

CLIENT ALERT

How to Navigate Supply Chain Disputes in a Pandemic

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COVID-19 has disrupted and will continue disrupting supply chains in many important ways, as suppliers, carriers and buyers navigate the global pandemic. But does the pandemic allow activation of force majeure clauses in your contracts? If a force majeure clause is activated, what are the rights and responsibilities of each party during the pandemic? When does performance restart and how? And, what if there is a dispute?

The following five steps should serve as a starting point to evaluate the efficacy of invoking a force majeure clause or similar doctrine in the face of a global pandemic.

1. What types of events excuse non-performance?

Many contracts include force majeure clauses, but they are not all the same – not even close. Thus, the very first step in your analysis should be to read the contract. Some force majeure provisions exclude certain types of situations like unprofitability, while others may specifically include a pandemic or infectious disease as a force majeure event. Your contract may be drafted in a way that limits force majeure events and only excuses non-performance in limited instances. Your contract may also instruct how to proceed in cases of supply or labor shortages. How your contract is worded, and the law that governs it, matter a great deal.

Some contracts do not include force majeure language. If this is the case, you will need to consider which state law governs the relationship. Many jurisdictions recognize the doctrines of impossibility or impracticability and frustration of purpose. The UCC codifies similar defenses. While there may not be a significant amount of case law interpreting these doctrines in your jurisdiction, you likely will find analogous fact patterns to inform the analysis.

2. What is the cause of the disruption?

You need to ask yourself if the pandemic itself has created the disruption, or if the cause of the disruption is an intervening factor, such as a third party's response to the pandemic. Potential reasons for a disruption may include the following:

- An aspect of the COVID-19 disease itself
- Government action or prohibition in response to COVID-19 (*e.g.*, many states have limited business operations to those deemed essential)
- Shortage of supply and/or raw materials required to perform under the agreement
- Shortage of labor, due to illness or quarantine or some other COVID-19-related cause
- Significant decline in demand or material drop in potential profitability of the business metrics supporting the agreement due to COVID-19 or related events
- Curtailment of transportation modalities or facilities

Performance may or may not be excused in each situation. You should also determine whether the contract allows for alternative means of performance, which may not be excused by the claimed disruption. Some supply contracts specify a particular upstream source, which if disrupted by a cause linked to the pandemic may excuse the supplier's performance to the buyer. Others may not limit the supplier to use a sole source, requiring the supplier to go elsewhere to perform the contract, even if at much greater cost.

3. What steps should or must you take to protect yourself?

Does the contract require notice to assert force majeure? What about timing? If you assert force majeure, are you permitted to suspend performance or terminate the contract? Are there allocation requirements for limited supply?

You should consider how any written communication or other documentation reflecting the problem may later be characterized, given the actual words of the force majeure clause and the governing law. You should think strategically about your business's operational needs and legal risks that the business faces. Consider how the arguments you are making in this dispute could impact other disputes, including those in which you may be disputing an assertion of force majeure. Be sure to keep copies of any documentation you are relying upon, including correspondence and emails between the parties.

4. What if your counterparty stops performing?

Can you stop performance? A counterparty's declaration of force majeure may or may not be, in and of itself, sufficient to excuse your non-performance. Whether or not performance under the contract is entirely excused will depend on a careful reading of the force majeure clause and the contract as a whole. Can you seek supplies elsewhere, i.e., cover who bears the additional risk and cost of alternative supply? Again, the answers to these questions depend on what the contract says and which jurisdiction's law governs.

5. What if there is a dispute?

Some contracts specify a dispute resolution procedure that must be followed before going to court. Some contracts require mediation. Think about what an acceptable resolution of a dispute looks like for your business. Carefully consider other issues in the supply relationship that are unrelated to the pandemic. This may be the time to take those up with your counterparty as well.

If you cannot resolve the dispute, then what? Some contracts call for binding arbitration in a particular forum instead of litigation in court. Other contracts allow you to sue, but only in certain courts. Either way, what damages or other remedies are available? Even if you hope to resolve the dispute amicably, developing a strategy that analyzes how your dispute may play out can give you leverage.

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