

Insights: Alerts

Coronavirus - Be Prepared: Contractual Impacts and How To Address Them

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Written by **Gunjan R. Talati**

Please note: The below information may require updating, including additional clarification, as the COVID-19 pandemic is dynamic and continues to develop. Please monitor this site and/or your email for updates.

The Coronavirus threat has become a major source of news, concern and irritation for businesses, governments and individuals alike. The resulting impacts to business, the global economy and stock markets are readily apparent. Over the past several weeks we have been approached by clients in both the commercial and public (government) contracting arenas to assist them in addressing concerns and contract performance issues associated with Coronavirus and the potential impacts that this epidemic may have on projects and contracts alike. This raises the question of what to do?

WHAT IS A FORCE MAJEURE?

The primary argument that one can use in circumstances such as those surrounding the Coronavirus epidemic arises from the doctrine of *force majeure* (“*fm*”). If successful, this doctrine acts to excuse performance or delays in performance while allowing the party claiming a *fm* to avoid incurring some, if not all, liability for delays or carry costs under circumstances such as the Coronavirus. *Black's Law Dictionary* (8th Ed.) defines “*force majeure*” as “[a]n event or effect that can be neither anticipated nor controlled. The term includes both acts of nature...and acts of people...” This definition provides the basis for explicit *force majeure* clauses and may also support a common law recognition of such conditions where no such clause exists in the subject contract.

While *force majeure* clauses are often narrowly construed and read, the circumstances associated with current epidemic seem to fall squarely within the intent of such provisions. Starting in China, a major player in the global supply chain for materials, equipment and supplies, the Coronavirus has spread around the globe. When first discovered, China responded by ordering broad quarantines, closing down ports and precluding free movement among its provinces. This, in turn, has impacted shipping to ports and harbors, export of goods, prevented workers from getting to their work places, and has had a clear ripple effect around the globe. Shipping ports were impacted by the virus, with significant losses of dock workers to the virus. This, in turn, has slowed down manufacturing and delivery of goods and equipment, with no end in sight. Many contractors, vendors and suppliers are dependent upon these manufacturers and suppliers in the impacted regions for those items necessary to perform various contracts. These quarantines carry the real possibility of delay to their contracts.

The foregoing description appears to fall within a number of possible *force majeure* events, including, acts of god and acts of a government, neither of which are within the control of the contracting parties.

Generally speaking, in order to have a *force majeure* event (or defense) resulting in an inability to perform, three elements must be met:

1. Unforeseeability: The event must be unforeseeable such that it could not be contracted away (this may not be beneficial in the case where the *force majeure* clause in question provides a specific listing of events constituting a *fm* and is not broadly worded);
2. Causation by an outside source or party; and
3. The event is unavoidable.

While each case is fact specific, the current pandemic may provide a basis for arguing excusable delay, *if* one can show that they were truly impacted by this event. In many cases this issue manifests itself in an inability or lack of availability of material and a delay in the shipment of materials from Asia to other locations. The forced shutdown of manufacturing facilities, the ban on inter-provincial travel and shipping have all acted to preclude the timely overseas delivery of goods and materials.

FORCE MAJEURE CLAUSES – SOME EXAMPLES

Commercial Agreements:

Many commercial agreements recognize the possibility of *force majeure* events and the excusability of the resulting delay. For example, in the context of construction, the American Institute of Architects A101™ states:

§ 8.3 DELAYS AND EXTENSIONS OF TIME^[1]

§ 8.3.1 **Excusable delays** are delays in the progress of the Work which at the time of the delays were critical path activities as shown on the most recently approved Progress Schedule and which prevent the Contractor from achieving Substantial Completion before the expiration of the Contract Time, **caused by conditions which could not reasonably be anticipated by, are beyond the control of, and are without the fault or negligence** of the Owner, as set forth in Section 8.3.2, the Contractor or anyone for whose acts the Contractor is responsible. Excusable delays do not include any delays caused in whole or in part by any Subcontractor, Sub-subcontractor or supplier which are considered unexcused delays. There shall be no compensation whatsoever for excusable delays. **Excusable delays may, but do not necessarily, include:**

1. **weather delays as further defined in Section 8.3.6;**
2. **acts of government and regulatory agencies and officials** (other than the County in its capacity as Owner);
3. catastrophic events such as fire, flood and unavoidable casualties; and

4. strikes or labor disputes.

Government Contracts:

Likewise, the Federal Acquisition Regulations (“FAR”) recognize the possibility of excusable delays arising out of a *force majeure* event. FAR Clause 52.249-14 “Excusable Delays”, states in relevant part:

(a) Except for defaults of subcontractors at any tier, the Contractor **shall not be in default because of any failure to perform this contract under its terms if the failure arises from causes beyond the control and without the fault or negligence of the Contractor**. Examples of these causes are **(1) acts of God** or of the public enemy, **(2) acts of the Government in either its sovereign or contractual capacity**, (3) fires, (4) floods, **(5) epidemics, (6) quarantine restrictions,** (7) strikes, (8) freight embargoes, and (9) unusually severe weather. In each instance, the failure to perform **must be beyond the control and without the fault or negligence of the Contractor**. Default includes failure to make progress in the work so as to endanger performance.

(b) If the failure to perform is caused by the failure of a subcontractor at any tier to perform or make progress, and if the cause of the failure was beyond the control of both the Contractor and subcontractor, and without the fault or negligence of either, the Contractor shall not be deemed to be in default, unless –

(1) The subcontracted **supplies** or services were obtainable from other sources;

(2) The Contracting Officer ordered the Contractor in writing to purchase these **supplies** or services from the other source; and

(3) The Contractor failed to comply reasonably with this order.

(c) **Upon request of the Contractor**, the Contracting Officer shall ascertain the facts and extent of the failure. If the Contracting Officer determines that any failure to perform results from one or more of the causes above, the delivery schedule shall be revised, subject to the rights of the Government under the termination clause of this contract.

As the foregoing language makes even more clear than the commercial example, acts of God, government, epidemics or quarantine issues can constitute *force majeure* events. This closely mirrors the fact pattern above.

The Common Law:

While there may be some argument to recognize an implied *force majeure* doctrine in contracts that lack a formal clause, there are other arguments which may provide a more supported foundation from which to argue.

The law has recognized that there is a doctrine of impossibility of performance, where it is virtually, if not actually, impossible to perform due to supervening events.

A lesser standard arises from the doctrine of commercial impracticability. Typically, this looks to the question of whether the event was unexpected (unusual or non-customary); was the risk of the event allocated by the contract or trade practice; and did that event make the performance impracticable?^[2] In other words, it makes no sense commercially to mandate performance. Both are very fact intensive analyses and carry high burdens of proof.

BEYOND FORCE MAJEURE

In addition to *force majeure* considerations, government contractors need to also understand whether they need to prioritize government orders, track costs of impact, and amend existing subcontracts. The Defense Priorities and Allocation System (DPAS) allows certain agencies such as the U.S. Department of Homeland Security, which includes the Federal Emergency Management Agency, and the Department of Defense to issue DPAS-rated orders. DPAS-rated orders “jump” to the front of the line of commercial orders and contractors receiving such orders are required to accept except in certain instances that are identified in regulations. Failing to satisfy DPAS-rated orders can result in criminal liability.

Cost impacts of disruption may also be recoverable by contractors. However, in order to recover any such costs, contractors must maintain appropriate records accounting for the additional costs. Without these records, contractors may not be able to satisfy the burden required to recover cost impacts.

Many contractors also utilize subcontractors on their government contracts. Subcontracts between a prime and sub are largely treated as commercial contracts. Accordingly, contractors should examine their existing contracts to determine if they include appropriate provisions that would apply to the outbreak. If not, contractors should look at options for modifying their subcontracts to include such provisions.

WHAT TO DO

1. DO NOT PANIC: First and foremost, it is critical that you do not panic. Epidemics such as the Coronavirus seem to occur with some regularity (e.g., the flu). Companies should have in place policies and procedures for addressing these types of situations, including requiring employees to work remotely and to not come to work if feeling ill or exhibiting a fever. As relates to your obligations to other parties (contracting parties) there are typically explicit clauses and common law duties and rights that address these sorts of situations at both the commercial and government levels.

2. REVIEW YOUR CONTRACTS: Does your contract have a *fm* clause? If so, is it broadly or narrowly worded (does it list specific *fm* events or is it openly worded)? Does the clause's scope cover your *fm* event, here the Coronavirus?

3. ENSURE ALL NOTICES ARE TIMELY MADE: More likely than not, if you are impacted by a *fm* event, the contract (and common sense) requires that the contractor provide notice to its upper (and perhaps lower) tier contracting parties. A good recommendation is that if a *force majeure* event may impact your work or deliverables even if it has not yet, notice to the other parties should be given as soon as reasonably possible. Even notice of the potentiality of a future impact can often play a key role should that “future event” come to pass. It often allows a party to manage expectations while also developing a record to support a later argument.

4. DO WHAT YOU CAN TO MITIGATE THE IMPACTS: Attempting to order materials or equipment from alternative suppliers or vendors may be a possibility. At least performing the requisite due diligence and having the option available is prudent. Seeking recompense for any cost increases may or may not be realistic (each case is different), but mitigation of your damages and impacts by reprocurement can often have a positive effect on the Project/contract's outcome. Likewise, making sure that your workforce is protected, avoids contact with potential "carriers" of the virus (or flu, or other illness) is key. Even if one is not impacted by overseas occurrences, it is possible that one "domestic carrier" can infect a significant part of one's domestic workforce. Having policies in place to protect the business and its workforce from sick personnel is key. This includes educating your employees on what to look for, what precautions to take to minimize spread of the virus/flu/illness and other (often common sense) approaches.

CONCLUSION

Globalization and the current state of the planet (global warming, international travel and shipping) and other "modern convenience" may also result in increased risk of illness, flooding, weather, and other "acts of God." Being prepared to address these issues as best as one can, even if the particular event is not foreseeable, should result in reduced risk to contracting parties and the populace overall. While not every event is foreseeable or avoidable, contractual and common law defenses may exist under the right circumstances to allow a party to a contract relief from delay and damages to other parties. Recognizing those circumstances, contracting for them as best as possible, and being proactive both to mitigate against them and to notify your fellow-contracting party are all good strategies to consider.

[1] Copyright American Institute of Architects 2017.

[2] See e.g., *Transatlantic Fin. Corp. v. United States*, 363 F.2d 312, 315 (D.C. Cir. 1966)

Related People



Gunjan R. Talati

t 404.815.6503

gtalati@ktslaw.com