

Chicago-Area Small Business Information on COVID-19: Force Majeure Clauses in Contracts and Business Interruption Insurance^{1 2 3}

Businesses across the Chicago area have had their normal operations disrupted by the COVID-19 (coronavirus) pandemic. Illinois is just one of many states that has issued a “stay at home” order, forcing all “non-essential” businesses to close their physical offices.⁴ While some businesses have been able to continue operating with their employees working remotely, others have been forced to completely or partially suspend operations.

The current situation has made it difficult, if not impossible, for many small businesses to meet all of their contractual obligations. This has led some business owners to question whether the COVID-19 pandemic can legally excuse them from performing under these contracts, either temporarily or permanently. This is a complicated legal question with no easy answers, but this handout is intended to serve as a guide to what are known as “force majeure” clauses in contracts. This handout will also briefly discuss whether the COVID-19 pandemic is covered under commonly-held business interruption insurance policies.

I. What is Force Majeure?

Force majeure is a French term that translates as “superior force.” In the context of contract law, a force majeure clause is a contractually defined event, beyond the control of both parties, which prevents a party from performing under the contract and legally excuses their obligation to perform.⁵ Depending on the language of the contract and the specific event, a party can be temporarily or permanently excused from performing. Some laypeople colloquially refer to these clauses as “Act of God” provisions.

II. Does Force Majeure Apply to My Contract?

At first glance, COVID-19 and the associated government “stay at home” orders would seem to be a classic example of a force majeure event. A pandemic is an unpredictable event beyond the control of any party to a contract. It is important to note, though, that a force majeure clause needs to appear in a contract in order to argue that contractual performance is excused by force majeure. Courts generally will not read a force majeure clause into a contract if none exists.

¹ Please note, (a) this is informational and not legal advice and (b) information is changing rapidly and may quickly become out of date.

² This information was prepared by the Institute for Justice Clinic on Entrepreneurship at the University of Chicago Law School, a legal clinic which assists low-income Chicago entrepreneurs with transactional and regulatory work.

³ Please visit <https://ij-clinic-on-entrepreneurship/information-for-local-businesses-covid-19-outbreak/> for other documents and further updates.

⁴ See the Illinois Executive Order at <https://www2.illinois.gov/Documents/ExecOrders/2020/ExecutiveOrder-2020-10.pdf>

⁵ Black’s Law Dictionary (11th Ed. 2019) defines force majeure as “[a]n event or effect that can be neither anticipated nor controlled; esp., an unexpected event that prevents someone from doing or completing something that he or she had agreed or officially planned to do.”

The words “force majeure” do not themselves need to appear in the contract, but there must be some specific provision excusing performance in the case of an intervening event or occurrence. These clauses will sometimes have other titles, such as “Termination for Cause.”

Like any other provision in a written contract, force majeure clauses must always be interpreted in accordance with the express language of the clause.⁶ These clauses are narrowly constructed, and typically refer to specific matters such as “acts of God,” war or civil disturbances, natural disasters, or strikes and labor disturbances.

Even if specifically mentioned in the contract, the force majeure event must be the “proximate cause” of the party’s non-performance or breach of contract.⁷ In other words, a party that is not actually harmed by the occurrence of a force majeure event cannot simply use the event to get out of a contract that they don’t like. Similarly, the event must actually prevent the party from performing under the contract – simply making performance costlier or more inconvenient will not suffice to trigger a force majeure clause.⁸

III. Specific Examples of Force Majeure Clauses

Obviously, the easiest scenario to analyze is a contract in which “epidemics” or “pandemics” are specifically mentioned in a force majeure clause. For example, a force majeure provision with this language might read:

“Force Majeure Event” means any act of God, labour dispute, shortage of labour or materials, earthquake, hurricane, flood, fire or other casualty, taking, civil commotion, riot, mob violence, insurrection, malicious mischief, sabotage, rebellion, act of public enemy, terrorism, war, invasion, embargo, **infectious disease**, material disruption in airline or other transportation systems, act of a Governmental Authority in its sovereign capacity, **local, regional or world threats or outbreak of epidemic or pandemic disease(s)**, travel advisories or alerts issued by any Governmental Authority or any international agency or body, or any event similar to the foregoing beyond the reasonable control of the Party claiming the benefit of the Force Majeure Event, but excluding the inability of a Party to meet its financial obligations and, in each instance, only to the extent the event or circumstance actually and materially affects the operation or occupancy of the Hotel or the timely performance of Owner’s or Operator’s obligations hereunder.

(emphasis added.) Under a contract with this language, a party would have a good chance of arguing that the force majeure clause excuses non-performance – assuming, of course, that the pandemic was the proximate cause of their inability to execute their obligations under the contract.

⁶ See *Wisconsin Elec. Power Co. v. Union Pac. R. Co.*, 557 F.3d 504, 507 (7th Cir. 2009).

⁷ See *N. Illinois Gas Co. v. Energy Co-op., Inc.*, 122 Ill. App. 3d 940, 951, 461 N.E.2d 1049 (1984).

⁸ While beyond the scope of this guide, a party may also have various common law defenses to contract performance, including frustration of purpose (also referred to as commercial frustration), impossibility, and impracticability. This guide focuses on force majeure contract clauses.

Most force majeure clauses, though, do not specifically refer to epidemics or pandemics. In these cases, a party seeking to invoke force majeure will often have to depend on the “catch-all” language in a force majeure clause. A standard force majeure clause with catch-all language might read:

If the Contract becomes illegal or impossible to perform by either party due to acts of God, war, terrorist act, disaster, strikes, civil disorder, **or other comparable unforeseeable emergency**, this Contract may be terminated for any one or more of such reasons by notice from one party to the other, along with refund of any prepaid deposits or amounts.

(emphasis added.) A party could argue that “other comparable unforeseen emergency” would include COVID-19, particularly since national and state emergencies have both been declared in response to the pandemic. Unfortunately, there is limited precedent on invoking force majeure in connection with public health situations, so it is unclear how a court would ultimately rule on that issue.⁹

IV. Invoking a Force Majeure Clause

A decision to invoke a force majeure clause in a contract should not be taken lightly. It will likely have long-term implications on your relationship with the counterparty, and could potentially lead to a costly legal battle with uncertain prospects of winning in court. If you are truly unable to perform your contractual obligations due to the COVID-19 pandemic, it may be worthwhile to reach out to the counterparty before formally invoking a force majeure clause. They may well be willing to compromise with you simply to avoid the cost of litigation in these uncertain times. Document and retain all of your communications (emails, text messages, letters) with the counterparty, as this may become important evidence if the dispute ends up in court.

If you do decide to invoke a force majeure clause, carefully consider how to frame the event. Document all efforts you have made to mitigate against the effect of the pandemic on your business. For some businesses this will be simple – for example, businesses such as beauty salons have been legally required to close their doors in Illinois while the shelter-in-place order is in effect. If you are classified as an “essential business” and have continued business operations, though (even if only remotely), it may be more difficult for you to effectively invoke a force majeure clause.

You should also make sure to follow the notice requirements in the contract. Most contracts will contain a section describing the procedure for providing counterparties with official notices under the contract. Some courts have held that failing to provide proper notice under a contract waives the right to declare force majeure, so simply ceasing to perform under a contract without notifying the counterparty can be a costly mistake.

⁹ One court has commented that the avian flu epidemic could “plausibly constitute an unforeseeable event precipitating a dramatic change in market conditions.” *Rexing Quality Eggs v. Rembrandt Enters.*, 360 F. Supp. 3d 817, 841 (S.D. Ind. 2018).

V. Business Interruption Insurance

Many small business owners may assume that the COVID-19 pandemic and associated government-ordered closures is covered by business interruption insurance. Unfortunately, the issue does not appear to be that simple. At this point, insurers are generally taking the position that business interruption insurance does not cover COVID-19. Some insurers are relying on explicit “virus” exclusions that appear in many policies, while other insurers are arguing that COVID-19 does not constitute the “property damage and physical loss of use” necessary to trigger coverage under most policies.¹⁰

In response, several businesses have already filed breach of contract lawsuits against their insurance companies seeking to force them to cover COVID-19-related losses. Several states (not including Illinois to this point) are also considering legislation that would retroactively apply business interruption insurance coverage. It is far too early to tell how these litigation and legislative efforts will play out – at this point, the best advice is to stay in touch with your insurance broker to determine if business interruption coverage might be available. Illinois small businesses should likely not count on being able to make claims at this time, though.

VI. Concluding Thoughts

If at all possible, strongly consider consulting an attorney before sending any formal notice to the counterparty. Especially with larger contracts involving higher dollar values, invoking a force majeure clause is a last-ditch effort that may well lead to litigation. As this guide has discussed, most force majeure clauses in contracts will not expressly refer to “epidemics” or “pandemics,” so the outcome of any protracted legal battle will likely be uncertain.

It’s also important to keep in mind the bigger picture. Parties on both ends of contracts (the party invoking force majeure, as well as the counterparty) should remember that being legally “right” is not always the same as being “right” from a business standpoint. Even if a force majeure clause in a contract does not technically cover pandemics such as COVID-19, if a party to a contract has genuinely lost all revenue as a result of having to temporarily shut down, is it really worthwhile pursuing them in court? In these uncertain times, engaging in communication with your business partners and exercising common sense can go a long way, and can hopefully help resolve many disputes.

¹⁰ <https://www.chicagotribune.com/coronavirus/ct-coronavirus-business-interruption-insurance-lawsuits-20200416-b5k13xaweja7refbqfr4cpgk3u-story.html>