Does Your Contract Protect You from the Coronavirus?

Coronavirus Legal Advisory

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Coronavirus contamination has disrupted the work force, supply chains, and transportation. Official bans on large public gatherings across the country, and the ordered closures of restaurants and bars implemented by many states, have also resulted in numerous event cancellations. Companies facing losses because they or their partners are unable to meet their obligations need to review their contracts with third parties, including those with insurers, to better understand their rights, obligations, and remedies.

Force Majeure

Where a company is unable to perform, the parties to the contract should review their contracts to determine which party bears the risk of loss if performance becomes impossible or impracticable. For example:

- Does the contract contain provisions regarding breach, cancellation, termination, or repudiation?
- Does the contract have a force majeure clause? That is a provision that excuses a party from obligations where performance is unworkable because of events the parties could not have anticipated and/or controlled.
- Does the provision expressly excuse performance for pandemics, epidemics, or quarantine?
- Does it specify acts of God as force majeure events?
- What law governs the contract?
- If the contract has no force majeure provision, does the controlling law nonetheless have principles offering relief for impossibility of performance or frustration of the purpose of the contract?

Broadly speaking, a force majeure clause excuses performance made impossible or impracticable by events neither anticipated nor controlled by contracting parties. Although these provisions may be narrowly construed by courts, depending on a contract's precise terms, the clause can apply to natural and man-made events (e.g., storms, strikes, and riots). These provisions typically do not apply to purely economic hardship, however. Whether and how a particular clause will apply to pandemics, such as COVID-19, depends on the language of the provision and controlling law.

Courts have held epidemics to be force majeure events. *E.g., Lakeman v. Pollard*, 43 Me. 463, 466 (1857) (cholera outbreak excused performance under a labor contract); *Coombs v. Nolan*, 6 F. Cas. 468 (S.D.N.Y. 1874) (epidemic among horses excused reasonable delay in shipping); *Sandry v. Brooklyn Sch. Dist.*, 47 N.D. 444, 449 (1921) (influenza epidemic excused school district from paying bus drivers during school closures). Whether a force majeure clause covers an epidemic, such as COVID-19, will depend largely on a contract's language.

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Parties may negotiate which specific events qualify as force majeure events. If epidemics are listed, this will likely relieve a party from performance. If the contract broadly excuses performance "for acts of God," the parties must consider whether the circumstances qualify. *Black's Law Dictionary* defines "act of God" to mean an "overwhelming, unpreventable event caused exclusively by forces of nature," and include "natural phenomena that are exceptional, inevitable, and irresistible, the effects of which could not be prevented or avoided by the exercise of due care or foresight." *Black's Law Dictionary* (11th ed. 2019). However, expect debate. One may argue that the COVID-19 pandemic is a natural phenomenon, spreading globally despite reasonable, if not extraordinary, precautions and efforts. Others may argue a global virus, such as the SARS outbreak and Zika virus, is predictable and therefore would be expected to be explicitly addressed by a force majeure clause if encompassed by it.

As the pandemic continues to wreak havoc and governments respond, corporations must examine their contracts closely, attempt to find alternative ways of fulfilling their contractual obligations, and consider whether nonperformance has implications beyond the contract that may require further scrutiny. As corporations evaluate their contracts' provisions, they will want to consider:

- any controlling law provisions;
- how force majeure events are defined;
- what performance is excused or delayed;
- whether events beyond force majeure events contributed to any delay or nonperformance;
- whether rights of termination apply and when;
- what mitigation efforts are required; and
- whether and how notice must be given under the circumstances.

Business Interruption Insurance Provisions

Property policies cover physical damage to property and business interruption losses. These policies often cover a policyholder's losses when its operations, or those of vendors, are disrupted. Careful analysis of policy language is necessary. For instance, business interruption coverage is often available, but it is usually linked to "direct physical loss" and/or "property damage" at the policyholder's location, or at a supplier's location in the case of contingent business interruption. Insurers will likely take the view that if a property has been closed for fear of the new coronavirus, but is otherwise habitable, these policy requirements are not satisfied. Depending on the circumstances, the governing law, and the applicable policy's language, they may well be wrong. If a property has been contaminated by an infected person, that will likely constitute direct physical loss. Some policies define physical damage to include loss of use and function. In fact, McCarter's Insurance Recovery Group convinced New Jersey's Appellate Court that physical damage includes loss of access, use, and functionality, even when the policy fails to so define those terms (other state courts agree). *Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co.*, 406 N.J. Super. 524, 968 A.2d 724 (App. Div. 2009). Furthermore, some policies likewise provide coverage when there is an order of civil authority preventing business operations, without regard to any direct physical loss. It is critical that policyholders understand the coverage provided by their insurance contracts, including any applicable sublimits and exclusions, for property damage arising from pathogens, bacteria, viruses, and other disease-causing agents.

Event Cancellation Insurance

Event cancellation policies, broadly speaking, cover policyholders' lost event-related revenue and expenses. These policies typically are triggered by events beyond the policyholders' control, and triggering events are listed in the policies. The policies may extend, depending on their provisions, to communicable diseases, epidemics, and pandemics. They also may cover events that organizers are forced to cancel due to governmental bans, such as those imposed on public gatherings across the country. Most cancellation policies require policyholders to make reasonable attempts to minimize their losses, perhaps by rescheduling the event if feasible. It is essential that policyholders review these contracts carefully to understand the express terms and to confirm the policies are consistent with their reasonable expectations at the time they were marketed and sold to them.

Notice

Notice triggers an insurance company's duty to investigate, and pay as appropriate, a claim or loss. Most insurance policies require the policyholder to give notice "as soon as practicable." A policyholder that fails to give appropriate notice may forfeit some or all of its coverage, for example, costs incurred prior to notice and without an insurer's consent. In most jurisdictions, however, an insurer cannot prevail on a late notice defense unless it can demonstrate it suffered prejudice because of the late notice. A minority of jurisdictions enforce notice requirements as conditions precedent to coverage without requiring any showing of prejudice.

Like insurance contracts, commercial contracts with force majeure provisions often require notice. Parties should determine when notice is required and how it should be given. Compliance with a notice provision is important because failure to provide timely notice can breach a contract and, in the case of an insurance contract, offer an insurer an excuse to seek to avoid or delay its coverage obligations.