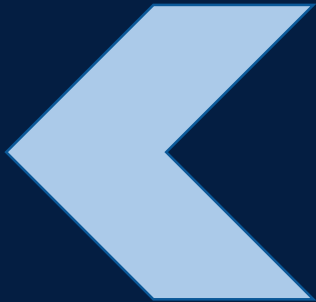


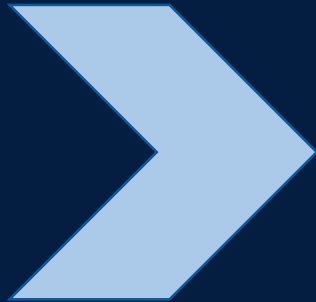
**SHARPENING THE AXE:
FORGING THE TOOLS NEEDED TO OPTIMIZE
YOUR RESPONSE TO THE COVID-19 DISRUPTIONS**

April 14, 2020

Sharpening the Axe



“Give me six hours to chop down a tree and I will spend the first four sharpening the axe.”



-Abraham Lincoln

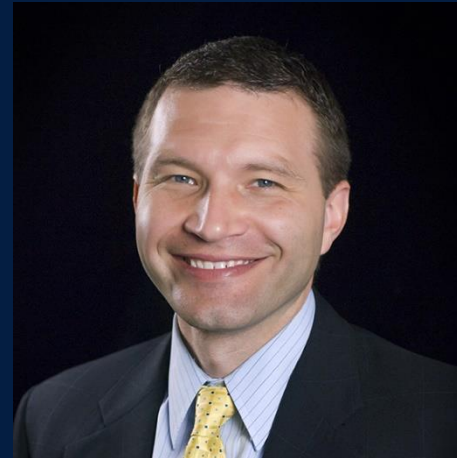
OUR PANEL OF HONERS



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AGENDA

- Brief overview of likely disputes
- Review of theories relating to excusing non-performance due to COVID-19 disruption
- Discussion of insurance which may be relied upon
- Critical issues in evaluating the viability of excuses
- Action steps to take in real time to best address excuses in re-negotiating or litigating

SCENARIO ONE: BRICKS & MORTAR

Cogs Unlimited (“CU”) manufactures a wide range of high performance, high-tech cogs for a variety of product manufacturers. It leases its manufacturing and distribution spaces (respectively in Westchester County, New York, and Davenport, Iowa) under 15-year leases negotiated and signed at least five years ago.

Since March 1, CU has received notices from seven large customers cancelling monthly orders of cogs; of these, four are for precision cogs made of high-tech alloys with high profit margins. CU’s marketing force hustled and found replacement contracts for 50% of the lost volume, but for much less-profitable products. CU has also received notice from Total Tooling (“TT”), the supplier of critical wear used in its manufacturing lines, that because of limitations in TT’s supply chain and because of the demands of other customers, TT will be unable to supply replacement tooling after May 15 until further notice. CU’s landlords have refused to adjust the rent payments owed for either property.

SCENARIO TWO: SERVICE INDUSTRY

- Dodson & Fogg is a full-service firm located in the (fictional) state of East Virginia, with a significant business, product liability, and tort litigation practice, and a strong transactional team.
- A team of 7 litigators from D&F were to begin a lengthy patent/ trade secret trial in Federal Court on May 4. In addition, since August 2019, two senior partners, three junior partners, four senior associates, and five junior associates have been negotiating the acquisition of one of D&F's client's largest competitors; for months, the closing has been set for May 26. Because of this outlook, on February 15, 2020, D&F signed a lease extension adding three floors to its office space, and at the same time, told its equity partners to plan for a Q2 tax draw double the usual one.
- One March 30, the Governor of East Virginia issued a stay-home order, including prohibiting gatherings of more than three people. On April 1, the Chief Judge for the Western District of East Virginia issued an order cancelling all civil trials until further notice.

SCENARIO THREE: MIXED PURPOSE RETAIL

- Springfield County has issued a COVID-19 stay-home order directing the closure of all "non-essential" businesses. The order contains enumerated exceptions for businesses that are deemed to be "essential."
- Buzz Bait is a mixed-purpose retail store that sells guns, ammunition, fishing gear, boats, recreational vehicles, clothing, and sporting goods. Super Store sells groceries, clothing, electronics, crafting supplies, guns, ammunition, and sporting goods.
- Buzz Bait received a notice of violation of the county stay-home order and was ordered to close its doors. Buzz Bait administratively appealed, and was allowed to remain open only for purposes of gun and ammunition sales, which were deemed to be "essential." Super Store remains open to sell any of its goods.

COVID-19 DISRUPTIONS

- Purchase and sales agreements
- Executory agreements
- Capital expenditures
- Supply chain disruptions
 - Upstream
 - Downstream
- Interruptions in utilities/supplies/food chain
- Leases/mortgages
- Construction projects and agreements
- Financing
- Service contracts of all sorts
- Bankruptcy (preferably, avoiding)

SYSTEM FOR ANALYSIS

- **Source of Obligation** – A contract is a promise the law will let you to sue to enforce. A statute is a promise the legislature created you can sue to enforce. The common law are societal promises you can sue to enforce.
- **Enforcement** is by appeal to government – the judiciary – to uphold the rights.
 - Not fair for judiciary (government) to enforce/not enforce.
- **Burden of proof** is on entity seeking to avoid performance.

SYSTEM FOR ANALYSIS

Excuses to Performance

- The Virus or the Government's Actions Stopped Me/Did Not Stop You
 - (a) From doing what the contract says?
 - (b) By making it impossible to perform?
 - (c) By making it impractical to perform?
 - (d) By frustrating the Purpose of performing?

SOURCE OF EXCUSE

The Force Majeure Clause

- What does the contract say?

FORCE MAJEURE ELEMENTS: OVERVIEW

- Purpose of force majeure: to relieve party from contractual duties when its performance prevented by source beyond its control or when contract's purpose has been frustrated

Beardslee v. Inflection Energy, LLC, 904 F.Supp.2d 213 (N.D.N.Y. 2012)

Contractual language is critical!

- The cited occurrence must fall within the “force majeure” events under the contract
- Even if the occurrence is an enumerated event within the contract
 - The event cannot have been reasonably foreseen
 - The party seeking application must show it cannot mitigate the potential nonperformance

FORESEEABILITY

- Nonperformance is not excused where the cited event was expected or a foreseeable risk
 - Time for judging: when the contract was executed
- Courts will look in context: what were the basic assumptions on which the contract was made
- Impracticability or economic hardship – rather than impossibility – typically does not warrant application
 - That performance would be “economically inadvisable” will not suffice, even if the event was a force majeure event
OWBR LLC v. Clear Channel Communications, Inc., 266 F. Supp.2d 1214 (D. Haw. 2003)
 - Thus, unextreme economic hardship cannot constitute force majeure
Vici Racing LLC v. T-Mobile USA, Inc., 763 F.3d 273 (3rd Cir. 2014)

SAMPLE CONTRACTUAL FORCE MAJEURE CLAUSE

Neither party shall be liable for damages for nonperformance or breach of this Agreement if, by reason of an act of God or act of war, act of terrorism, riot, fire, or any governmental order, rule or regulation prohibiting performance (a “Force Majeure Event”), it shall be delayed in, or prevented from, furnishing any materials, equipment, facilities, services, to be furnished by it under this Agreement, or otherwise complying with the terms of this Agreement as a result of a Force Majeure Event, provided that the party invoking this provision takes commercially reasonable steps to mitigate delays and as soon as the cause of delay is removed, such party shall proceed diligently with its performance under the Agreement. The party whose performance is prevented by a Force Majeure Event must provide written notice to the other party as soon as is reasonably practicable, and its time for performance of the affected obligation shall be extended by the time of the delay caused by the Force Majeure Event. Neither party shall be excused from any obligations not directly affected by a Force Majeure Event, and if the Force Majeure Event is caused by a party’s failure to comply with any of its obligations under this Agreement or by such party’s negligence or omission, there shall be no relief for such party from any of its obligations under this Agreement.

SOURCE OF EXCUSE

The Force Majeure Clause

- What does the contract say?
 - Look at the scope of types of events
 - Pandemic, epidemic, illness?
 - Acts of God?
 - Act of war?
 - Fires? Floods?
 - Does it even mention government action?
 - If so, what kind?

SOURCE OF EXCUSE

The Force Majeure Clause

- Does government action of the current type apply?

EXAMPLES OF GOVERNMENT ACTIONS

- Which one is sufficient to trigger?
 - Jan. 31st – Administration “order” suspended entry into the United States by any foreign nationals who had traveled to China in the past 14 days.
 - March 4th – California Governor proclaimed a “state of emergency” in California.
 - March 7th – NY declares state of disaster.
 - March 11th – The World Health Organization declared the COVID-19 a global pandemic.
 - March 12th – NYC Mayor declares state of emergency.
 - March 14th – Administration declares a national emergency.
 - March 15th – CDC “recommends” no gatherings of 50 or more. NYC Mayor “advises” practice social distancing. 33 States close public schools.
 - March 23rd – Washington, Oregon, California, Louisiana, Illinois, Ohio, New York, Massachusetts and New Jersey have issued “state-at-home orders.”
 - March 28th – CDC “urges” NY, NJ, and Conn. “refrain” from non-essential travel for 14 days.

SOURCE OF EXCUSE

The Force Majeure Clause

- Does government action of the current type apply?
- If so:
 - Is the business Essential/Non-essential?
 - Is the affected part of the business essential/non-essential?
 - Even if essential, are there complementary business or “supply-chain” type businesses that are non-essential?

SOURCE OF EXCUSE

The Force Majeure Clause

- What does the contract say?
 - Look at the scope of types of events.
 - Pandemic, epidemic, illness?
 - Acts of God?
 - Act of war?
 - Fires? Floods?
 - Does it even mention government action?
 - If so, what kind?
 - Scope of relief available
 - Requirements to secure relief

SOURCE OF EXCUSE

Outside the contract

- Impossibility = Supervening impossibility
 - Many courts look to Restatement of Contracts § 261 for guidance
 - Has the government action/virus changed a “basic assumption” of the contracting parties? Courts surprisingly unpredictable in fact-specific “basic assumption” inquiry
- Impracticability
 - Split in jurisdictions regarding application
- Commercial Frustration

Statutes

SOURCE OF EXCUSE: ARTICLE 2 (GOODS)

- Contract for Sale of Goods – Article 2 of the Uniform Commercial Code (UCC)
- UCC replaces the requirement of objective impossibility with a standard of impracticability
Nora Springs Co-op. Co. v. Brandau, 247 N.W.2d 744 (Iowa 1976)
- Excused for nonperformance “if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made” *UCC 2-615*
 - Applies if one party doesn’t assume a greater liability in the contract
- Delay in delivery, or non-delivery, in whole or in part
 - If in part, requires a fair and reasonable allocation between regular customers and contract customers
 - Requires seasonable notification of delay or non-delivery
- Consider trade usage, course of dealings, course of performance

SOURCE OF EXCUSE: ARTICLE 2 (GOODS)

Case Law

- Increased cost alone does not excuse performance unless rise in cost is due to an unforeseen contingency which alters essential nature of performance.
UCC 2-615, comment 4
 - Severe shortage of raw materials or supplies due to a contingency such as war, embargo, local crop failure, *unforeseen shutdown of major sources of supply*, or the like which causes a marked increase in cost or prevents the seller from securing necessary supplies is contemplated by UCC 2-615
- Don't continue to accept orders if you have a raw material shortage.
Roth Steel Prod. v. Sharon Steel Corp., 705 F.2d 134 (6th Cir. 1983).
- Damages not limited to quantity that should have been fairly and reasonably allocated.
Cosden Oil & Chemical Co. v. Karl O. Helm Aktiengesellschaft, 736 F.2d 1064 (5th Cir. 1984).
- May provide an excuse for the buyer as well. *UCC 2-615, comment 9. General Elec. Supply Co., a Div. of General Elec. Co. v. Gulf Electroquip, Inc.*, 857 S.W.2d 591 (Tex. App. 1993).

SOURCE OF EXCUSE

Outside the contract

- Impossibility = Supervening impossibility
- Impracticability
 - Split in jurisdictions regarding application.
- Commercial Frustration

Statutes

Regulations

- Performance may be made impracticable because of having to comply with a supervening government regulation
 - But not where the court concludes that regulatory changes are foreseeable as a matter of law. *Drummond Coal Sales, Inc. v. Kinder Morgan Operating LP “C”*, 2017 WL 3149442, *5 (N.D. Ala. 2017)

SOURCE OF EXCUSE

Executive/Government Orders

- What qualifies?
 - CDC Recommendations?
 - WHO Declarations?
 - State governor orders?
- Change in law must be unexpected.
- Not all Executive Directives may provide a force majeure excuse
 - *Aukema v. Chesapeake Appalachia, LLC*, 904 F.Supp.2d 199 (N.D.N.Y. 2012)

MITIGATION

- Excusing obligations typically requires efforts to mitigate
 - But, this varies depending on contract language and among states
- Typical scope of duty
 - Party must show that despite the use of skill, diligence, and good faith on its part, performance became impossible
 - In some states, court may accept unreasonably expensive
- If you're in a mitigation state, document steps being taken

MITIGATION

- Mitigation Issues for Business Interruption Insurance

IMPOSSIBILITY, IMPRACTICABILITY, FRUSTRATION OF PURPOSE...LET'S CALL THE WHOLE THING OFF

Commercial Frustration/Frustration of purpose

- Goes more to the heart of the exchange:
- The contract defense of frustration requires that:
 - (1) the parties' principal purposes in making the contract is frustrated
 - (2) without that party's fault
 - (3) by the occurrence of an event, the non-occurrence of which was a basic assumption on which the contract was made....” *Chicago, M., St. P. & P. R. Co. v. Chicago & N. W. Transp. Co.*, 263 N.W.2d 189, 192 (1978)

IMPOSSIBILITY, IMPRACTICABILITY, FRUSTRATION OF PURPOSE...LET'S CALL THE WHOLE THING OFF

Commercial Frustration/Frustration of purpose

- Frustration is not a form of impossibility of performance
- Instead, relates to the consideration for performance
- Under the frustration doctrine, performance remains possible, but is excused when the fortuitous event supervenes to cause a failure of the consideration or a practically total destruction of the expected value of the performance

IMPOSSIBILITY, IMPRACTICABILITY, FRUSTRATION OF PURPOSE...LET'S CALL THE WHOLE THING OFF

Commercially frustration/Frustration of purpose

- “That the frustrating event need not be unforeseeable
- “Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the nonoccurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary

Chicago, M., St. P. & P. R. Co. v. Chicago & N. W. Transp. Co.,
263 N.W.2d 189, 192 (1978)

CAUSATION...IT'S ALL ABOUT THE FACTS

Causation

- Fact-specific
 - “Application of the defense of impossibility of performance is a fact-specific inquiry...”
 - “[T]he doctrine of impossibility of performance to those factual situations, too numerous to catalog, where the purposes for which the contract was made have, on one side, become impossible to perform.”

Kemel v. Kenco/the Oaks at Boca Raton, LP, 2008 WL 2245831, *3 (S.D. Fla. 2008), aff’d, 321 Fed. Appx. 807 (11th Cir. 2008)

CAUSATION...IT'S ALL ABOUT THE FACTS

- Causation
- What is likely *not* enough?
 - “[C]ourts are reluctant to excuse performance that is not impossible but merely ... profitless and expensive—that is, it must be positively unjust to hold the parties bound.”
Int'l Ship Repair & Marine Services, Inc. v. Barge B. 215, 418 F. Supp. 3d 1051, 1057 (M.D. Fla. 2019)
- So what is enough?
- Likely to be a *major* battleground going forward

PARTIAL FORCE MAJEURE/IMPOSSIBILITY

- What if the “uncontrollable” event does not prevent complete performance, but only partial compliance?
 - Supply chain for some components (but not all) blocked, allowing only partial delivery of finished product
 - Partial interruption in services needed to comply with contract.
 - Trials in some courts – but not all – suspended
 - Ability to sell some (but not all) products in Buzz Bait, leading to inability to maintain rent payments and levels of employment agreed to with collective bargaining groups

PARTIAL FORCE MAJEURE/IMPOSSIBILITY

Partial Force Majeure

- Recognized in *dicta* in a few cases
- Coal supplier failed to supply coal to utility; claimed failure was result of “force majeure” event
 - Despite there being two events -- labor stoppage and geological problems – supplier only gave notice of labor problems and only submitted proof at trial about the labor stoppage
- At trial, unsuccessfully argued labor stoppage as the cause; trial court found, instead, that that the geological issues were the primary cause

Aquila, Inc. v. C.W. Mining, 545 F.3d 1258 (10th Cir. 2008)

PARTIAL FORCE MAJEURE/IMPOSSIBILITY

- On appeal, then-Judge Gorsuch wrote:
 - Language of contract allowed reliance upon partial force majeure to the extent that that event caused the failure to perform
 - **But**, supplier's exclusive reliance at trial upon the labor stoppage as the force majeure event precluded its efforts on appeal to cite the geological issues as a partial force majeure event
 - Coupled with the lack of force majeure notice regarding the geological issues, the supplier's efforts were unavailing

Aquila, Inc. v. C.W. Mining, 545 F.3d 1258 (10th Cir. 2008)

PARTIAL FORCE MAJEURE/IMPOSSIBILITY

Lessons

- Review contract language
- Draft notice to cover all possible force majeure events that cause the inability to perform
 - Including partial causes
- Do not be myopic in then establishing, arguing, and (if necessary) proving at trial that the force majeure event was a cause
 - Be mindful of all supported causes
- And be constantly mindful of gathering and supporting proof of causation between the event and the inability to perform

BUSINESS INTERRUPTION INSURANCE

Common insuring clause language:

- When the Declarations show that you have coverage for Business Income and Extra Expense, you may extend that insurance to apply to the actual loss of Business Income you sustain and reasonable and necessary Extra Expense you incur due to the “suspension” of your “operations” during the “period of restoration”
- The “suspension” must be caused by direct physical loss or damage at the premises of a “dependent property,” caused by or resulting from a Covered Cause of Loss

BUSINESS INTERRUPTION INSURANCE

Some businesses may also have “Contingent Business Interruption” coverage

- Designed to cover the insured business's loss of income resulting from the loss, damage, or destruction of property owned by others, particularly **direct suppliers** of goods or services and potentially **direct customers/recipients/distributors**
- For this coverage to apply, the supplier's/customer's loss must be of the type that would be covered by the policy issued to the insured business

BUSINESS INTERRUPTION INSURANCE: CAUSATION AND COVERAGE ISSUES.

- Expect litigation related to whether business interruption insurance will pay losses for COVID-19-related claims. Two significant areas for litigation:
 - “Direct physical loss or damage” is the language typically used in the insuring agreement
 - Many policies exclude coverage for losses caused by “virus”
- However, many policies identify acts of a civil authority as a covered cause of loss, or do not exclude it
- Insurance coverage is very much a creature of state law - there are significant state-specific variables regarding, for example, the doctrine of “concurrent causation”

LEARNING FROM THE PAST

Past outbreaks

- 1918 Influenza, smallpox, other turn of the century health care through the late 1920s
- SARS
- Pandemic foreseeable therefore contracting parties allocated risk
 - Who had obligation to foresee? Is pandemic one of the contingencies that could have been contract for?

September 11th

- Music industry conference at Hawaii resort 5 months after 9/11. Outcome: “From an economic standpoint, it was certainly unwise, or economically inadvisable, ...to continue with the...event. Nonetheless, a force majeure clause does not excuse performance for economic inadvisability, even when the economic conditions are the product of a force majeure event.”

LEARNING FROM THE PAST

Landlord-Tenant

- Lease for commercial space – Tenant is ready, willing, and able to pay rent, but Landlord is prevented from delivering the space because of government action.
- Alternatively, Landlord has delivered the space but it is government action that prevents the tenant from using the space?
- Who wins?

Oil & Gas

LEARNING FROM THE PAST

- Insurance coverage disputes - Lessons from Hurricane Katrina
- Legislative action to mandate insurance coverage, even retrospectively, is increasingly within the realm of plausibility
- Actions by state Attorneys General could sway the coverage outcomes
- Insurance coverage is a state law creation, and the landscape varies significantly - there are many ways this could play out around the U.S.

CHECKLIST

Building Your Evidence in Real Time

- What is the likely event that will be the subject of the argument?
 - How many government, NGO, etc. actions can you find/eliminate to support your defense/claim?
 - For each, is the business or task “essential” or “nonessential,” and why?
 - If facially “nonessential,” what steps can/should be taken to redesignate?
 - Drill deeply – not just “Covid-19,” but what about today’s events?
- Is/are the event(s) within the language of your agreement(s)?
 - What alternate legal theories may apply, and in what jurisdictions?
 - Is this an Article 2 sale of goods?

CHECKLIST

Building Your Evidence in Real Time

- What is the evidence regarding whether that event and impact was foreseeable at the time of contracting?
- What do you believe are the impacts on you or your counterparty?
 - Look beyond first impacts; consider longer-term events.
 - Are there multiple events that can/should be cited?
 - Is this “just lost profits?”
 - What facts support/negate that it goes beyond that?
 - What if the loss is “positively unjust?”

CHECKLIST

Building your Evidence in Real Time

- What notice has been given/needs to be given? Was it timely?
- Did the event(s) prevent performance? Or just make it more costly?
 - What is the evidence supporting or rebutting that
- What is the evidence for specific causation?
 - Contemporaneous proof.
- What have you done (or has your counterparty done) to mitigate the impact?
- Is there first party insurance available?

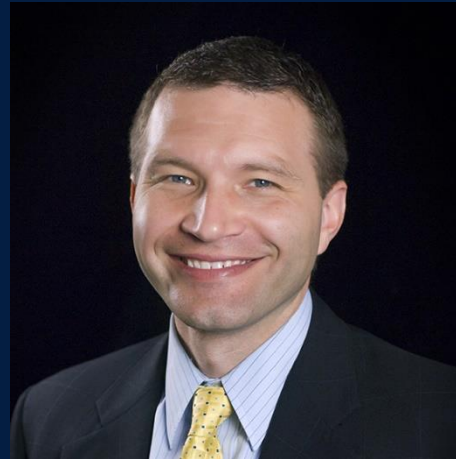
This is not “one and done” – as the pandemic progresses, and as governmental responses change, the analysis must be updated.



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