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FORCE MAJEURE – THE BIGGEST BUZZ TERM OF LITIGATION IN A COVID-19 WORLD

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In the coming months, many firms will grapple with contracts that have now become impractical or impossible to perform. One question is likely to arise repeatedly: Does an unexpected event like the COVID-19 pandemic operate as a release from my contract? Or, conversely, can my business hold another party to a contract it is now trying to escape? In many states, including Texas, the answer will most often depend both upon the language of the contract itself, and upon whether the object of the contract has become truly impossible to perform.

Force Majeure

Force Majeure — literally French for "superior strength" — can operate as a contractual release when unforeseen circumstances prevent a party from fulfilling a contract. Texas law on *force majeure* clauses is nuanced and well-developed. Texas appellate courts have ruled that "[t]he scope and effect of a '*force majeure*' clause depends on the specific contract language, and not on any traditional definition of the term." Put another way, *force majeure* is now "a descriptive phrase without much inherent substance" under the common law. *Sun Operating Ltd. P'Ship v. Holt*, 984 S.W.2d 277, 283 (Tex. App.—Amarillo 1988, pet. denied). "Indeed, its scope and application, for the most part, is utterly dependent upon the terms of the contract in which it appears." *Id*.

Accordingly, "when the parties have themselves defined the contours of *force majeure* in their agreement, those contours dictate the application, effect, and scope of the *force majeure* provision and

reviewing courts 'are not at liberty to rewrite the contract or interpret it in a manner which the parties never intended.'" *Allegiance Hillview, L.P. v. Range Texas Prod., LLC*, 347 S.W3d 855, 865 (Tex. App.—Fort Worth 2011, no pet.), quoting *Sun Operating Ltd.*, 984 S.W.2d at 283. *See also Zurich Am. Ins. Co. v. Hunt Petroleum (AEC), Inc.*, 157 S.W.3d 462, 466 (Tex. App.—Houston [14th Dist.] 2004, no pet.) ("Regardless of its historical underpinnings, the scope and application of a *force majeure* clause depend on the terms of the contract").

In keeping with its commitment to honoring contractual language, Texas law requires the exercise of reasonable diligence prior to invocation of a *force majeure* clause *only* when the underlying contract expressly dictates such a showing. *Sun Operating*, 984 S.W.2d at 283-84. In the absence of such an express contractual clause "requiring the lessee to 'exercise due diligence and take all reasonable steps to avoid, remove and overcome the effects of force majeure," Texas courts will "choose not to rewrite the contract by interjecting such a duty." *Id*.

When "reasonable diligence" is required by contract, Texas law defines it as "such diligence that an ordinarily prudent and diligent person would exercise under similar circumstances." *El Paso Field Servs. L.P. v. Mastec N. Am., Inc.*, 389 S.W.3d 802, 808-09 (Tex. 2012) (internal citations omitted). This is "usually a question of fact." *Id*. The Texas Supreme Court has acknowledged that this term is "incapable of exact definition," and "must be determined by the circumstances of each case." *Id*. However, the parties are free to give it a "technical or special meaning" if they do so clearly in the text of the clause. *Id*.

Any *inherent* meaning for a *force majeure* clause under Texas common law is thus quite limited—what matters is the parties' expressed intent. In construing that intent, however, some general principles govern. When parties adopt a standard *force majeure* clause, Texas law presumes they usually intend to excuse contractual performance only when the intervening obstacle "constituted an event beyond their reasonable control." *Hydrocarbon Mgmt., Inc. v. Tracker Exploration, Inc.*, 861 S.W.2d 427, 435-36 (Tex. App.—Amarillo 1993, no writ). The fact that performance has become unprofitable, or even economically ruinous, does not, by itself, qualify under this standard—because "an economic downturn in the market for a product is not such an unforeseeable occurrence[.]" *Valero Transmission Co. v. Mitchell Energy Corp.*, 743 S.W.2d 658, 663 (Tex. App.—Houston [1st Dist.] 1987, no writ). *See also Measday v. Kwik-Kopy Corp.*, 713 F.2d 118, (5th Cir. 1983) (economic loss not sufficient grounds to repudiate contract).

How do these criteria apply to contracts rendered unworkable by the impact of COVID-19? Unsurprisingly, the answer is complex. If the *force majeure* clause expressly references pandemics, pathogens, quarantines, or epidemics, the party seeking to invoke it should be bullish on its prospects. References to governmental action, national emergencies, labor stoppages, military interventions, or supply-chain problems may also be helpful—especially given current government orders to close or limit businesses and/or stay at home. In the absence of such language, expect to focus on the meaning of phrases like "act of God" contained in most *force majeure* clauses. Precedent reflecting on the meaning of this phrase in a situation like the COVID-19 epidemic is sparse, however. Certainly there is a good case that this is an unforeseeable event, and thus within the realm of the "act of God" catchall phrase. On the other hand, this is not the first epidemic in human history, its ultimate human toll is

unknown, and its secondary economic impacts may seem less impressive to courts when cases originating today reach their apex in two years.

A typical *force majeure* clause might read as follows: "Should performance of any obligation . . . become illegal or impossible by reason of fire, flood, act of God, governmental authority, labor disputes, war or any other cause not enumerated herein but which is beyond the reasonable control of the Party whose performance is affected, then the performance of any such obligation is suspended during the period of, and to the extent of, such prevention or hindrance, provided the affected Party provides reasonable notice of the event of *force majeure* and exercises reasonable diligence to remove the cause of *force majeure*."

Meanwhile, the Texas Pattern Jury Charges on General Negligence and Intentional Personal Torts state that "An occurrence is caused by an act of God if it is caused directly and exclusively by the violence of nature, without human intervention or cause, and could not have been prevented by reasonable foresight or care." From this one can surmise the scope of exercise for a properly drafted *force majeure* clause — it can be invoked to the extent non-performance was caused directly and exclusively by the intervening incident, which was not caused by the actions of any person, and which could not have been prevented by reasonable precaution.

Critically, the historic impact of a calamitous event, by itself, does not guarantee that courts will find that a particular *force majeure* clause encompasses that event. This is true in Texas and in other jurisdictions. Litigation in federal court in the months following the 9/11 attacks makes this clear. In *OWBR, LLC v. Clear Channel Commc'ns*, 266 F. Supp.2d. 1214, 1223 (D. Haw. 2003), Clear Channel had booked a large Hawaiian resort for a music industry conference scheduled approximately five months after September 11, 2001. The district court recognized that the circumstances imposed severe economic hardship on Clear Channel, but nonetheless held that the *force majeure* clause in the parties' contract could not excuse performance:

From an economic standpoint, it was certainly unwise, or economically inadvisable, for Defendants to continue with the Power Jam 2002 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.

Id. The court added that:

[T]o excuse a party's performance under a *force majeure* clause ad infinitum when an act of terrorism affects the American populace would render contracts meaningless in the present age, where terrorism could conceivably threaten our nation for the foreseeable future.

The court did allow that:

[H]ad the Power Jam 2002 event been scheduled for the weeks immediately following September 11, Defendants' argument . . . would be much stronger. However, five months following September 11, when

there was no specific terrorist threat to air travel . . . Defendants cannot escape performance under the Agreement.

Id. Needless to say, this is a fuzzy line in the sand, and the specific details and timing of a dispute arising in the context of COVID-19 will be important.

Prior cases can provide some firmer guidance in Texas litigation, at least in some contexts. A Texas appellate court affirmed enforcement of the *force majeure* provision in a natural-gas supply contract when hurricanes destroyed gas-production platforms and pipelines. *Virginia Power Energy Mktg., Inc. v. Apache Corp*., 297 S.W.3d 397, 403 (Tex. App.—Houston [14th Dist.] 2009, pet. denied). When the Texas Railroad Commission issued shut-in orders that precluded the production of gas from a site, another Texas appellate court excused performance under a mineral lease pursuant to a *force majeure* clause that expressly included failure to comply caused by Federal or State law or regulation. *Frost Nat'l Bank v. Matthews*, 713 S.W.2d 365, 368 (Tex. App.—Texarkana 1986, writ ref'd n.r.e.); *but see Hydrocarbon Mgmt*., 861 S.W.2d at 436-37 (*force majeure* clause was inapplicable because defendant's failure to comply with a Texas Railroad Commission regulation, resulting in shut-in order that prevented performance under oil and gas lease, was found to be "within the reasonable control" of defendant).

Similar precedent governs most other jurisdictions. Some states, like New Mexico, had little precedent construing *force majeure* clauses until relatively recently; others, like New York, have extensive case law on this topic. The outcome is similar in most states, however. *See, e.g., Maralex Res., Inc. v. Gilbreath*, 76 P.3d 626 (N.M. 2003) (New Mexico Supreme Court ruled that "what types of events constitute *force majeure* depends on the specific language included in the clause."); *Aukema v. Chesapeake Appalachia*, 904 F. Supp. 2d 199 (N.D.N.Y. 2012). *Aukema* is an especially stark example of the limits of the common *force majeure* clause. In *Aukema*, the district court ruled that a New York law banning hydraulic fracturing could not stay the expiration of gas leases under a *force majeure* clause. While the new law made it commercially impracticable to profitably drill the leased land, it was not *impossible* to do so using traditional drilling techniques. Since the contract did not specify that an inability to specifically and profitably use hydraulic fracturing was a *force majeure* event, Chesapeake could not invoke the clause.

When attempting to enforce or evade a *force majeure* clause, it is critical to pay special attention to any notice provisions it contains. Many clauses require reasonable notice, within a specified timeframe after the *force majeure* event—for example, a clause stating that a party "shall give immediate notice thereof to the other Party." *Advanced Seismic Tech., Inc. v. M/V Fortitude*, 326 F.Supp.3d 330, 336- 37 (S.D. Tex. 2018). When a contract contains such a clause, courts have ruled that it precludes reliance on a *force majeure* clause. *Id*. Here, it may be difficult to conclusively determine when the *force majeure* event occurred. There are many benchmarks that could be used — declarations by the WHO, CDC, federal government, state government, local governments; the closing of critical institutions and banning of gatherings of persons; the critical mass of COVID-19 cases; the issuance of stay-at-home orders. One should expect these points to be hotly litigated in any contest over the invocation of a *force majeure* clause.

Impossibility of Performance

In the absence of an effective and timely invoked *force majeure* clause, a party breaching a contract may be able to use the common law defense of "impossibility of performance." Texas common law is informed by the Restatement (Second of Contracts) Section 261: "Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary." *SeeCentex Corp. v. Dalton,* 840 S.W.2d 952, 954 (Tex. 1992); *Tractebel Energy Mktg, Inc. v. E.I. Dupont de Nemours & Co.*, 118 S.W.3d 60, 64 n.6 (Tex. App.—Houston [14th Dist.] 2003, pet. denied). While "[f]orseeability is one factor used to decide which party assumed the risk of supervening impossibility . . . the foreseeability factor has, however, gradually decreased in importance." *Centex Corp.*, 840 S.W.2d at 954.

For deliveries of goods, Texas has enacted the Uniform Commercial Code, which has a similar provision: "Delay in delivery or non-delivery in whole or part by a seller who complies with Subdivisions (2) and (3) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made." Tex. Bus. & Comm. Code § 2.615(1). Subdivision 3 of this Section requires seasonable notice of non-delivery; while subdivision 2 requires allocation of delivery amongst customers where the seller's capacity to perform is only partly affected (2).

Importantly, neither the UCC nor the Restatement define the term "impracticable" (or sometimes "impossible."). The Restatement does provide that impossibility generally applies in at least three circumstances:

(1) death or incapacity of an essential person;

(2) destruction of a thing necessary to perform; or

(3) illegality of performance as the result of intervening law or regulation.

"Texas courts have excused performance in each of these situations (though not using the term impracticability)." *See Tractabel Energy Mktg.*, 118 S.W.3d at 64-65. More generally, in Texas law performance of a contract can be either subjectively or objectively impossible. Performance is objectively impossible if "the thing cannot be done," as when the object has become logically impossible to achieve. *See Grayson v. Grayson Armature Large Motor Div., Inc.* No. 14-09-00748-CV, 2010 WL 2361432, at *5 (Tex. App.—Houston [14th Dist.] June 15, 2010, pet. denied) (mem. op.). Performance is subjectively impossible if the individual promisor cannot do it, as in the case of financial inability to pay. *Id*. Objective impossibility is a strong defense to a contract claim; subjective impossibility is not. *See Walston v. Anglo-Dutch Petroleum (tenge) LLC,* No. 13-07-00959-CV, 2009 WL 2176320, at *6 n.2 (Tex.App.—Houston [14th Dist.], July 23, 2009, no pet.)*; see also Janak v. FDIC*, 586 S.W.2d 902, 906–07 (Tex. Civ. App.—Houston [1st Dist.] 1979, no writ); *Ellwood v. Nutex Oil Co.*, 148 S.W.2d 862 (Tex. Civ. App.—El Paso 1941, writ ref.); *United Sales Co. v. Curtis Peanut Co., Inc.*, 302 S.W.2d 763 (Tex. Civ. App.—Dallas 1957, writ ref. n. r. e.).

Even for a facially valid use of objective impossibility, the party must first deploy "reasonable efforts to surmount the obstacle to performance." *Tractabel Energy Mktg.*, 118 S.W. 3d at 68. A party must provide not just "*opinions* that its efforts were reasonable, but . . . *evidence*" sufficient to convince a jury, or to place the issue beyond reasonable dispute. *Id.* at 70 (emphasis in original). In *Tractacbel*, for instance, the 14th Court of Appeals at Houston ruled that although circumstances may have rendered it impossible for one party to sell its own emissions credits to its counterparty, a jury reasonably concluded that it could have sought to purchase such credits elsewhere in order to perform the contract. Even though the "seller" had no saleable credits, therefore, the failure to attempt such a purchase-and-resale doomed the impossibility defense. *Id*. at 72.

This is a good reminder that courts in almost all jurisdictions construe the "impossibility" defense narrowly. Both sides of a dispute over an impossibility defense will be well-served to make substantial efforts to perform, and to comprehensively document those efforts, the intervening circumstances, and their impacts. For suppliers of goods, for instance, the disruption of supply chains may not be sufficient if the firm has not made substantial efforts to re-source and work around the problem. Likewise, the quarantine of a critical person may be sufficient to establish "impossibility," but only if the company has made valid efforts to replace his or her contribution to the performance of the contract. ***Stay-at-home orders*** and similar government directives closing certain businesses may provide adequate grounds for an impossibility defense in many contexts—***but the details will matter***. A gym or spa will certainly have a valid defense for failing to provide its facilities to its paying customers, but it may not have one for failing to pay its vendors.

If you have any questions about a *force majeure* clause or the impossibility defense, please contact Craig Warner.

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