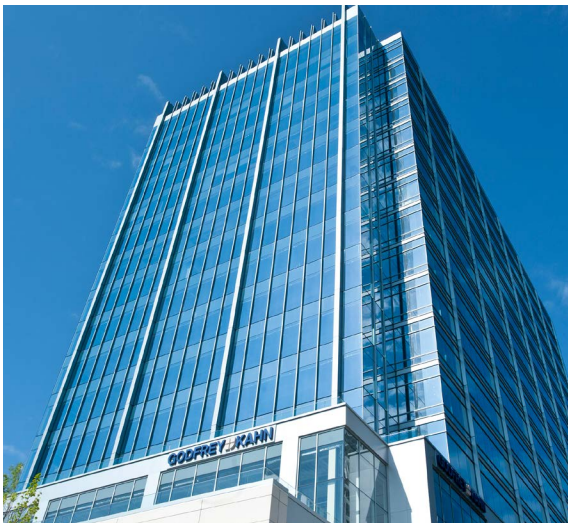
GODFREY & KAHN S.C.

GK QUARTERLY

MARCH 2020 | EDITION 3

CORONAVIRUS: A GLOBAL FORCE MAJEURE



Godfrey & Kahn attorneys have consulted on numerous *force majeure* (**FM**) scenarios since the beginning of the 2019 novel coronavirus (COVID-19) pandemic. There are now virtually limitless resources available online analyzing the narrow legal interpretation of this issue.

At the risk of oversimplifying, here is the consensus as we see it:

1. **Open set:** If you are the party seeking an "excuse" from performance, your cause will be strengthened if an epidemic, pandemic or similar trigger to excuse performance is specifically called out by the FM provision in your contract. You may also be excused from performance if the provision is book-ended with a catch-all, *i.e.*, that along with the list of specific triggers, performance is also excused by "… any other event, circumstance or condition which is not within the reasonable control of the affected party…"

2. **Closed set:** If a pandemic or similar trigger is not specifically called out in your FM provision and your provision is a closed set, then you may not have an excuse from performance within the contract and should consider other factors.

Let's turn to more strategic considerations when reviewing upstream (supplier), downstream (customer) or other contracts and FM considerations:

- **Notice of force majeure:** A principal component of most FM provisions is that the affected party (**AP**) will provide notice to the unaffected party (**UP**) as soon as they become aware that they are or may be, depending on the scope of the provision, unable to perform their obligations as a result of the cited event. Aside from being a good sport, the purpose of the communication covers the same issue from the AP and the UP side of the equation. The UP is made aware of the possibility that it will need to pursue other avenues to meet its requirements, and the AP has notified the UP of known facts. As a result, the UP is now aware that performance may be affected, and (the argument goes) should begin to take remedial steps that should help mitigate the UP's losses.

  Consider, for example, the UP who had an at-market priced contract to purchase a key component from an overseas supplier (the AP). Upon receiving notice of the supplier's constraints, the UP hustles to purchase equally suitable components at 110 percent of the price of the original order. In this scenario, if the AP had an enforceable FM provision, it would likely owe nothing to the UP by the technical terms of the contract. If the AP did not have such a contractual protection, the UP would arguably have, at a *minimum*, a breach of contract claim for the extra cost to procure the substitute goods. If the AP was making a key component for the UP, which (arguably) caused the UP to shut-down a production line and/or miss sales, UP's damages claim could start to pry around consequential damages (e.g., lost sales/profits).

- **Preemptory notice and anticipatory breach:** At this stage of the proceedings, you could probably make an argument that most businesses in modern economies are either operating under pending FM or reasonably expect FM to occur in the near-term. So can we concede FM for the globe and save the paper/email spam?

  The pro: While you could argue it has the effect of white noise, notice of FM before you've actually suffered FM could, on the whole, be beneficial to the AP by establishing a clear demarcation date to point to in future breach of contract litigation. This would be beneficial not to avoid liability for breach – you either have an FM excuse, you don't or it's arguable – but to argue for limitations to the plaintiff's damages claims on the basis of a failure to mitigate its losses.

  The con: A preemptory notice of FM is not without risk. There is a principle within contract law that a party who is bound by a contract's terms cannot be required to live under those terms if they have no reasonable belief that their counterparty is able to perform the contract. Consider a scenario where the AP has a value-added contract with a supplier (the UP), where the AP has the supplier locked into a long-term agreement at favorable pricing and warranty terms and under some element of exclusivity, and the supplier has come to have seller's remorse over the arrangement. Would a preemptory notice by the AP lay the groundwork for an anticipatory breach argument by the supplier in future litigation? Depending on the jurisdiction and relative merits, it may.

- **Master Supply Agreements (MSAs) and everything else:** You are ready to march forward with an FM claim as you have an airtight FM provision in your terms. But do you actually have a contract at all?

  MSAs: Master Supply Agreements, Master Purchase Agreements and their ilk, with both supplier and customer signing, are clearly (in most cases, assuming good contracting principles) binding agreements. Find the FM provision, interpret and make a decision.

  Battle of the forms: Alternatively, consider the more probable scenario: transacting order by order. Do AP's or UP's "standard terms and conditions of purchase/sale" govern the situation? The answer to that question will vary jurisdiction to jurisdiction, in the U.S. and globally. However, the upshot is that if the business relationship in question is operating on an order by order basis, both the AP and the UP likely have ambiguity in their contracting terms which can be used to their advantage (or disadvantage).

- **Separating the wheat from the chaff:** Commercially reasonable actors realize that, at a certain level, even if the UP has the AP dead-to-rights on the contract terms (*i.e.*, there is no FM provision), if the amount at dispute is below a threshold pain point which is obviously less than a certain dollar amount, a game of who will blink first will ensue, gambling on the unwillingness of the UP to bear the cost of litigating and collecting on a winning legal claim. This is the zone in which relative contract terms and merits of an argument carry less weight than in greater stakes disputes, and from a commercial litigator's perspective over transaction costs, possible outcomes and relative leverage is indispensable.

- **Clean hands?** With respect to the above long-term supply agreement with terms favorable to the AP, the UP should consider assessing its motivations to move to terminate in the face of the AP's FM notice. It's not inconceivable that those managers within the UP have been reminded what an unwise decision that contract was. Colleagues email and text each other and make statements in meetings to the effect that they'd love to get out of this thing, but it's a contract, "what can you do?" Then the pandemic occurs, opening an FM argument, and the UP acts to terminate the relationship, but those emails and texts and, to a less useful extent, statements persist indefinitely. Is FM the true basis for termination, or is it a pretext to escape a losing proposition? Those texts, emails and conversations will become the subject of the ensuing litigation.

- **Is the juice worth the squeeze?** The AP has an airtight FM provision and can walk. But while the AP could, **should** it? In less than two weeks, we have seen:

  - National retailers accused of price gouging
  - Public officials accused of profiteering and insider trading
  - Accusations of medical care rationing based on wealth and status

  If a business, while totally within its rights from a legal perspective, nevertheless missteps in its timing, messaging or estimation of the consequences of its actions, the cost could far exceed the benefits of throwing aside any particular contract. Public opinion, with social media as its accelerant, develops quickly.

PART OF YOUR TEAM

The unprecedented speed at which global legal and economic issues are developing requires strategic, timely and multidisciplinary thinking. This is how Godfrey & Kahn approaches our clients' business. Let us know how we can help your business assess its risk and choose the best path, including as to force majeure-related (Matt Wuest - 414.287.9244) and third party coverage (Zach Bemis - 608.284.2224) issues.

UPCOMING EVENTS

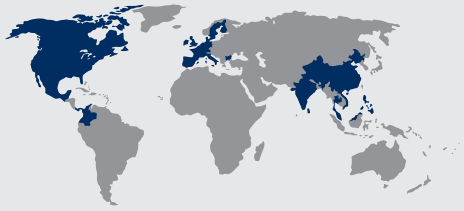
Webinar: The Families First Coronavirus Response Act Overview

Tuesday, March 24, 2020
1:00 – 2:00 p.m.

For more information on our events, visit www.gklaw.com/events.

LOCAL FIRM, GLOBAL REACH.

To date, our deals have spanned across all 50 U.S. states and 34 countries:



Through our TERRALEX network, clients benefit from our long-standing relations with other law firms around the globe.