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THE COVID-19 PANDEMIC AND FORCE MAJEURE CLAUSES

The COVID-19 pandemic, and the accompanying government public health orders, caused the greatest economic turmoil in the United States in living memory. From March to April 2020, 22 million workers lost their jobs, causing the unemployment rate to soar from 3.5% to 14.7%. Several hundred thousand businesses collapsed. As people stayed home and cut consumption, and businesses cut production, economic output collapsed by nearly 33% (at an annual rate) in the second quarter of 2020. From mid-February to late-March the S&P 500 lost more than a third of its value. While a financial panic was narrowly averted by the Fed in March 2020, and an eviction moratorium and government transfers prevented widespread suffering, the economic turmoil played havoc with business relationships.

Naturally, litigation followed. According to a search of a database of federal and state cases, almost 1,500 contract disputes related to the pandemic have taken place. A subset of these cases involved attempts by parties to escape their contractual obligations based on force majeure clauses or common law theories of impossibility or frustration. These cases typically pitted a party who had agreed to supply goods or services to another party who either no longer needed them or could not afford to pay for them because of the COVID-19 pandemic. For example, as restaurants lost customers, many of them could no longer afford to pay rent, and argued that rent should be suspended or the lease terminated. Other cases involved supply-chain disruptions: a supplier could not keep its promises to deliver goods because its factory was shut down, or the buyer could not (or did not want to) keep its promise to buy goods because its customers had disappeared. Pandemic-related disruptions of transportation, including commercial air travel, also created disputes between travelers and shippers, on the one hand, and carriers, on the other.

The contracts fall into two categories: those with force majeure clauses and those without them. A force majeure clause is a clause in a contract that authorize one or both parties to suspend or cancel performance if a “force majeure event” occurs. Force majeure events include wars, natural disasters like hurricanes and earthquakes, and other unforeseen events that are outside the control of the parties and that prevent performance or eliminate the economic value of performance. Fairly typical boilerplate might say: “If either party shall be delayed or prevented from the performance of any obligation through no fault of its own by reason of war, riots, insurrection, adverse weather, Acts of God, or other similar causes beyond the control of such party, the performance of such obligation shall be excused for the period of the delay.” Some clauses omit the list of specific events, while others include longer lists that may contain, for example, pandemics, labor strikes, hurricanes, floods, and so on. Force majeure clauses may release only one or both parties from their contractual obligations, but typically release both; they may only suspend performance or may excuse performance as well; and they frequently require the party that benefits from force majeure to give notice to the other party if it intends to invoke the clause and to use diligence or best efforts to renew performance as soon as possible if the force majeure event causes a temporary disruption.

When a force majeure clause exists, the court’s duty is to interpret the clause in the light of events that gave rise to the dispute. When the clause does not exist, the party that seeks to escape or suspend its
obligations must fall back on the common-law excuse doctrines—the impossibility (or impracticability) doctrine or the frustration doctrine. In the case of the impossibility or impracticability doctrine, it is usually the seller who seeks to escape its obligation to manufacture, deliver, or transport goods. The seller argues that it is impossible or impracticable to perform. In the case of the frustration doctrine, it is usually the buyer who seeks to escape its obligation to buy goods. The buyer argues that the economic purpose for which it bought the goods has been frustrated by supervening events. Parties are rarely successful in invoking these doctrines, which are interpreted narrowly and applied gingerly by courts. Sophisticated commercial parties therefore almost always write force majeure clauses into their contracts, and rely on them, rather than the common-law excuse doctrines, if they seek to escape contractual obligations. But most courts have interpreted force majeure clauses fairly narrowly as well, fearing that broad interpretations would enable parties to opportunistically escape their contractual duties.

As the COVID-19 pandemic began, commentators anticipated an avalanche of force majeure claims. In fact, there have been (so far) only about 70 in the federal and state courts. This may be surprising but there is a good reason. The pandemic caused such a massive disruption to the economy that in many if not most cases, it destroyed the value of a transaction for both parties. If both the supplier’s factory and the buyer’s warehouse are shut down because of a public health order, both parties may prefer to terminate or suspend a contract of sale. In that case, there will be no litigation. And in many other cases, no doubt parties were willing to make allowances for late payments or deliveries because they preferred to maintain their business relationships.

The cases are nonetheless important. For one thing, they provide guidance as parties update their force majeure clauses so that they account for possible future pandemics. For another, they provide a kind of stress test of courts’ understanding of force majeure principles. The tradition in many jurisdiction, including New York, has been to interpret force majeure clauses narrowly, lest they become get-out-of-jail-free cards for businesses that have changed their mind about the benefits of a contract. As we will see, the courts have been somewhat more generous toward force majeure claims arising out of the pandemic. That said, parties that attempted to invoke force majeure were by no means guaranteed victory; they more frequently lost.

Most of the cases so far have involved commercial leases. Retail stores closed their doors or reduced operations because the pandemic deprived them of customers or because the government ordered non-essential businesses to close. The landlords sued for unpaid rent, and the retailers argued that they were excused from paying the rent, or even released from the lease altogether, because of a force majeure clause or, lacking that, the doctrines of impossibility or frustration. Where the retailers relied on a force majeure clause, they argued that the pandemic or shutdown orders constituted force majeure events. Where they relied on the doctrines of impossibility or frustration, the retailers argued that the purpose of the lease was frustrated by the pandemic orders, or the lease was impossible to perform for the same reason.

Courts usually ruled in favor of the landlords. A representative case is In re CEC Entertainment, Inc., 625 B.R. 344 (Bankr. S.D. Tex. Dec. 14 2020), which involved the bankruptcy of a nationwide chain of restaurants. The debtor sought to escape liability under its commercial leases, citing the force majeure clauses, which referred to acts of God and government restrictions. The debtor argued that the pandemic was an act of God, and that either it or the government shutdown orders prevented it from
operating. The court rejected the force majeure defense because the force majeure clauses explicitly excluded “inability to pay” from the definition of force majeure. To similar effect, in *Palm Springs Mile Assocs. Ltd. v. Kirkland Stores Inc.*, 2020 WL 5411353 (S.D. Fla. Sept. 9, 2020), a court held that a government shutdown order would not trigger a force majeure clause merely because it deprived the tenant of the revenue it needed to pay the landlord. The implication was that force majeure would result only if the government order actually blocked payment.

But outcomes for tenants were not always so bleak. *In re Hitz Restaurant Group*, 161 B.R. 374 (Bankr. N.D. Ill. June 3, 2020), was another pandemic-induced bankruptcy. The debtor, a restaurant group, argued that it should be excused from paying rent because of the lease’s force majeure clause, which provided that performance would be excused for so long as performance was prevented by “laws, government action or inaction, [or] orders of government,” although it also said that “[l]ack of money shall not be grounds for Force Majeure.” In contrast to the court in *CEC*, the court held that government orders that prohibited indoor dining triggered the force majeure clause because they deprived the restaurants of most of their revenues, preventing the debtor from paying rent. The court required the debtor to continue paying a portion of the rent, 25%, out of revenues that the restaurants received from take-out orders, which continued.

There have been a few interesting force majeure cases outside the area of commercial real estate. In *JN Contemporary Art LLC v. Phillips Auctioneers LLC*, 2020 WL 7405262 (S.D.N.Y. Dec. 16, 2020), the plaintiff alleged breach of contract against an auction house who canceled the auction of the plaintiff’s painting during the pandemic. The contract contained a termination provision stating that “[i]n the event that the auction is postponed for circumstances beyond our or your reasonable control, including, without limitation, as a result of natural disaster, fire, flood, general strike, war, armed conflict, terrorist attack or nuclear or chemical contamination,” the auction house had the right to “terminate this Agreement with immediate effect.” The court rejected the plaintiff’s argument that the clause did not apply because it did not specifically mention pandemics, holding that the pandemic counted as a “natural disaster.”

In *Rudolph v. United Airlines Holdings, Inc.*, 2021 WL 534669 (N.D. Ill. Feb. 12, 2021), involved a transaction we all can relate to. Plaintiffs sued United Airlines for refusing to refund ticket fares for flights canceled during the pandemic. United invoked its broadly worded force majeure clause, which referred to “[a]ny condition beyond [United’s] control including, but not limited to, meteorological or geological conditions, acts of God ... civil commotions ... disturbances, or unsettled international conditions, either actual, anticipated, threatened or reported, or any delay, demand, circumstances, or requirement due directly or indirectly to such condition” as well as “[a]ny event not reasonably foreseen, anticipated, or predicted by” United. The court observed that if the force majeure clause were interpreted literally, it would contradict other provisions of the contract that entitle passengers to refunds under certain conditions. More to the point, the court denied United’s motion to dismiss since discovery might show that United canceled the flights to save operating costs rather than as a result of force majeure. However, the court granted the motion to dismiss the claim of one of the plaintiffs. That plaintiff held a ticket for a flight to Costa Rica at a time when that country closed its borders. Because United could not reasonably send a flight into Costa Rica, the force majeure clause applied.

Parties that fail to protect themselves with a force majeure clause can fall back on the common-law excuse doctrines. But courts have traditionally applied these doctrines cautiously, and this pattern has
continued for COVID-19 cases. In *Nguyen v. Stephens Institution*, 2021 WL 1186341 (N.D.Cal. 2021), for example, a student sued a university for breach of contract after it moved classes online. At the motion to dismiss stage, the court rejected the impossibility defense, holding that the university must show that it would have been impossible to hold in-person classes. While the university would have the opportunity to prove impossibility at trial, the existence of the pandemic alone did not establish impossibility: the university is required to prove that in-person classes were impossible. To similar effect, in *CAI Rail, Inc. v. Badger Mining Corporation*, 2021 WL 705880 (S.D.N.Y. 2021), a court rejected the impossibility and frustration defenses of a mining corporation who sought to escape liability for breach of a lease of rail cars for the purpose of transporting sand for hydraulic fracking. The defendant argued that the pandemic and related government regulation rendered the contract “worthless” and impossible to perform, but the court noted that the defendant did in fact continue to use some of the cars that it leased, and failed to show that government regulations prohibited its business. However, defendants do prevail sometimes. In *Bay City Realty, LLC v. Mattress Firm, Inc.*, 2021 WL 1295261 (E.D. Mich. 2021), a mattress store avoided liability for rent for the pendency of a shutdown order. The court found that the lease had been frustrated because it permitted the mattress store to use the premises only for selling mattresses: the store could not use the premises for any other activity such as storage, and hence the entire value of the lease was destroyed.

Still, as a general matter, courts will excuse parties from performance only under narrow circumstances. As one court that denied a tenant’s impossibility defense explained, this was

[a] harsh result, to be sure, but so in its own way would be mass rescission of commercial leases, assigning all risk of the pandemic to property owners who face their own unrelenting expenses and economic burdens.

*A/R Retail LLC v. Hugo Boss Retail, Inc.*, 2021 WL 2020879 (N.Y. Sup. Ct. May 19, 2021). The court rejected both a force majeure defense (because the clause did not apply to inability to pay) and the impossibility defense (because the force majeure clause showed that the parties anticipated government orders of the sort that prevented the tenant from operating). As the court observed, the losses resulting from the pandemic and government orders must fall on either the tenant (who loses customers) or the landlord (who would rent if the lease is not enforced). It is far from obvious why the court should transfer the risk from tenants to landlords in the absence of a contractual command to do so. If bankruptcy must be the result because someone must bear the losses associated with the pandemic, it is not clear why bankruptcy of tenants is worse than bankruptcy of landlords.

To be sure, parties may want to share the risk of the losses if another pandemic occurs. And if another pandemic occurs, courts will be even less sympathetic to arguments that the pandemic is “unforeseeable,” as required by the excuse doctrines and most force majeure clauses. Thus, it is essential for parties to write into their contracts how the losses should be allocated in the case of a pandemic or another force majeure event. The cases suggest some lessons for drafting.

First, parties that enter long-term contracts like commercial leases should explicitly identify pandemics as force majeure events if they believe that performance should be suspended or terminated if another pandemic strikes (or if another wave of COVID-19 variants result in further economic disruption). Parties should not assume that a future court will necessarily interpret a catchall phrase like “act of God,” “natural disaster,” or “other similar causes” as covering a pandemic. The reason is that most courts
interpret such phrases as implicitly requiring that the event in question was unforeseeable. Now that we have all lived through a pandemic, the argument that another pandemic is unforeseeable will not be credible.

Second, as we have seen in the commercial lease cases, most courts require tenants to pay the rent even if their business is shut down by a pandemic if the force majeure clause does not apply to “inability to pay.” However, at least one court did reduce the rent payments of the tenant. Drafters of commercial leases should use clearer language, so that there is no doubt whether the tenant is required to pay despite the shutdown of its business, or not.

Third, drafters should also be aware that courts were more willing to find force majeure when a government shutdown order prevented performance than when a party closed shop because of the risks posed by the pandemic itself. In practice, many businesses could not operate even when the government did not order them to close. Customers and workers disappeared because they got sick or feared contagion. A clause that releases or partially releases a party from performance if some measure of its business (such as revenues) clearly indicates that it cannot operate would be more easily enforced and would add predictability to the relationship.

Fourth, and related, the problem of causation adds another wrinkle of complexity to drafting. A force majeure event excuses a party from performance only if the event prevents performance. Suppose a supplier shuts down its factory because of a pandemic, and as a result is unable to perform. If the supplier voluntarily shut down the factory as a precaution, a court may hold that the pandemic did not actually block performance. If the supplier shut down the factory because its workers became sick or because the government issued a shutdown order, then the causation requirement is likely met. Intermediate cases—where the supplier shut down the factory when less draconian precautions, like protective equipment for workers, would have been adequate—will be difficult to adjudicate. Courts may seek to avoid penalizing factories that take precautions, but also may refuse to excuse parties from performance if they were excessively cautious.

The causation requirement may cause trouble for many firms that are unable to perform because of the financial and economic crisis that has followed on the heels of the pandemic, rather than because of the pandemic itself. Consider, for example, a seller who has not been directly affected by the pandemic but has lost business because its customers have been laid off from their jobs. As a result, the seller seeks to invoke a force majeure clause with one of its suppliers, so that it is not required to buy goods that it cannot resell. However, even if the seller can prove that the customers lost their jobs because employers have been shut down by the pandemic, a court might hold that the causal chain from pandemic to nonperformance is too long. General adverse economic conditions rarely qualify as force majeure events on their own.

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Lawyers and parties need to understand that force majeure clauses are not get-out-of-jail-free cards. Courts interpret the clauses narrowly, and even when the clauses are triggered, the party that benefits from a force majeure clause must act reasonably. As we have seen, even a catastrophe like the COVID-19 pandemic will not necessarily excuse parties from their obligations.

Courts worry that if they interpret force majeure clauses too liberally, they will unsettle contractual
relations even more than the pandemic has, just because so many businesses have been impacted by it. Another factor may also lead courts to act cautiously: government financial support for businesses may enable many of them to absorb contractual liability, in which case excusing them from their contractual obligations may be unnecessary.

The current pandemic may continue in some places, and even if it does not, future pandemics may occur. Parties that enter new contracts during periods of relative economic normalcy will need to address the possibility, even likelihood, of periodic government-ordered lockdowns or other pandemic-related interruptions of economic activity during the period of their contractual relationship. Parties should not rely on generic force majeure clauses to address these risks. They should write into the contracts their specific obligations in case of these interruptions. In doing so, they should give careful thought as to the allocation of the risks of pandemic-related interruptions, and what their remedies should be if those interruptions occur.

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