

CLIENT ALERT

Business Interruption and Commercial Contracts: The Anatomy of the Dispute

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The impacts of COVID-19 are rapidly evolving and quickly disrupting business operations. If they haven't already done so, many businesses are deciding whether to activate contractual force majeure clauses or looking to other doctrines that may excuse non-performance. While many businesses during this global pandemic may want to address performance disruptions amicably to the extent possible, understanding how disputes over force majeure clauses are decided allows a business to act strategically. This is true whether you are the party seeking damages for non-performance or invoking a defense to performance. Even with a well-crafted force majeure clause, parties can disagree about whether the defense applies, what the implications are to continued performance, and what damages, if any, are recoverable. While each dispute is highly fact-specific and likely to be affected by the language of the contract and governing law, we provide guidance below on the factors most likely to be relevant to resolution of the dispute.

What if the parties disagree about whether performance was excused?

Any effort to obtain a declaration that your non-performance is excused by force majeure, or respond to an unjustified invocation of a defense by a non-performing party, should start with a review of the contract. Some contracts specify a notice and negotiation procedure the parties must participate in prior to arbitration or litigation. Other contracts provide that only certain disputes be arbitrated, or specify a jurisdiction or forum for disputes. Courts (and arbitrators) generally require that parties strictly follow these requirements.

Practice Pointers:

- The failure to bring a dispute in the proper forum can result in unnecessary motion practice or other procedures that can delay resolution of a dispute. If you intend to bring a complaint or arbitration demand, make sure you first understand and follow any contractual dispute resolution procedures to avoid an unnecessary delay to ultimate relief. If you are on the receiving end of a complaint or arbitration demand, review those procedures to determine if you have a forum defense.
- If a dispute appears inevitable and you are the party invoking a non-performance defense, consider seeking a declaratory judgment that the defense applies and excuses your non-performance. Although force majeure or related doctrines provide a defense to breach of contract, disputes in this context—in litigation or arbitration—are often framed as declaratory judgment actions. Affirmatively initiating litigating or arbitration has its advantages, enabling the non-performing party to more effectively frame the scope and pace of the proceedings. Of course, this is not a step to take lightly, as it involves initiating litigation against a party with potential counterclaims for damages.
- Consider whether you have taken inconsistent positions on force majeure provisions in other contracts. While arguably not relevant—each contract should be evaluated first within its four corners—these positions may be the subject of discovery in any dispute.

How strong is the basis for asserting force majeure?

This question will be at the core of many disputes involving COVID-19 and business interruptions. While global pandemic or government responsive actions may be the type of unforeseeable, uncontrollable events that qualify as force majeure, they may not excuse non-performance if they are not the *actual* cause of the business disruption. Where a contract does not specify a sole source of supply, for example, an unforeseen disruption to that source may not justify non-performance if supply may be obtained elsewhere, even at a much higher cost.

Practice Pointers:

- Courts in most jurisdictions construe force majeure clauses narrowly and the burden is on the party claiming force majeure.
- Consider carefully the specific language of any force majeure clause, the precise performance required by the contract, and the causal linkage between the claimed force majeure event or condition and the inability to perform the obligation.

Do other doctrines excuse performance?

If the contract lacks a force majeure clause, consider whether the doctrines of impossibility, impracticability or frustration of purpose excuse performance. Review your contract to determine what law applies so you can evaluate whether and how these different doctrines may come into play.

Practice Pointers:

- While courts apply these doctrines differently, they generally will not excuse performance that is simply more costly or less profitable due to the occurrence of a force majeure event.

Was force majeure properly asserted?

It is important to understand what actions must be taken to declare force majeure and the implications of a declaration. Many force majeure clauses contain a notice provision, and if this requirement amounts to a condition precedent, failure to give notice will foreclose a party's reliance on that clause. Similarly, it is important to understand if there are additional actions that must be taken once a force majeure event is declared before contractual obligations can be excused, and whether performance is entirely excused or just suspended. The failure to comply with any continuing obligations can open you up to liability if your counterparty ceases performance but you are still required to perform.

Practice Pointers:

- Whether a notice provision amounts to a condition precedent – such that the failure to provide timely and proper notice results in a partial or total bar to invoking force majeure – will depend on the contractual language. When notice is required, make sure you provide it in the proper manner, at the required time, to the appropriate parties, using the correct contact information. If you are on the receiving end of the notice, make sure your counterparty has complied with the contract's notice provision. And, if your counterparty asserted force majeure without giving notice, carefully review your contract to see if there is an argument that the failure to give notice resulted in a waiver of the defense.

- Where a force majeure event exists, the non-performing party generally must look for reasonable ways to limit the scope or duration of its impairment. Most force majeure provisions will expressly require such efforts, but even where they do not, courts generally expect such efforts under the implied duty of good faith and fair dealing read into contracts.
- If a counterparty invokes a contractual clause to excuse its non-performance, the contract language will control whether your performance is also excused. Some force majeure clauses specify that only one party's performance is excused, while other clauses state that both parties' performance obligations are excused. Some may have different clauses to address different contingencies, so it is important to review the contract in its entirety prior to acting.
- If a party invokes a related common law defense like commercial impracticability or frustration of purpose (*i.e.*, if the contract lacks a force majeure clause), the other party will generally be excused from performing, too.

What are the potential remedies?

It is important to understand your exposure if a court (or arbitrator) finds your performance was not excused, and what damages you can seek against a counterparty who improperly stopped performance.

Practice Pointers:

- Evaluate any express limitations of liability in the governing contract. Some contracts do not allow recovery for consequential damages, while others only allow them if they are directly traceable to the breach.
- Consider any provisions that provide for liquidated damages, and whether they apply in the context of the non-performance at issue. If they do apply and are enforceable, liquidated damages generally will supplant both ordinary measures of contract damages (e.g., lost profits) and the obligation to mitigate them.
- Because courts rarely award specific performance, it is important that your damages be quantifiable.
- No matter what the contract says, damages will only be recoverable if you can prove them. Make sure to keep records of any lost accounts, expenditures and other increased costs during the non-performance. And, if you are the party against whom damages are being sought, make sure you keep records of any mitigation that could offset any damages.

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