



# *Force Majeure* and COVID-19

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# Force Majeure and COVID-19

As the COVID-19 outbreak continues to spread across the country, more and more offices, schools, and businesses are being shut down by federal, state, and local quarantine regulations. Business activity has dropped precipitously due to required closures and home confinement. It will be months—or even years—before we understand the full legal, economic, and societal costs of this pandemic. But one persistent question our clients are asking us right now is: Does the pandemic and the ensuing disruption trigger the *force majeure* clause in my contract? If not, are there any other defenses to non-performance that may be applicable?

There are no universal answers to these questions. Each contract must be interpreted in light of its specific contract language and the applicable case law in the governing jurisdiction. Still, there are general principles that apply to interpreting *force majeure* clauses and common issues that arise. This paper surveys many of those issues. We open with a few key action steps every party to a contract should consider taking right now (Section I). We then discuss the general principles of *force majeure* clauses and how they may be interpreted and applied (Section II). Next, we analyze common-law defenses for non-performance (Section III). Finally, we offer a few pointers and issues to watch for in specific types of contracts (Section IV).

## I. EXECUTIVE SUMMARY AND ACTION STEPS

*Force majeure* clauses in contracts allocate the risk of non-performance due to unforeseen or uncontrollable events and may excuse or suspend a party's obligation to perform under the contract in some cases. They are sometimes also called “Unavoidable Delay” or “Act of God” clauses. The scope and applicability of *force majeure* clauses are discussed in more detail below, but here are some steps that you can take immediately:

- **Review Your Contracts Immediately.** The specific language in each contract is the single most important factor in determining whether *force majeure* may apply. Contract language varies widely, so it is important to understand what is covered and excluded in each contract. Some contracts do not include a *force majeure* clause at all, but the parties may have the benefit of the common-law defenses discussed below.
- **Send Notice.** Many *force majeure* clauses include notice requirements and deadlines by which a *force majeure* event must be declared. Even if your contract does not include a notice requirement, it is a best practice to send notice anyway if you intend to claim *force majeure* or impossibility of performance.
- **Take Reasonable Steps to Mitigate Damage.** Even in situations where *force majeure* does apply, each party to a contract is required to make reasonable efforts to perform and to act reasonably to mitigate its damages.
- **Anticipate Disputes.** Many *force majeure* clauses are not clearly drafted, and there may be ambiguity as to whether they apply to the current situation. A unilateral claim of *force majeure* and suspension of performance may be met with a notice of default from the counterparty. It is important to understand how these claims may be resolved in your jurisdiction before declaring or disputing a counterparty's declaration of *force majeure*, and you may want to involve litigation counsel in these discussions from the beginning.

- **Update Contractual Language.** Consider updating or amending contracts to specifically address the risk of non-performance because of COVID-19 and to acknowledge that the parties are aware that the pandemic may lead to additional disruptions. This also is a good time to include updated language addressing pandemics in your standard *force majeure* clauses moving forward.
- **Review Insurance Coverage.** Parties may look to insurance coverage—like business interruption insurance—to cover losses, but many insurance contracts exclude coverage for shut downs related to pandemics. Contact your insurance counsel, broker, or carrier immediately to determine the scope of your coverage.

## II. FORCE MAJEURE— GENERAL PRINCIPLES

**A. Scope and Interpretation.** *Force majeure* clauses are contract clauses, and courts interpret them by the general principles of contract interpretation. The intent of the parties, as expressed in the specific language of the contract, is paramount. As such, there is no universally applicable determination of when *force majeure* applies and when it does not. Still, some trends emerge from the case law on how courts interpret these clauses:

*Narrow Construction.* Typically, courts read *force majeure* clauses narrowly and require that the clause must unambiguously cover the triggering event for performance to be excused.<sup>1</sup> As an example, in prior cases courts have held that sudden market downturns<sup>2</sup> were not covered by a particular *force majeure* clause, based on the scope of the specific language in the applicable contracts, although these events may have been covered under a more inclusive clause.

*Causation.* The party claiming *force majeure* must show a causal connection between the claimed event and the inability to perform.<sup>3</sup> This is a high bar.<sup>4</sup> An event that makes performance merely more expensive or difficult, but not impossible, may not qualify.<sup>5</sup> For COVID-19, this requirement introduces much uncertainty. Whether a *force majeure* clause is triggered may vary based on the degree of state and local restrictions. For example, in a jurisdiction where the local permitting agencies are closed, a construction contractor may be excused from performance if it cannot get the necessary permits to proceed with the work. In that case, there is a clear causal connection. By contrast, in a jurisdiction where permits are still obtainable but there is a labor shortage because the schools have been closed, performance may not be excused because the causal connection is more attenuated.

1 *Kyocera Corp. v. Hemlock Semiconductor, LLC*, 886 N.W.2d 445 (Mich. Ct. App. 2015) (“[T]he clause will generally only excuse a party’s nonperformance if the event that caused the party’s nonperformance is specifically identified.”) (internal citations and quotations omitted).

2 *Langham-Hill Petroleum, Inc. v. Southern Fuels Co.*, 813 F.2d 1327 (4th Cir. 1987) (holding that sudden drop in oil prices did not excuse performance); *Elavon, Inc. v. Wachovia Bank, NA*, 841 F. Supp. 2d 1298 (N.D. Ga. 2011) (“The economic downturn in 2008 and the subsequent events that followed do not constitute a force majeure . . .”).

3 *Frigillana v. Frigillana*, 266 Ark. 296 (1979) (“The burden of proving impossibility of performance, its nature and extent and causative effect rests upon the party alleging it.”); *see also* 14 Corbin on Contracts § 74.16.

4 *Frigillana*, 266 Ark. 296 at 302-03 (“The burden of proving impossibility of performance, its nature and extent and causative effect rests upon the party alleging it. He must show that he took virtually every action within his power to perform his duty under the contract. It must be shown that the thing to be done cannot be effected by any means.”).

5 *Publicker Industries, Inc. v. Union Carbide Corp.*, 1975 U.S. Dist. LEXIS 14305\* 5 (E.D. Pa. 1975) (“Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen [sic.] contingency which alters the essential nature of the performance. Neither is a rise in the market in itself a justification, for that is exactly the type of business risk which business contracts cover.”).



Triggering Events – Inclusive and Exclusive Clauses. Most *force majeure* clauses list events or categories of events that excuse a party's obligation to perform. They often include occurrences like war, civil unrest, extreme weather events (hurricane, tornado, earthquake, flooding, etc.), labor strikes, and supply shortages. Courts scrutinize these clauses carefully to decide whether a particular event is covered. In general, *force majeure* clauses come in two varieties: (i) exclusive clauses that refer to a specific list of triggering events and exclude all others, and (ii) inclusive clauses that include some form of general “catch-all” language that expands the scope of the clause beyond the listed events.

Exclusive clauses generally list covered *force majeure* events and do not include any language that would expand the scope to cover unlisted events. Sometimes, they are explicitly exhaustive, using language like “the following events but no others.” Other times, the lists simply do not include a catch-all, and unlisted events are excluded under the principle of narrow construction. More recent *force majeure* clauses are more likely to specifically include pandemics and related government shutdowns and quarantines as triggering events. These have become increasingly common (though still not universal) after outbreaks of SARS, Ebola, and MERS in recent years. If a *force majeure* clause specifically lists a pandemic or declared state of emergency as a triggering event, we expect that this language would be interpreted to cover COVID-19, given that the World Health Organization has declared COVID-19 a pandemic, and governments at every level have declared states of emergency and taken measures ranging from banning large gatherings to instituting curfews.

Inclusive clauses generally use some form of “catch-all” language like “including;” “including but not limited to;” or “any other event not under the reasonable control of the parties.” They may also refer to “Acts of God.” Depending on the specific contract language, this language may serve to expand the scope of the *force majeure* clause to include a pandemic or state of emergency even if it is not specifically listed.<sup>6</sup> Given the widespread use of these clauses in contracts and the uncertainty surrounding their interpretation, we expect that this will be a common source of disputes and litigation in the COVID-19 pandemic.

Beware that some jurisdictions interpret inclusive clauses more narrowly than others. Some courts apply the doctrine of *ejusdem generis* (“of the same kind”) to interpret catch-all language to include only events that are similar to those specifically listed.<sup>7</sup> For example, if the listed events include only natural causes or weather-related events, then similar events may be included, but war or pandemic likely would not be covered.

“Acts of God” also have their own unique interpretive history. Courts typically interpret “Acts of God” to mean natural causes, outside of human control, such as “lightning, storms, perils of sea, earthquakes, inundations, sudden death, or illness.”<sup>8</sup> There is very little case law addressing whether a pandemic is an “Act of God.” Although the virus itself may be viewed as a natural event, its spread and the resulting response and emergency declarations may be interpreted as being within human control.<sup>9</sup>

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6 *Eastern Air Lines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957 (5<sup>th</sup> Cir. 1976) (holding that a *force majeure* clause which listed reasons for excusable delay and which contained the phrase “including but not limited to” was broader than just the excusable delays listed.).

7 *Stoud v. Forest Gate Dev. Corp.*, 2004 Del. Ch. LEXIS 66 \*16-17 (Del. Ch. Ct. May 4, 2004) (“A “catch-all” phrase . . . must be construed within the context established by the preceding listed causes.”).

8 *Felder v. Oldham*, 199 Ga. 820, 824-25 (1945) (holding that World War II was not an Act of God).

9 *SNB Farms, Inc. v. Swift & Co.*, 2003 U.S. Dist. LEXIS 2063 (N.D. Iowa Feb. 7, 2003) (holding that a disease outbreak among pigs was an Act of God, but did not excuse performance because the seller failed to give notice as required in the contract).

**B. Foreseeability.** Courts generally do not apply *force majeure* clauses where the event is reasonably foreseeable and “could have been prevented by the exercise of prudence, diligence, and care.”<sup>10</sup> This requires that parties take reasonable steps to avoid foreseeable *force majeure* events, and to use advance planning to minimize adverse impacts. Parties must be proactive and not just reactive to these events. Where a party did not try to avoid or mitigate the impact of a *force majeure* event, courts are unlikely to excuse non-performance after the fact, even if the event is included in the *force majeure* clause.

**C. Mitigation.** Even where a *force majeure* event exists, the parties must make good-faith efforts to perform.<sup>11</sup> For instance, a contractor experiencing a labor shortage must try to cover the shortage by hiring temporary workers or having current employees work longer hours. Even where performance is impossible, the non-performing party must mitigate the damages from not performing.<sup>12</sup> Courts also may often impose a duty to mitigate on both parties, so even the party that continues to perform must take reasonable steps to mitigate the damages resulting from the non-performing party’s claim of *force majeure*.<sup>13</sup>

In the context of COVID-19, parties should not rely solely on the existence of the pandemic, emergency declarations or other events to declare that a *force majeure* event has occurred, regardless of the scope of the contractual language. A party is only entitled to suspend performance when a *force majeure* event has occurred *and* the party is unable to perform despite its reasonable mitigation efforts. All mitigation efforts should be well-documented by the parties in case of future disputes.

### III. COMMON LAW CONTRACT DEFENSES – IMPOSSIBILITY AND FRUSTRATION OF PURPOSE.

Some contracts do not contain a *force majeure* clause at all. If there is no *force majeure* clause, affected parties may still have common law contract defenses—like impossibility or frustration of purpose—available to them. Some jurisdictions permit these defenses even if the contract includes a *force majeure* clause,<sup>14</sup> while others do not allow common-law defenses when the contract includes a *force majeure* clause, instead allowing the allocation of risk in the contract to prevail.<sup>15</sup>

**A. Impossibility.** Under modern impossibility doctrine, performance may be excused where it is made impossible by an intervening event, and the agreement was based on the assumption that that event would not occur.<sup>16</sup> Some courts rely on an older impossibility standard based on whether the event was foreseeable rather than whether

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<sup>10</sup> *Great Lakes Gas Transmission Limited Partnership v. Essar Steel Minn., LLC*, 871 F. Supp. 2d 843 (D. Minn. 2012) (holding that a party’s inability to obtain financing was a foreseeable event and did not excuse performance).

<sup>11</sup> *Paper Makers Importing Co. v. Milwaukee*, 165 F. Supp. 491 (Wisc. E. D. 1958) (“I am unable, therefore, to conclude that the city was excused from performance of its contractual obligations by causes unavoidable or beyond its control since no active effort was made to avoid or to control the causes which prompted the city officials to repudiate the contracts.”).

<sup>12</sup> *Id.* at 505.

<sup>13</sup> 2<sup>nd</sup> Restatement Contract § 350.

<sup>14</sup> *Rembrandt Enters. v. Dahmes Stainless, Inc.*, 2017 U.S. Dist. LEXIS 144636 (N.D Iowa Sept. 7, 2017) (applying Minnesota law).

<sup>15</sup> *Perlman v. Pioneer P’Ship*, 918 F.2d 1244, 1248 (5th Cir. 1990) (applying Wyoming law).

<sup>16</sup> 2<sup>nd</sup> Restatement of Contract § 261; UCC §§ 2-615 & 2-616.

the event not occurring was a basic assumption of the contract.<sup>17</sup> The modern trend is for courts to reject the foreseeability test, but interpretation varies by jurisdiction. Government regulation that makes performance impossible can also excuse performance in some jurisdictions.<sup>18</sup> Where the impossibility is temporary, the affected party's obligation to perform is tolled during the period of impossibility.<sup>19</sup>

In the context of the COVID-19 pandemic, the different standards can lead to different results. For example, under the foreseeability test, a court could find shuttering businesses in the United States was foreseeable given the existing prior outbreaks and the spread of COVID-19 in China, Italy, and Iran. Under the "basic assumption" test, however, a court may reach a different conclusion, because the absence of a government-ordered shutdown may be considered a basic assumption of most contracts.

**B. Frustration of Purpose.** Where an intervening event destroys the principal purpose of the contract, some courts will excuse performance.<sup>20</sup> A common example is when an underlying event is cancelled.<sup>21</sup> In the COVID-19 pandemic, we expect that there will be many claims in this category, given the cancellations of sporting events, concerts, and other gatherings. For example, stadiums and teams whose events have been cancelled may have a defense to breach for contracts with their vendors for services such as printing posters or promoting the events.

#### **IV. FORCE MAJEURE CLAUSES -- SPECIFIC EXAMPLES.**

Certain categories of common contracts have common *force majeure* issues that may arise in connection with the COVID-19 pandemic:

**A. Leases.** Most leases include a *force majeure* clause, but specifically carve out payment of rent and other monetary obligations from the obligations that may be excused or suspended, in which case tenants would be required to continue to pay rent even if they cannot access their premises or operate their businesses. Many leases also provide that payment of tenant improvement allowances by landlords is not excused during a *force majeure*. Other lease provisions that do not address monetary obligations, such as co-tenancy clauses, go-dark clauses, and operating hours requirements, may be excused by *force majeure* events.

Despite these common carve-outs, we expect that many tenants, facing dire economic conditions as a result of the COVID-19 response, will claim that the pandemic response constitutes a *force majeure* event excusing the payment of rent. The success of these claims will depend on the specific language of the lease. If tenants are unable to access their premises, they may seek to rely on other lease clauses, such as casualty, constructive eviction, or breach of the covenant of quiet enjoyment. They also could assert a frustration of purpose defense, arguing that being able to access the space to operate their business was a basic assumption of the lease.

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17 *Opera Co. v. Wolf Trap Found.*, 817 F.2d 1094, 1102-1103 (4<sup>th</sup> Cir. 1987) (discussing why foreseeability should not be the standard).

18 2<sup>nd</sup> Restatement of Contract § 264.

19 *Id.* § 269.

20 2<sup>nd</sup> Restatement of Contracts § 265.

21 *See id.*, Illustration 2.

**B. Construction Contracts.** Nearly all construction contracts have *force majeure* or “unavoidable delay” provisions. These provisions are often narrowly focused on supply or labor shortages and weather events that interfere with construction activities. Delays resulting from *force majeure* events may automatically delay deadlines for completion and other milestones, as well as penalties for failing to meet these deadlines, but often have strict notice requirements that may require the contractor to provide prompt written notice of any *force majeure* events. Construction contracts often account for some amount of expected delay by building “float” into the construction schedule, and owners may insist that the contractor exhaust that “float” before declaring a *force majeure*. In the COVID-19 pandemic, construction contracts are likely to be significantly affected by government shutdowns as local permitting offices either close or are slowed as they switch to remote working.

**C. Purchase and Sale Agreements/ Asset Purchase Agreements.** Purchase and sale agreements often do not include *force majeure* clauses at all, instead relying on express termination rights and carefully crafted conditions to closing. Because these contracts often do not include *force majeure* clauses, parties may have common law defenses like impossibility and frustration of purpose available; however, if the contract includes a “time of the essence” clause, the non-performing party may have more difficulty asserting an impossibility defense. In the COVID-19 pandemic, parties to real estate purchase agreements may find closing to be impossible if recording offices are shut down or if title insurance companies are unable to issue policies or gap coverage, and should build in contract provisions to protect against these events.

**D. Loan and Financing Agreements.** *Force majeure* provisions are typically included in construction loan documents, but not always found in other kinds of financing documents. In construction loan documents, *force majeure* provisions can vary, but are primarily focused on delays in construction caused by the *force majeure* event. Delays may be capped at a certain number of days, after which delays in construction will no longer be excused under the agreement. Further delays may be considered an event of default, entitling the lender to additional remedies. In non-construction loan documents, if a *force majeure* clause is present, a borrower’s ability to claim *force majeure* will often be limited exclusively to its inability to undertake necessary repairs and upkeep. In both types of loan documents, *force majeure* will seldom, if ever, excuse a borrower from payment under the agreement.

**E. Entitlements/Permits and Contingencies.** Many contracts are contingent upon obtaining permits or entitlements and, as government agencies and permitting offices shut down, it may become difficult or impossible to obtain those permits within applicable contract deadlines. Parties required to obtain governmental approvals should take reasonable steps to obtain those permits before shutdowns spread to mitigate any potential damages, and they should document their efforts to obtain those permits. We are already seeing permitting offices, administrative boards, and courts extend deadlines for permits and appeals. Parties should consider agreeing to extend any contingency deadlines by an equivalent amount of time to avoid future disputes.

## V. CONCLUSION

The COVID-19 outbreak and related closures evolve rapidly. A situation that was not a *force majeure* event today may be one tomorrow, and vice versa. Parties to contracts need to review them carefully and fully understand their rights, obligations and the applicable law before declaring or responding to a *force majeure* event and may need to act quickly to protect their interests.

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