutdowns of public transportation.

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Initial Steps to Take (cont'd)

- In particular, identify affected **vendors** to help the municipality:
  - Determine if it can meet its own contractual obligations that depend on these parties.
  - Identify cases where it may need to, for example seek alternate:
    - sourcing of or delivery methods for goods; or
    - service providers or perform services itself, if possible.
- Identify affected **customers** that may not be able to perform (*e.g.,* pay for services). If the municipality is facing its own inability to perform, taking into account contractual and legal requirements, it should also:
  - Determine how to prioritize customers to receive limited products or services.
  - Inform each customer as early as possible if and when they can expect disruptions.

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Initial Steps to Take (cont'd)

- Review **insurance-related** obligations and rights. For example:
  - Identify and review insurance policies that may cover damages related to the event.
  - Identify any obligations your municipality has under applicable policies (for example, notice).
- Keep **detailed records** and **supporting evidence** of:
  - The scope of the interruption to the business.
  - All losses and expenses related to the event.

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Analyze Affected Contracts

Identify key provisions in contracts at issue that may be relevant during the force majeure event, such as:

- Force majeure clauses.
- Termination provisions.
- Allocation provisions.
- Insurance or indemnity provisions.
- Limitations of liability.
- Liquidated damages or other remedies clauses.
- Compliance with laws or change in laws clauses.

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Analyze Force Majeure Clauses

- Determine if the contract at issue contains a **force majeure clause**. If not, analyze if any **other legal defenses** to non-performance apply.
- If so, determine if the specific event triggers the force majeure clause, looking at whether:
  - The event or type of event is **specifically listed** (for example, in the case of COVID-19, is a pandemic, public health emergency, government action, or quarantine specified).
  - If it is not listed, a **catch-all provision** can apply to the event (such as "any similar events beyond the impacted party's reasonable control" or "act of God").
  - Any specific **exclusions** may apply.

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Analyze Force Majeure Clauses (cont'd)

Consider other issues:

- **Foreseeability**. The force majeure clause or applicable law may exclude events that were foreseeable. If so, this may affect the allocation of risks not listed that the parties were aware of when the contract was executed.
- **Causation.** The impacted party may need to:
  - Show a causal link between the event and its failure to perform.
  - Establish that the event either made performance:
    - impossible; or
    - substantially more difficult, depending on the contract language or applicable law.

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Analyze Force Majeure Clauses (cont'd)

- **Mitigation.** The impacted party may have a duty to mitigate under the contract or applicable law.
- **Notice requirements.** Review whether the clause has any notice requirements to ensure the timeliness, complete content, and proper delivery method of any notice.
- **Consequences of a force majeure event.** Review the contract language to determine if establishing force majeure:
  - Provides for temporary relief from performance during the event.
  - Gives either party (or both) a right to terminate if it continues for an extended period.

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Considerations When Providing a Force Majeure Notice

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Considerations When Sending a Notice

- Comply with the contract's force majeure and notice provisions on:
  - Timing of notice.
  - Delivery method.
  - Content of notice.
- If the contract does not have a force majeure clause, review notice requirements under the relevant excuse for non-performance (for example, under the UCC).
- Even if the contract or legal doctrine does not expressly require notice, provide notice promptly.

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Considerations When Sending a Notice (cont'd)

- Consider the **consequences** of giving notice on obligation to perform (for example, termination or only temporary relief).
- Monitor **changes in circumstances** during the event.
- **Document** all actions taken.
- **Engage in discussions** with your counterparty.
- If applicable, consider **allocation requirements**.

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Considerations When Responding to a Force Majeure Notice

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Responding to a Force Majeure Notice

- Obtain **relevant facts** before taking a position on the claim.
- **Evaluate** the information in the notice to determine if:
  - Notice is valid.
  - The claim falls within the requirements of the force majeure clause or legal defense being invoked (consider causation, foreseeability, etc.).
- Consider your **options** (for example, litigation or settlement) if you do not believe the claim is valid.
- Determine any **remaining contractual obligations** your municipality may have and any rights (e.g., termination rights) that may exist after a covered event has occurred.

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Responding to a Force Majeure Notice (cont'd)

- If your municipality is a buyer of goods and the supplier indicates it is allocating, consider if the **allocation** complies with contractual or legal requirements.
- Determine if the municipality has any duty to **mitigate** damages.
- Prepare to issue **back-to-back force majeure notices** to downstream customers, if applicable.
- **Respond promptly** in writing and document all actions, and related costs and losses.
- Engage in **communications** with your counterparty.
- Consider if any **insurance policies** apply and, if so, provide **notices** to the insurers.

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Recent Developments

Recent COVID-19 Force Majeure Case

- *In re: Hitz Restaurant Group*, 616 B.R. 374 (N.D. Ill 2020)
  - Force majeure clause in commercial lease excused performance of either party's obligations if prevented, delayed, or **hindered** by "…laws, **government action** or inaction, **orders of government**… "
  - Due to COVID-19, the Governor of Illinois issued an **executive order** that prevented tenant Hitz from providing on-premises dining at its restaurant (but allowed takeout service).
  - The court held the lease's force majeure clause relieved Hitz from the obligation to pay rent, but only partially (since it could still provide takeout).

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Thank You