BLANKROME

Business Litigation

MARCH 2020 • NO. 1

Coronavirus Guidance for Businesses: Commercial Arrangements, Contractual Performance, and *Force Majeure*

As delays, closures, cancellations, workforce issues, states of emergency, and the World Health Organization's declaration of "pandemic" caused by the reaction to the spread of COVID-19 (also known as the coronavirus) continue to mount, businesses and their consumers are being substantially impacted. Are sufficient products being manufactured here in the United States or abroad to meet demand? Are supply and distribution chain impacts here and abroad preventing on-time deliveries? Are workforce issues harming operations? Are preventive shutdowns and cancellations causing substantial business losses and inability to service customers and patrons? These and many other similar issues are at the top of mind. What should a supplier, purchaser, or business that offers goods, services, or entertainment to consumers be doing to protect its business as these events unfold? Businesses should begin by reviewing their commercial contracts to assess rights and remedies available in the event that they—or their contractual counterparties—are unable to perform.

One of the provisions included in many commercial agreements, often overlooked as potential boilerplate, is a *force majeure* clause. *Force majeure* clauses are included in commercial arrangements to protect the parties from the effects of adverse occurrences beyond their control. Looking to Delaware law as an important resource for corporate and commercial law throughout the United States, Delaware courts scrutinize the language of *force majeure* clauses to assess the parties' intent and strictly construe those provisions to ascertain the scope of protection those clauses afford.[1] It is thus very important to understand the specific language agreed upon in a business' specific commercial arrangements.

In the current COVID-19 environment, a *force majeure* clause that expressly addresses circumstances, such as an "epidemic," "pandemic," "contagious disease," or other similar public health-related occurrence would likely provide the greatest protection for the contracting parties (and, of course, a business also needs to understand if the language of its *force majeure* clause is mutual or unilateral). The protections afforded by other circumstances frequently used in *force majeure* clauses, such as "Act of God," "disaster," or "emergency," are less clear as it relates to the effects of COVID-19. For instance, the phrase "Act of God" commonly refers to natural disasters, such as tornadoes, earthquakes, or floods, rather than disruptions

1. *See Stroud v. Forest Gate Dev. Corp.*, 2004 WL 1087373, at *5 (Del. Ch. May 5, 2004).

caused by widespread illness. The terms "disaster" and "emergency" are likewise vague, and their application to the negative effects of COVID-19 may be difficult to predict. And, importantly, it may seem reasonable to assume that a nation's, state's, or even a municipality's "state of emergency" declaration may provide a basis to invoke a *force majeure* clause that excuses performance in the event of a disaster or emergency. However, because a governmental declared "state of emergency" could be used primarily to trigger access to certain funding sources, such a declaration may not be sufficient to invoke a *force majeure* clause.

Furthermore, some *force majeure* provisions may contain open-ended language, such as "including, but without limitation," "similar or dissimilar events," or "acts beyond their reasonable control"—language designed to capture the overall purpose of a *force majeure* clause, or stated differently, to protect an impacted party if an unforeseen harm outside of the party's control frustrates the party's performance. However, unless the parties make it clear that such phases are intended to expand the possible circumstances justifying a *force majeure* event, courts may be required to construe such phrases narrowly, consistent only with the otherwise enumerated events.[2]

While novel and rarely seen, the global spread of COVID-19 is not the first time a viral epidemic has given rise to *force majeure* questions in court. For example, in the Northern District of Iowa, Rembrandt Enterprises, Inc., an egg producer, brought suit against Dahmes Stainless, Inc., an industrial manufacturer, seeking declaratory relief that it was justified in terminating its construction contract with Dahmes due to severe financial difficulty caused by the 2015 outbreak of Avian Flu.[3] Rembrandt argued that its excuse should be viewed under the frustration of purpose doctrine and *not force majeure;* Dahmes, on the other hand, argued for application of the *force majeure* provision. Denying summary judgment to both parties, the trial court explained that Dahmes' position on the *force majeure* provision failed. At trial, Rembrandt prevailed.

In sum, when considering whether to invoke a *force majeure* clause, careful attention must be made to the specific language in the clause to assess whether any of the events described therein could be applied to the commercial effects of the COVID-19.

Like in the *Dahmes* case discussed above, Uniform Commercial Code ("UCC") and common law doctrines, such as "commercial frustration" and "impossibility/impracticability," may also provide potential defenses to claims of nonperformance resulting from coronavirus-related disruptions. Commercial frustration provides that when the occurrence of an event substantially frustrates a contracting party's principal purpose, the party's remaining contractual duties are discharged, so long as: (1) the non-performing party is not at fault; (2) the non-occurrence of the event was a basic assumption on which the contract was made; and (3) the language of the contract or surrounding circumstances do not provide to the contrary.[4] Importantly, frustration of purpose is a future-facing defense; it can only be used to excuse *future* performance.[5]

Similarly, the defense of impracticability/impossibility requires a party to demonstrate: (1) the occurrence of an event, the nonoccurrence of which was a basic assumption of the contract; (2) that continued performance is not commercially practicable; and (3) that the party invoking the defense did not expressly or impliedly agree to perform notwithstanding the impracticability.[6] Applied here, if a party is prevented from providing contractually-required services or goods due to a supply-chain disruption or because a particular source of material required for the goods or services cannot be accessed due to a quarantine, "commercial frustration" and/or "impossibility/impracticability" could be viable defenses to a claim of breach for nonperformance.

In addition to focusing on the specific language of businesses' commercial arrangements, including any *force majeure* provisions, it is also important for businesses

2. *Id.*
3. *See Rembrandt Enters. v. Dahmes Stainless, Inc.,* 2017 WL 3929308 (N.D. Iowa Sept. 7, 2017).
4. *See Wal-Mart Stores Inc. v. AIG Life Ins. Co.,* 872 A.2d 611, 620-21 (Del. Ch. 2005)*, aff'd in relevant part,* 901 A.2d 106 (Del. 2006).
5. *See id.;* Restatement (2d) of Contracts, § 265.
6. *Bobcat North America, LLC v. Inland Waste Hldgs., LLC,* 2019 WL 1877400, at *9 (Del. Super. Ct. Apr. 26, 2019).

to document the specific problems and issues they are encountering in meeting their contractual obligations, and to notify their clients, customers, and other counterparties as soon as possible if they believe they will be unable to perform. If a contract requires that a particular form of notice be sent in order to be effective, it should be strictly adhered to for all correspondence concerning delays, cancellations, supply-chain disruptions, or other adverse events caused by the coronavirus. Providing proper written notice will not only help strengthen a defense premised on a *force majeure* clause or under Uniform Commercial Code/common law legal doctrines, it may also trigger the counterparty's duty to begin mitigating damages, thereby limiting the business's liability in the event other defenses are unsuccessful.

Businesses should also now proactively be reviewing and addressing insurance, customer relations, employment, and workforce issues and other areas being impacted by COVID-19. Blank Rome's client advisories addressing these topics can be found on the Firm's Coronavirus ("COVID-19") Task Force page.

For additional information, please contact:

Larry R. (Buzz) Wood Jr.
Philadelphia Office/Wilmington Office
Partner, Corporate Litigation
215.569.5659 |302.425.6474 | lwood@blankrome.com

Stephen D. Schrier, Philadelphia Office
Partner, Corporate Litigation
215.569.5651 | schrier@blankrome.com

Brandon W. McCune, Wilmington Office
Associate, General Litigation
302.425.6406 | bmccune@blankrome.com

John P. Wixted, Philadelphia Office
Associate, Commercial Litigation
215.569.5649 | jwixted@blankrome.com

Harrison M. Brown, Los Angeles Office
Associate, Corporate Litigation
424.239.3433 | hbrown@blankrome.com