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3-25-2020

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Cardozo Arts & Entertainment Law Journal

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Recommended Citation

Wrisley, Andrea, "Who's Going to Pay? Where the Fine Print Matters" (2020). *AEJ Blog*. 233.

<https://larc.cardozo.yu.edu/aelj-blog/233>

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Who's Going to Pay? Where the Fine Print Matters

BY [ANDREA WRISLEY](#)/ ON MARCH 25, 2020



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These past couple of weeks have changed life in the U.S. and around the world drastically: major league sports all over the world have ceased,[\[1\]](#) the State Department placed a Level 4 warning on a record number of countries,[\[2\]](#) most major educational institutions closed their campuses and sent students home.[\[3\]](#) Most significantly, “one in four Americans will soon be under orders to stay mostly indoors” as state governments urge their citizens to practice social distancing in an effort to slow the spread of the virus and save lives.[\[4\]](#) The COVID-19 pandemic and preventative measure are creating an economic blow to most major economies.[\[5\]](#)

In all the chaos, we are left wondering who is going to pay for the cancelled flights, the forgone tickets sales, the remaining dormitory fees, and who will compensate those employees who are not able to work from home. The world is in panic mode, people have surrendered themselves to “prepping”, creating a canned goods and toilet paper shortage in the U.S..[\[6\]](#) Not to mention the shortage this surge in demand has created on essential goods like medical supplies.[\[7\]](#)

Given our country's reliance on global supply chains, we worry about the impact as the pandemic spreads.[\[8\]](#) The Institute of Supply Management reported that coronavirus disrupted close to 75% of supply chains for U.S. companies—citing that manufacturers in China are operating at 50% capacity with 56% of their normal staff.[\[9\]](#) While orders and demands for goods have sky rocketed, production is significantly reduced. This explains why your mom's shipment of toilet paper is on a three-week delay.[\[10\]](#) However, it's not just the wholesale business that is impacted by Coronavirus, every industry whether tech, fashion, legal, or education will be impacted by this pandemic.

So how can companies combat this unexpected strain? The legal industry is buzzing about the implications of *Force Majeure* clauses in contracts. A force majeure clause "operates to relieve one or both parties of some or all of their contractual obligations if an unforeseeable event beyond either party's control prevents or delays full or partial performance of obligations under the contract."[\[11\]](#) The term *force majeure* is interchangeable with the phrase "act of god" in a contract. This is because it typically takes a true act of god, such as a natural disaster: hurricanes, wild fires, floods, earthquakes, volcanic eruptions, tsunamis, etc., for the force majeure clause to be implicated. However, it is important to note that the trigger event could not have been anticipated or guarded against in the contract.[\[12\]](#)

Many businesses are asking themselves if a pandemic like COVID-19 would fall under the force majeure clauses of their contracts: specifically, those with suppliers. As with any contract term, the application of a force majeure clause will depend on the language used in the clause.[\[13\]](#) If the contract has a force majeure clause, "[o]rdinarily, only if the force majeure clause specifically includes the event that actually prevents a party's performance will that party be excused."[\[14\]](#) To determine if a pandemic like this one constitutes a trigger event by the terms of the contract, courts will look for language like "disease," "epidemic," "quarantine," or "acts of government" in the controlling clauses.[\[15\]](#) If the provisions do not have this language, the parties will need to consider if COVID-19 could be encapsulated in terms like "action by government" or "catch-all" language that refers to events "outside the reasonable control of the party affected."[\[16\]](#)

Events that could conceivably constitute a force majeure, have to satisfy the following criteria: "(i) the event must be out beyond the reasonable control of the affected party; (ii) the affected party's ability to perform its obligations under the contract must have been prevented, impeded or hindered by the event; and (iii) the affected party must have taken all reasonable steps to seek to avoid or mitigate the event or its consequences."[\[17\]](#) As with all matters, the force majeure provisions will be considered case-by-case under the precise terms and the specific situation. Courts will interpret force majeure clauses in accordance with their purpose, "which is to limit damages in a case where the reasonable expectation of the parties and the performance of the contract have been frustrated by circumstances beyond the control of the parties."[\[18\]](#)

The concept of force majeure is based on a common law doctrine that arose out of the principle of impossibility of performance on a party's contractual obligation.^[19] If the contract does not specifically define this situation to be a triggering event for the force majeure clause, or if the contract does not have a force majeure clause, the parties could rely on the common law doctrine of impossibility and frustration.^[20] Impossibility excuses a party only when "the means of performance makes performance objectively impossible" and where lack of performance is not occasioned on economic hardship alone.^[21] This doctrine is narrowly applied and many factors will be weighed. The doctrine of frustration will apply if: "(i) the underlying event is not the fault of any party to the contract; (ii) the event or circumstance occurs after the formation of the contract and was not foreseen by the parties; and (iii) it becomes physically or commercially impossible to fulfil the contract, or transforms the obligation to perform into a radically different obligation from that undertaken initially."^[22]

The current laws and restrictions on businesses imposed by their local government will weigh heavily. The "stay indoors" order in California has stopped virtually all non-essential businesses that require their employees to be physically present to complete their jobs. At this point, in many areas of the country businesses and commerce have ceased. For each particular situation following this COVID-19 outbreak, courts will weigh numerous factors. Businesses will be asking themselves: Is delayed performance enough to trigger a force majeure clause? Does the contract require notice? What obligations will be excused? What is the ultimate outcome of the event? Does termination right arise if the force majeure event continues for an extended period of time and what does that mean?

Whether coronavirus is legally a frustrating event depends on the party's individual circumstances and the developing impact of the pandemic. As Mayer Brown best wrote, "[i]f suppliers, subcontractors and contractors want to continue working together in the future, in circumstances where no party is at fault, understanding on both sides will be required. If the shared objective is the resumption of performance as soon as possible, collaboration (underpinned by a sound understanding of the contractual position), rather than confrontational legal battles, may be the way forward."^[23]

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^[1] Gabrielle Fernandez, *Coronavirus Live Updates: NBA, MLB, PGA, and other Sports Around the World Stop Play Amid COVID-19 Outbreak*, CBSSports (Mar. 15, 2020, 3:24 PM) <https://www.cbssports.com/general/news/coronavirus-live-updates-nba-mlb-pga-and-other-sports-around-the-world-stop-play-amid-covid-19-outbreak/live/> . See also, Ben Cohen,

Louise Radnofsky and Natalie Andrews, *How a Doctor, Congressman and NBA Star Shut Down American Sports*, (Mar. 13, 2020, 11:04 A.M.) <https://www.wsj.com/articles/it-started-with-a-congressional-hearing-it-ended-with-the-nbas-shutdown-11584111811>.

[2] U.S. News Staff, *Places You Should Not Visit Right Now*, U.S. News (Mar. 18, 2020) <https://www.usnews.com/news/best-countries/slideshows/places-the-us-government-warns-not-to-travel-right-now>.

[3] Li Zhou, *Harvard's Coronavirus Response Highlights How College Closing are Hurting Low-Income Students*, Vox (Mar. 15, 2020, 08:10 A.M.) <https://www.vox.com/2020/3/15/21179640/harvard-coronavirus-move-out>.

[4] *Coronavirus Live Updates: Stay-at-Home Orders Spread as U.S. Death Toll Passes 200*, N.Y. Times (Mar. 21, 2020) (Last updated 11:10 A.M.) <https://www.nytimes.com/2020/03/21/world/coronavirus-news.html>.

[5] David Uberti, *What Does the Covid-19 Economy Look Like? Chicken Prices Might Hold a Clue*, Wall Street Journal (Mar. 18, 2020, 8:11 A.M.) <https://www.wsj.com/articles/what-does-the-covid-19-economy-look-like-chicken-prices-might-hold-a-clue-11584523802>.

[6] Scottie Andrew, *The Psychology Behind Why Toilet Paper, of All Things, is the Latest Coronavirus Panic Buy*, CNN (Mar. 9, 2020, 5:14 P.M.) <https://www.cnn.com/2020/03/09/health/toilet-paper-shortages-novel-coronavirus-trnd/index.html>.

[7] Andrew Jacobs, Matt Richtel, and Mike Baker, 'At War With No Ammo': Doctors Say Shortage of Protective Gear is Dire, N.Y. Times (Mar. 19, 2020) <https://www.nytimes.com/2020/03/19/health/coronavirus-masks-shortage.html>.

[8] Proskauer Rose, LLP, *The Coronavirus and Force Majeure Clauses*, The Nat'l L. Rev. (Mar. 2, 2020) <https://www.natlawreview.com/article/coronavirus-and-force-majeure-clauses>.

("[A]t least 51,000 (163 Fortune 1000) companies around the world have one or more direct or Tier 1 suppliers in the impacted regions, and at least five million companies (938 Fortune 1000) around the world have one or more Tier 2 suppliers in the impacted region.").

[9] Dion Rabouin, *Coronavirus Has Disrupted Supply Chains for Nearly 75% of U.S. Companies*, Axios (Mar. 11, 2020) <https://www.axios.com/coronavirus-supply-chains-china-46d82a0f-9f52-4229-840a-936822ddef41.html>

[10] Ina Fried, *Manufacturers' Unease grows with Coronavirus Outbreak*, Axios (Mar. 13, 2020) <https://www.axios.com/coronavirus-manufacturer-business-china-b67b91e4-8a18-497f-9536-4ae5945498f1.html>.

[11] Proskauer, *supra*, note 8.

[12] David B. Saxe and Michael Mix, *Contractual Force Majeure Provisions and the Spreading Coronavirus*, the N.Y. L. Journal (Mar. 9, 2020) <https://www.law.com/newyorklawjournal/2020/03/09/contractual-force-majeure-provisions-and-the-spreading-coronavirus/?slreturn=20200215155155> (quoting *Kel Kim v. Central Mkts.*, 70 N.Y.2d 900, 902 (1987)).

[13] Anita Sabine and W. Joseph Anderson, INSIGHT: Coronavirus and Contracts-Force Majeure Redefined (Mar. 12, 2020 04:01AM) <https://news.bloomberglaw.com/corporate-governance/insight-coronavirus-and-contracts-force-majeure-redefined>.

[14] Saxe and Mix, *supra*, note 12. (quoting *Kel Kim*, 70 N.Y.2d at 90).

[15] Saxe and Mix, *supra*, note 12. (contracts will enumerate examples of force majeure events).

[16] COVID-19: Force Majeure Event? Shearman & Sterling (Mar. 12, 2020) <https://www.shearman.com/perspectives/2020/03/covid-19-force-majeure-event>.

[17] Shearman & Sterling, *supra*, note 16.

[18] *Constellation Energy Servs. of N.Y. v. New Water St.*, 146 A.D.3d 557, 558 (1st Dept. 2017)

[19] Saxe and Mix, *supra*, note 12.

[20] The court will look to see if the contract has a force majeure clause, if it doesn't, the court will look at the provisions for breach, termination, or cancellation to establish the controlling clause. The other provisions may not spell out "force majeure" but they will implicate the impossibility or frustration concepts. *See*, Proskauer, *supra*, note 8.

[21] Saxe and Mix, *supra*, note 12. (quoting *Kel Kim*, 70 N.Y.2d at 90 (emphasis added) and 407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp., 23 N.Y.2d 275, 281 (1968) ("[W]here impossibility or difficulty of performance is occasioned only by financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy, performance of a contract is not excused.")).

[22] Shearman & Sterling, *supra*, note 16.

[23] Kwadwo Sarkodie, Geoffrey Y.M. Chan Charles E. Harris, II, and Alejandro Lopez Ortiz, *Coronavirus COVID-19 Construction, Frustration, Force Majeure – What Does Contract Law Say?* Mayer Brown (Mar. 11, 2020) <https://www.mayerbrown.com/en/perspectives-events/publications/2020/03/coronavirus-covid19-construction-frustration-force-majeure-what-does-contract-law-say>.