The Legal Impact of the Coronavirus On Your Business

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Porzio Client Alert

Over the last few weeks, our business clients have been raising questions regarding the legal impact of the Coronavirus: How does the Coronavirus impact the company's contracts? Can the company invoke a force majeure clause and/or utilize its business interruption insurance to cover any losses? Can damages be recovered for terminated contracts?

An illustration of this issue would be a performance contract for an event. ABC Company is holding a large marketing event at a conference center at a major hotel. There are several contracts involved, including ABC's contract with the marketing company and the hotel. The marketing company has contracts and commitments with its vendors, speakers and attendees. The hotel has contracts with its vendors and plans to increase staffing for the event. What if ABC Company decides to cancel the event because of Coronavirus fears on the part of suppliers and attendees? The trickle-down effect can create legal consequences, from breach of contract claims to demands for payment of damages.

So how can your business anticipate these issues? Businesses often allocate the risk of unanticipated business interruptions through their contracts and insurance policies. Businesses can anticipate what their contracts and other obligations require and what protections are available should the need arise.

Force Majeure Clauses: Generally, a force majeure clause in a contract excuses a party's performance of its obligations when certain circumstances beyond that party's control arise, making performance of the contract commercially impracticable, illegal or otherwise impossible to carry out. Natural disasters and war are examples of events falling within this clause. A careful review of your company's contracts to determine whether they include force majeure clauses would be prudent; however, note that not all force majeure clauses are alike. After 911 and Superstorm Sandy, the drafting of a force majeure clause has taken on a heightened level of scrutiny. New Jersey Courts (following the *Marchak v. Claridge Commons, Inc*. 1993 ruling) construe force majeure clauses in light of the contractual terms, the surrounding circumstances and the purpose of the contract. Typically, force majeure clauses refer to an event as an "Act of God" and may include the words "disease", "epidemic" or "pandemic"; however, additional terminology has been historically included whereby the kinds of impossibility that excuse the performance under the contract in many instances are caused by human beings who could not foresee the misfortune.

New Jersey courts have recognized that force majeure clauses may not be included in every contract. As established by the Restatement (Second) of Contracts and as cited in the 2002 *M.J. Paquet, Inc. v. N.J. Dep't of Transportation* case, courts have looked to the totality of the circumstances if performance becomes impracticable as a result of a supervening event. Courts may also give a narrow interpretation to a force majeure clause. Excusing performance may become a subjective analysis: While the company's force majeure clause may include words like "disease", adverse parties may contend that the party's performance is not excused due to the Coronavirus' potential and unknown impact (if the business is solely in the United States). If your business is solely in China or has contracts with business operations in China, then excused performance based on health concerns may be more plausible.

Insurance: A careful review of your company's insurance policy may disclose insurance that would provide coverage during the Coronavirus outbreak. The first examination of coverage should be the company's business interruption insurance. This coverage typically provides coverage if there is a direct physical loss such as fire, flood or earthquake that results in partial or complete interruption of the business of the insured. With respect to the Coronavirus, a direct physical loss may not be readily apparent. However, there may be situations that could trigger a physical loss such as a factory outbreak or other workplace shutdown due to the workforce being contaminated. Another scenario may be the Coronavirus-related shutdown of a supplier that affects your company's operations. This scenario could fall under the definition of a "Dependent Property" insurance claim, which is generally defined in the insurance industry as "insurance that pays for the loss of income or increase in expenses resulting from damage from a covered cause of loss to the premises of another organization on which the insured depends, such as a key supplier or customer."

Additional sources of coverage could relate to coverages triggered by the actions of civil or military authority. If, for example, access to property or services is impeded by an order of a civil or military authority, there is a potential claim for recovery.

Recommended Steps: If your business operation is faced with a potential breach of contract due to the Coronavirus or is contemplating breaching a contract due to this pandemic, then consider the following:

1. Evaluate Contracts: Evaluate the impact the Coronavirus may have on your business and the ability to perform under its contracts. Consider the other party's obligations and the impact of this outbreak on its performance. Is the contract impractical or otherwise impossible to perform? Please note that decreased performance (such as a decrease in attendance at a conference) may not be a sufficient basis to invoke a force majeure clause as it may not be construed by the adverse party as an unforeseeable event.

2. Evaluate Insurance Policies: Determine whether you have business interruption insurance, and if not, contact your insurance agent to determine the best insurance coverage options.

3. Continue to Monitor: As the Coronavirus outbreak evolves, additional U.S. government and WHO declarations may require additional restrictions on travel or force event cancellations, thus making it more plausible to invoke a force majeure termination. In addition, depending on the state(s) in which your business operates or conducts business, there may be a declared state of emergency.

4. Record Keeping: Keep detailed records of the factors leading up to the interruption of your business and the resulting loss in revenue and other costs.

5. Legal Review: Each contract will be drafted differently and may or may not contain a force majeure clause or other applicable language which may excuse performance and/or provide a means for recovering relief. Each contract may have a notice provision or other obligations that need to be followed in order to compel performance or mitigate damages should the need arise.

As you evaluate your agreements and consider the above steps for each relevant contract, we can assist in providing a more detailed review of your contracts and insurance policies to determine the best course of action to mitigate risk and possibly recover damages. Early legal evaluation may also result in a less costly outcome down the road.