

Contracts for the Next Catastrophe: Advanced Drafting Tactics

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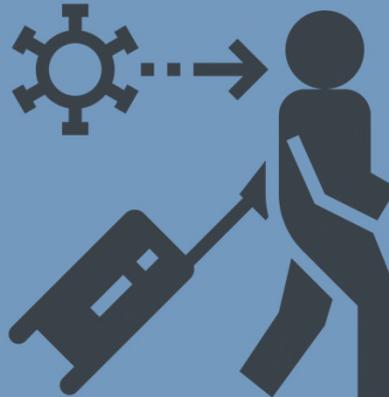
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RISKS TO THE SUPPLY CHAIN



Global Supply Chain Risks

"supply chain":

1. A **network** between a company and its suppliers to produce and distribute a specific product or service to the final customer.
2. The **steps** it takes to get the product or service from its original state to the customer.⁽¹⁾

(1) www.investopedia.com

Global Supply Chains

- Over the past few decades, companies have focused on reducing inventories and **optimizing supply chains** for the production and distribution of products and services.
- Increased **complexity** and **specialization** have made companies and economies globally more interconnected and dependent.
- The **risks of disruption** due to adverse events on a global scale in turn are **accelerating in number** and potential **impact**.

Global Supply Chain Risks

- These risks include widespread **epidemics** in regions where supply chain manufacturing is concentrated; full stop global **pandemics** such as COVID-19; significantly increasing episodes of mass flooding, heat waves, droughts, fires, Category Four and Five hurricanes, and other **extreme weather** events attributable to climate change; **geopolitical instability** including economic confrontations between major powers, such as an all-out **trade war** between China and the US; industry or infrastructure-wide ransomware or **cyberwarfare** attacks; **breakdowns** in the **financial** and banking system.

Global Supply Chain Risks

- Of the top 12 pandemics in recorded history, **two** of those [H1N1 and COVID-19] have occurred within the **last 10 years**, in addition to a number of recent large scale epidemics such as SARS-CoV and MERS-CoV.
- The **past five years** have been the **hottest** on record globally in the **last 100 years**.



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Risks of Disruption

The **new standard** for supply chains for goods and services resulting from these conditions will be:

- **More disruption.**
- **Longer and higher-impact disruption.**
- **Fewer sources of supply.**

I. FORCE MAJEURE PRINCIPLES



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Force Majeure Principles

- The default rule in US law is that contracting parties are **strictly obligated** to perform under the contract, and failure to do so is a breach of contract.⁽²⁾
- **Exceptions** to this strict obligation either must be stated in the contract itself or be subject to a judicial or statutory exception **not contradicted** by the language of the contract.

(2) "As [Oliver Wendell] Holmes pointed out a century ago, you can bind yourself to perform acts over which you have no control." *Field Container Corp. v. I.C.C.*, 712 F.2d 250, 257 (7th Cir. 1983). See Restatement of Contracts 2d, Chapter 11, § Scope, *supra*.

Note that the following discussion assumes that US law will govern the contract and the transactions between the parties. It is incumbent on the parties to a contract to determine which law applies and draft their terms and conditions accordingly.

Force Majeure Principles

- The legal principle of **force majeure** ("greater or important force") can permit a party impacted by an extreme event to **delay** or **excuse** contractual obligations that are prevented by the event.⁽³⁾
- These are known as "**force majeure**" events and commonly include floods, fires, earthquakes, other acts of God, terrorism, strikes, governmental actions and regulations, and shortages of power, infrastructure or transportation.

(3) Restatement of Contracts 2d, § 261; U.C.C. § 2-615. It may also be worth noting that "le majeur" also means the middle finger in French.

Force Majeure Principles

- **Force majeure** is rooted in three universal theories of contract law which state that performance may be excused if, **due to a supervening event**:
 - **Doctrine of Impossibility**: Performance is made actually or legally **impossible**. The thing cannot be done.
 - **Frustration of Purpose**: The thing can be done but the **reason** for doing so no longer exists. The underlying purpose of the contract cannot be achieved and neither party is at fault.

Force Majeure Principles

- **Doctrine of Impracticability:** Performance is possible and the purpose can be fulfilled, but doing so has become **economically senseless**.⁽⁴⁾

(4) P.J.M. Declercq, *Modern Analysis of the Legal Effect of Force Majeure Clauses in Situations of Commercial Impracticability*, 15 J.L. & Com. 213, 215 (1995).

Force Majeure Principles

- **Examples:**
 - **Impossibility:** An earthquake destroys a manufacturing facility, making it impossible for the seller to install new industrial machines in the building.
 - **Frustration of Purpose:** The essential purpose of building new worker dormitories next to the destroyed factory has been negated.
 - **Impracticability:** A large chemical spill caused by the earthquake contaminates the property, making it cost-prohibitive and impracticable to remediate and construct a new facility at that site.

Force Majeure Principles

- These exceptions to performance all are based on the concept that there has been the unforeseeable occurrence of an event, the **non-occurrence** of which was a "**basic assumption** on which the contract was made".⁽⁵⁾

(5) Restatement 2d of Contracts, Chapter 11, § Scope

Force Majeure Principles

Economic Loss:

- Economic loss or hardship generally are **not** sufficient to invoke the defense of impossibility or frustration of purpose;
- but may be sufficient for impracticability if it is **severe**.⁽⁶⁾

(6) See, e.g., *Fed. Trade Comm'n v. A.S. Research, LLC*, Civil Action No. 19-cv-03423-PAB-KMT (D. Colo. July 21, 2020) (COVID-19; changed economic circumstances were not sufficient to establish frustration of purpose); *407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp.*, 23 N.Y.2d 275, 281 (N.Y. 1968) ("financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy", is insufficient to excuse performance); *Aluminum Co. of Am. v. Essex Grp., Inc.*, 499 F. Supp. 53, 56 (W.D. Pa. 1980) (a \$60 million unforeseen loss to seller was sufficient to invoke a commercial impracticability defense). Note that it is common particularly in civil law jurisdictions to require parties to renegotiate their terms if an unforeseen event imposes excessive hardship on one of the parties [discussed below].

Force Majeure Principles

- **Gap Fillers:** These doctrines are generally held to be "gap fillers" to be used **in the absence** of unambiguous contract language [including force majeure clauses] that allocates the risk of an event as between the parties.⁽⁷⁾
- **Contrary Language:** These rules excusing performance are applicable "**unless the language or the circumstances indicate the contrary**".⁽⁸⁾

(7) See, e.g., *R & B Falcon Corp. v. American Exploration Co.*, 154 F. Supp. 2d 969 (S.D. Tex. 2001); *Commonwealth Edison Co. v. Allied-General Nuclear Services*, 731 F. Supp. 850 (N.D. Ill. 1990). This is especially the case in negotiated clauses as opposed to mere boilerplate.

(8) Restatement 2d of Contracts, § 261, comment (c), § 265, comment (b).

Force Majeure Principles

Statutory Versions: UCC Section 2-615

- Non-performance by seller **excused** if performance has been made **impracticable** by (i) an **unforeseen** event not contemplated by the parties that alters the essential nature of the performance, or (ii) compliance with government regulations.
- Where **partial performance** is possible, the seller must allocate the goods in a **fair and reasonable manner** across its customers.
- This rule is overridden "so far as seller may have **assumed a greater [contractual] obligation**."⁽⁹⁾

(9) U.C.C. § 2-615.

Force Majeure Principles

Statutory Versions: Other State Codes

- A number of states have other codified versions of the default common law principles.
- For example, California Civil Code Section 1511(2) provides that performance is excused "when it is prevented or delayed by **an irresistible, superhuman cause, or by the act of public enemies** of this state or of the United States, unless the parties have expressly **agreed to the contrary**."⁽¹⁰⁾

(10) Cal. Civ. Code § 1511(2).

Force Majeure Principles

Statutory Versions: CISG

- The **UN Convention on Contracts for the International Sale of Goods** ("CISG") has rules for force majeure events. Over 50 countries are signatories including the US, China, and major EU countries.
- Under Art. 6 the parties can **opt out** of the CISG by contract or vary any of its terms.
- As a treaty the CISG is part of US law and unless excluded by contract **preempts** and **overrides** other domestic law, including the **UCC**.⁽¹¹⁾

(11) *E.g., Medellin v. Texas*, 552 U.S. 491, 504–05 (2008); *Forestal Guarani S.A. v. Daros Intern., Inc.*, 613 F.3d 395, 397 (3d Cir. 2010).

Force Majeure Principles

Statutory Versions: CISG

- Art. 79(1) of the CISG: "A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an **impediment beyond his control** and that he could not **reasonably be expected** to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it, or its consequences."⁽¹²⁾
- Essential to opt out and exclude the CISG in international transactions to avoid this rule.

(12) CISG Art. 79. Note that when the choice of law of the contract is a non-US jurisdiction, it is critical to determine whether there are statutes within the jurisdiction imposing force majeure or similar relief.

Force Majeure Principles - Core Points

- **Common law and statutory rules** can excuse the performance of a party in the case of **supervening events** not within the contemplation of the parties.
- To counteract this outcome the relevant parties must draft and include **contrary language** in their contract dealing with these force majeure events.
- The entire objective is to expressly **shift the risk** of unexpected events to the intended party and to have that allocation enforced.

Question:

Which party bears the risk of a force majeure or similar unexpected event?

II. FORCE MAJEURE CLAUSE



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Indicative Clause

"**Force Majeure:** No party shall be liable for a failure or delay in performing any of its obligations under this Agreement to the extent that such failure or delay is due to causes beyond the reasonable control of the affected party, including but not limited to: (a) unusually severe weather or other acts of God; (b) fire, explosion or earthquake; (c) war, invasion, terrorism, riot or other civil unrest; (d) governmental laws, orders, restrictions, embargoes or blockages; (e) national or regional emergency; (f) highly infectious diseases, epidemics, pandemics; (g) injunctions, strikes, lockouts, or other industrial disturbances, (h) inability to obtain or use necessary transportation, power or infrastructure, (i) inability to obtain or use necessary products or materials, or (j) other causes whether similar or dissimilar to the foregoing ("force majeure"), provided that the affected party promptly notifies the other party of the force majeure in writing and exercises reasonable efforts to resolve such causes and resume performance as soon as possible. If such force majeure event(s) continue for more than sixty (60) calendar days in the aggregate during any 12-month period, the other party may terminate this Agreement in its sole discretion by written notice to the affected party."

Contracting Against Force Majeure

- Parties can override or supplement common law or statutory rules by use of a **force majeure clause** which establishes **what qualifies** as a force majeure and the **actions** required of each party if the event occurs.⁽¹³⁾

(13) Restatement 2d of Contracts, § § 261, comment (c), 265, comment (a), *supra*.

Contracting Against Force Majeure

- **Force majeure clauses** allow parties to negotiate:
 - the **scope of qualifying events** and **excusable obligations**;
 - the non-performing party's **notice** and **mitigation** requirements; and
 - the **options** and **remedies** available to each party.

Rules of Construction

- **Force majeure** clauses are generally interpreted under the same rules governing any other contractual provision.
- While this varies by state, in general US courts will interpret force majeure provisions **narrowly** and focus on the **specific language** of the force majeure clause to establish the scope of the provision.⁽¹⁴⁾

(14) See, e.g., *Route 6 Outparcels, LLC v. Ruby Tuesday, Inc.*, 931 N.Y.S.2d 436, 438 (3d Dep't 2011) ("When the parties have themselves defined the contours of force majeure in their agreement, those contours dictate the application, effect and scope of force majeure"); *Watson Labs. Inc. v. Rhone-Poulenc Rorer, Inc.*, 178 F. Supp. 2d 1099, 1111 (C.D. Cal. 2001).

Force Majeure Clause - Baseline

(1) FM Party is the Sole Beneficiary: The force majeure party is relieved of its contractual obligations under the force majeure clause. This in fact is the **sole** purpose of the clause.

(2) No Breach: The force majeure party is deemed to **not have breached** the contract and is therefore **not liable** for damages. The other party has **no claims** unless otherwise expressly provided in the force majeure clause.⁽¹⁵⁾

(15) Force majeure provisions operate as an excuse for non-performance and must be asserted as an affirmative defense. *Corbin on Contracts* § 7.1.7 (2018); *Williston on Contracts*, § 77:31 (4th Ed., 2020). As a result the force majeure party generally bears the burden of proof to establish that defense, including whether the event was within its reasonable or other control as required by the contract. *E.g., Hydrocarbon Management, Inc. v. Tracker Exploration, Inc.*, 861 S.W.2d 427, 436 (Tex. App. 1993).

Force Majeure Clause - Baseline

(3) No Mutuality: These clauses are often "mutual" but **only the seller** of goods or services usually benefits as the nonperforming party. The concept of **mutuality** is generally false.

(4) Ambiguous: Most boilerplate force majeure clauses are ambiguously drafted and use **broad** and **nonspecific** terminology to the detriment of the other party.

(5) Not Contractually Excused: Most boilerplate force majeure clauses are **silent** on the corresponding obligations of the buyer or other party to continue to perform.

Force Majeure Clause - Baseline

- * *For convenience, in these materials the contracting parties are referred to as (1) "seller" or "force majeure party" and (2) "buyer", generally in the context of the manufacturing and supply of products or raw materials in a supply chain, where the seller primarily is the performing party.*

These concepts however apply equally to a service agreement where one party is obligated to perform services for the other party.

Force Majeure Clause - Baseline

- **Point of view [POV] of the Buyer:** The following materials are relevant to both parties but in general address the issues from the point of view of the **Buyer**.
- **Note** also that the Seller at any point of the supply chain often is also a buyer of upstream goods and services from its suppliers in the chain. The tactics being discussed can assist the Seller in dealing with those suppliers and in turn assist in avoiding disruption in its downstream performance for its Buyer.

III. FORCE MAJEURE OR NOT?



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Types of Transactions

- Drafting tactics for force majeure clauses are best understood **in context**.
- In each case it is necessary to understand the particular type of transaction and relationship at issue in order to determine your **set point** [the desired or target value] in negotiating the contract.
- Consider the following indicative transaction types, ranked by **degree of connectedness** between the parties:

Types of Transactions

Class A [Commodities]: Seller of commodity goods or materials. Buyer has choice of a broad group of other sellers. **Objective: cut your losses** if any issues.

Class B [Deal Terms]: Seller of standard interchangeable goods or materials. Buyer has choice in the market but quality or pricing or long term supply guarantees in this deal are worth protecting. **Objective: Protect favorable deal terms.**

Types of Transactions

Class C [Product Sourcing]: Seller of necessary goods or materials in a market with limited sources or long lead times or a more complex product design or supply chain. Access to or change of sellers more difficult. **Objective: Continued sourcing.**

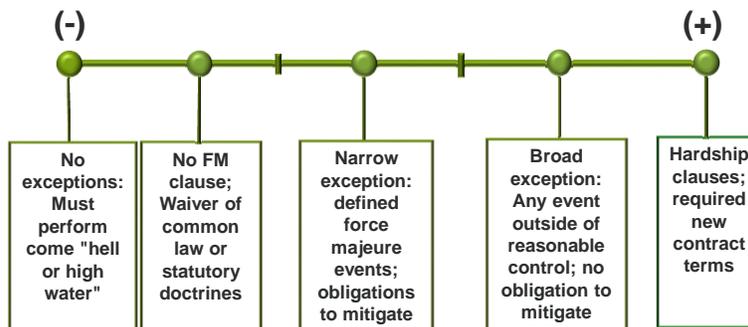
Class D [Critical Components]: Seller is the sole or only one of a few suppliers of critical components needed by the buyer. These may include jointly developed components or products, patented technologies, shared trade secrets, or technology licenses between the parties. **Objective: Continued access to critical components or technology.**

Types of Transactions

- These categories are not exclusive and much can depend in a particular case on other factors, generally concentrated around the concept of **leverage**.
- For example, in a Class D transaction [critical components], Seller may be the sole source of supply but Buyer may be its **largest customer** by far or may be deemed essential to **validate** the technologies in the market, giving Buyer substantial leverage in the deal.

Force Majeure or Not?

- In the context of a force majeure, the obligation of a party to perform can fall along the following **spectrum**:



(1) Hell or High Water Clauses

Hell or High Water:

- **No Outs:** Buyer may be able to negotiate language which holds Seller responsible for **any failure or delay in performance**, including upon the occurrence of any force majeure event. These are known as "**hell or high water**" clauses.
- **Factors:** Whether Buyer will do so depends on the **transaction level** involved and what **relative leverage** Buyer has.⁽¹⁶⁾

(16) For example, if Buyer can freely move to other suppliers [Classes A and B] this type of clause may not be necessary. A hell or high water clause may be considered when performance is more critical [Classes C and D].

(1) Hell or High Water Clauses

▪ Hell or High Water Example:

"No event of force majeure, nor any other occurrence of any nature whatsoever, shall excuse Seller from performance of all of its obligations hereunder, and all risks (including risks of impossibility, frustration of purpose, and impracticability) are hereby expressly assumed by Seller. Upon the occurrence of event which causes any delay or failure of performance by Seller for any reason, Seller shall be deemed liable and in breach of its obligations under this Agreement."

(1) Hell or High Water Clauses

- There are no published decisions addressing the enforceability of "**hell or high water**" provisions per se in the general force majeure context.
- US courts however do permit these type of clauses for certain contracts, including government contracting and leasing agreements, even where performance is deemed impossible.⁽¹⁷⁾

(17) See, e.g., Williston on Contracts § 77:54 (4th ed.); *RNJ Interstate Corp. v. United States*, 181 F.3d 1329, 1331 (Fed. Cir. 1999). In government contracting these provisions are known as "Permits and Responsibility Clauses".

(1) Hell or High Water Clauses

- Provided the language is "**plain, unequivocal, and unqualified**", a party **can assume** the very risk that makes performance impossible, at least in the absence of manifest unreasonableness, bad faith or unconscionability.⁽¹⁸⁾

(18) Note that force majeure clauses in sales of goods can be limited by U.C.C. Sections 1-102(c), 1-203 and 2-302, which prohibit agreements that are manifestly unreasonable, in bad faith, or unconscionable. In the absence of such conditions, however, the cited U.C.C. § 2-615 permits the Seller to "[assume] a greater [contractual] obligation" and override the statutory protection against commercial impracticability.

(1) Hell or High Water Clauses

- **Caution:** It is not sufficient to simply omit having a force majeure clause in the contract.
- In the absence of a force majeure clause and a strict assumption of risks, the default **common law** and **statutory doctrines** of impossibility, frustration of purpose or impracticability [or similar statutory rules] will be applicable to excuse the affected party.

(2) Express Waivers

- **Waiver:** A similar or combined approach is use of an **express waiver** in the contract of the applicable common law and statutory force majeure doctrines.
- The courts have held that a seller is entitled to use its bargaining power to contract out of liability by extracting a force majeure clause. The willing waiver by the seller of common law and statutory defenses should be equally enforceable.⁽¹⁹⁾

(19) See generally *InterPetrol Bermuda Ltd. v. Kaiser Aluminum Int'l*, 719 F.2d 992, 1000 (9th Cir. 1983); *Jon-T Chemicals, Inc. v. Freeport Chemical Company*, 704 F.2d 1412 (5th Cir. 1983) (parties retain the utmost freedom to anticipate business risks and allocate them accordingly). See *Brunner & O'Connor on Construction Law* § 19:60 (2020) ("Because force majeure clauses do not exculpate a party for bad behavior but only from bad luck, they rarely invoke public policy concerns or judicial ire").

(2) Express Waivers

- For example:

"No event of force majeure, nor any other occurrence of any kind or nature whatsoever whether foreseeable or unforeseeable, shall excuse Seller from performance of its obligations hereunder. All doctrines of force majeure or non-performance, whether statutory or otherwise, including without limitation, impossibility, frustration of purpose, commercial or other impracticability, or any other similar rights under applicable law, are hereby expressly and irrevocably waived."

(3) Negotiated Force Majeure Clauses

- The third alternative on the spectrum is a form of **negotiated force majeure clause** in the contract.
- The following parts of these materials discuss these clauses in detail.

(4) Hardship Clauses

- **Hardship clauses** are a separate category of clause involving an unforeseen event outside of the control of a party that renders continued performance **excessively onerous**.
- Under a hardship clause, the parties are required to **negotiate alternative contractual terms** to take into account the consequences of the event. This form of relief is also provided by statute in various civil law jurisdictions.⁽²⁰⁾

(20) For example, French Civil Code Art. 1195 requires renegotiation of contracts under French law in the case of an event causing extreme hardship [excessivement onéreuse]. If the other party refuses to negotiate or if the renegotiation fails, then the French court can interfere with the contract and revise the contract or terminate it under the conditions set by the judge. In the alternative the parties can expressly accept this hardship risk and waive the effects of this rule by contract.

(4) Hardship Clauses

For example:

"Where a party to a contract proves that (1) the continued performance of its contractual duties has become **excessively onerous** due to an event beyond its reasonable control which it could not reasonably have been expected to have taken into account at the time of the entering into of the contract; and that (2) it could not reasonably have avoided or overcome the event or its consequences, the parties are bound, within a reasonable time of the invocation of this clause, to **negotiate alternative contractual terms** which reasonably allow for the consequences of the event."⁽²¹⁾

(21) See ICC Force Majeure and Hardship Clauses, March 2020.

IV. DRAFTING TACTICS



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(5) General Structure of Clause

Force majeure clauses in general have **five parts**:

- (1) **Delay or excuse** of performance if a force majeure event occurs;
- (2) A **specific list** that qualify as force majeure events;
- (3) **Notice** obligations;
- (4) The extent of the force majeure party's **obligation to mitigate** the effects of the event; and
- (5) **Remedies** of each party initially or if the force majeure event continues past a stated period, including **termination** rights.

(5) General Structure of Clause

Core objectives: Optionality and Speed

- A well-designed force majeure clause can provide a company with the optionality and speed to absorb shocks, whether as a seller or buyer:
 - **Optionality:** A menu of rights and remedies from which to choose the best response under the circumstances.
 - **Speed:** The means of asserting those rights and remedies quickly and unambiguously without judicial intervention (if possible).

(6) Scoping Issues

- The first two sections of the force majeure clause are:
 - (1) the **excuse or deferral** of the obligation and
 - (2) the specific **force majeure events** that trigger the clause.
- These sections break down into the following core components: (i) **excuse** ⁽²²⁾ **versus deferral** of performance; (ii) **causation**; (iii) conditions of **control**; (iv) categorical **exceptions** from force majeure events; (v) **listed** force majeure events.

(22) For convenience both are referred to as "excuse" unless otherwise indicated.

(7) Scope - Excuse

(i) Excuse versus Deferral:

Examples:

- "No party shall be **liable** for a failure or delay in performing any of its obligations under this Agreement..."
- "A party shall be **temporarily relieved** in the performance of its obligations hereunder if such performance is prevented or delayed..."
- "A party will **temporarily excused for any default or delay or failure** in performance to the extent the delay or failure is caused by ..."

(7) Scope - Excuse

(i) Excuse versus Deferral:

- Force majeure clauses take one of two approaches: the party is either (1) **excused from liability** due to the event or is (2) temporarily **relieved** from its performance **obligations**.
- In most cases this may not be a material distinction [*i.e.*, "temporarily excused"]. However an excuse from liability is less precise and more ambiguous than temporary relief if the parties intend that the **performance occur at a later time**.

(7) Scope - Excuse

(i) Excuse versus Deferral:

- The clause must be coordinated with the **expiration term of the contract**.
- If performance is critical to the Buyer [for example, a critical component], the term of the contract may need to be **extended** or **post-termination performance** be required in order to avoid a complete excuse of performance by the Seller due to timing out during the force majeure period.⁽²³⁾

(23) See *Beardslee v. Inflection Energy, LLC*, 25 N.Y.3d 150, 31 N.E.3d 80 (N.Y. 2015) (suspension of performance and rights due to governmental order under force majeure clause did not extend term of lease).

(8) Scope - Causation

(ii) Causation:

- The clause must establish a **direct causal link** between the force majeure event and the nonperformance of Seller. It is always necessary for the Seller to establish causation.⁽²⁴⁾
- The force majeure event also must not be self-inflicted due to **fault or negligence** of the Seller.⁽²⁵⁾

(24) See, e.g., *Future St. Ltd. v. Big Belly Solar, LLC*, Civil Action No. 20-cv-11020-DJC (D. Mass. July 31, 2020) (COVID-19; pandemic did not cause failure to perform); *Gulf Oil Corp. v. Federal Energy Regulatory Commission*, *Gulf Oil Corp. v. F.E.R.C.*, 706 F.2d 444, 453 (3d. Cir. 1983); *OWBR LLC v. Clear Channel Communications Inc.*, 266 F. Supp. 2d 1214 (D. Haw. 2003)(indirect causation; force majeure negated).

(25) See *TGI Office Automation v. Nat'l Electronic Transit Corp.*, *United States District Court for the Eastern District of New York*, Sep. 14, 2015 (13-CV-3404)) (negligent failure to prepare for possibility of flooding).

(8) Scope - Causation

(ii) Causation:

▪ Example:

"Any delay or failure of Seller to perform its obligations under this Agreement will be temporarily excused if and to the extent that the delay or failure was caused **directly** by a Force Majeure Event outside of the control and without the **fault or negligence** of Seller."

(8) Scope - Causation

(ii) Causation:

- "**caused by [the event]**": This language requires **direct causation** of the delay by the force majeure event. Be cautious of broader terminology such are "**arising out of**", "**related to**" or "**in connection with**" the force majeure event, which can significantly undermine the causation link and expand the scope of the clause.⁽²⁶⁾

(26) See generally *Coregis Ins. Co. v. American Health Found.*, 241 F.3d 123, 128-129 (2d Cir. 2001); *Simula, Inc. v. Autoliv, Inc.*, 175 F.3d 716, 721 (9th Cir. 1999); *MAK Mktg. v. Kalapos*, 620 F. Supp. 2d 295, 306 (D. Conn. 2009).

(8) Scope - Causation

(ii) Causation:

- **"to the extent" or "solely"**: This additional limiting language requires the Seller to continue performance to the extent not impeded by the force majeure.⁽²⁷⁾
- **Example**: Seller is excused from performance "[solely] to the extent caused by such Force Majeure Event."

(27) *Aquila v. C.W. Mining*, 545 F.3d 1258, 1264 (10th Cir. 2008) (performance excused per the contract only "to the extent" made necessary by the force majeure).

(9) Scope - Control

(iii) Outside Control of Seller:

- **Example**:
"due to causes beyond the **reasonable control** of the affected party..."
- **Boilerplate**: This is very common boilerplate language in force majeure clauses, but there is no definitive standard for the term "**reasonable**" and its interpretation is entirely dependent on the particular facts of the case.

(9) Scope - Control

(iii) Outside Control of Seller:

- "Outside of the control" of a party is generally interpreted to mean a sudden and unforeseeable event, not circumstances where a party could have taken steps to avoid the force majeure event and protect itself from risk.⁽²⁸⁾

(28) See, e.g., *Williston on Contracts* § 77:31 (noting that a party seeking the benefits of a force majeure clause must show that performance is impossible "in spite of skill, diligence, and good faith" to continue to perform); *Butler v. Nepple*, 54 Cal.2d 589, 599 (1960) (requiring a party invoking force majeure to demonstrate that they made "sufficient" or "reasonable" efforts to avoid the consequences of a force majeure event, including (for example) seeking an alternate supplier or pursuing other methods of performance); *Heritage Commons Partners v. Vill. of Summit*, 730 F. Supp. 821, 824 (N.D. Ill. 1990) (explaining that parties have a duty "to take reasonable measures to prevent conditions constituting force majeure from arising, and to cure them if they do arise").

(9) Scope - Control

(iii) Outside Control of Seller:

- Examples - More stringent language:
 - "outside the control of [Seller] with the exercise of [due diligence][best efforts] and without the fault or negligence of [Seller]"
 - "outside the reasonable control of [Seller], and which by the exercise of due foresight could not have avoided, and by the exercise of due diligence could not have been overcome."

(9) Scope - Control

(iii) Outside Control - Order and Location:

- The exact **order and location** of the outside of control clause are important.
- There has been extensive litigation as to whether the outside of control requirement (i) **covers all listed and general events** or (ii) whether a specific **listed event** is deemed per se to be a force majeure trigger whether or not within the control of the force majeure party.⁽²⁹⁾

(29) E.g., *Watson Laboratories, Inc. v. Rhone-Poulenc Rorer*, 178 F. Supp. 2d 1099, 1110 (C.D. Cal. 2001) (US courts tend to interpret the reasonable control language to apply to all events but proper drafting can be binding if unambiguous); *Nissho-Iwai Co. v. Occidental Crude Sales, Inc.*, 729 F.2d 1530, 1539-40 (5th Cir. 1984).

(9) Scope - Control

(iii) Outside Control Examples:

- **Control requirement for all events:** "The obligations of a party are excused for any failure or delay in performance which is (i) outside the reasonable control of such party and (ii) caused by _____ or _____."
- **More limited control requirement:** "The obligations of a party are excused for any failure or delay in performance caused by _____ or _____; or by any other cause which is outside the reasonable control of such party."

(10) Scope - Exclusions

(iv) Excluded Classes of Events:

Buyer can and should also **expressly exclude** certain generic classes of events from force majeure. These could include one or more of the following:

- any **payment** obligations of Seller;
- **indemnification** and defense obligations of Seller;
- **financial hardship** generally;
- changes in **cost or availability** of materials, components or services;

(10) Scope - Exclusions

(iv) Excluded Classes of Events:

- any changes in **market conditions**;
- Seller's contract disputes or any acts or omissions of Seller's **upstream suppliers**.
- Compliance with **applicable laws**.

Example: "Notwithstanding any contrary provision hereof, none of the following events or conditions will excuse or delay the performance by Seller of any of its obligations under this Agreement or be deemed to be a force majeure event for any purpose: _____, _____." #

(11) Scope - Force Majeure Events

(v) Express Force Majeure Events:

- The force majeure clause will either
 - (1) contain an unrestricted **general events** clause, or
 - (2) will list a finite **series of specific classes** of events intended to qualify as force majeure events,
subject to any other express limitations in the clause.

(11) Scope - Force Majeure Events

(1) Unrestricted General Clause: Defines force majeure events using broad language relating to **causation, unforeseeability and unavailability:**

- generally **pro seller**
- similar application as the default rules
- offers greater flexibility, but may invite unpredictable judicial intervention.

(11) Scope - Force Majeure Events

(1) Unrestricted General Clause Example:

"A 'Force Majeure Event' shall be defined as any event which is not with the reasonable control of Seller [and which, by the exercise of due diligence of Seller, could not have been prevented or is unable to be overcome]."

(11) Scope - Force Majeure Events

(2) Finite List of Force Majeure Events: Defines force majeure events more precisely using a **set list of specific events**.

- generally **pro buyer**
- more clarity, but narrower application
- in practice often has catch-all language that can be treacherous to draft or interpret.

(11) Scope - Force Majeure Events

(2) Finite List Clauses:

When preparing the **list** of force majeure events in a finite list clause, the challenge is to define qualifying events with:

- **enough specificity** to anticipate how the provision will be applied by the courts,
- while providing **enough flexibility** to cover an unexpected or new type of event.

(11) Scope - Force Majeure Events

(2) Finite List Clauses:

- Listed events can be industry, geographic and context specific, but are usually selected from the following **categories**:
 - **weather**-related (rain, floods, hail, drought, tornadoes, hurricanes, cyclones, lightning, violent storms);
 - **naturally-occurring** non-weather-related (volcanoes, tidal waves, earthquakes);
 - **disease** (pandemics, epidemics, plague, pest outbreaks);

(11) Scope - Force Majeure Events

(2) Finite List Clauses:

- **governmental** authority (regulations; sanctions, embargoes, orders, court actions, expropriation, confiscation and nationalization);
- **acts of war** and other conflicts (acts of war, hostilities, blockade, riots, civil war or insurrection);
- **acts of terrorism**, sabotage or piracy;
- **combustion** (fire, explosion, implosion);

(11) Scope - Force Majeure Events

(2) Finite List Clauses:

- **computer-based** (cyberwarfare, ransomware or other cyberattacks)
- **labor** strikes or shortages or lock-outs
- **interruption of trade or facilities** (interruption of transportation or other infrastructure, destruction or shortage of equipment, components or materials, failure of power or telecommunication systems).

(11) Scope - Force Majeure Events

- **Events Not Listed:** If there are a number of specific event categories listed in the clause, **the majority rule** in the US is that any class of events omitted from the list is **outside the scope** of the contract and is **not** a force majeure event.⁽³⁰⁾
- **Catch-All:** As a result, sellers or other relevant parties often add a **catch-all** phase to **expand the scope** for other unlisted and unforeseen events.

(30) See, e.g., *Kel Kim Corp. v. Cent. Markets, Inc.*, 70 N.Y.2d 900, 902-03 (1987) ("only if the force majeure clause specifically includes the event that actually prevents a party's performance will that party be excused"); *In re Cablevision Consumer Litigation*, 864 F. Supp. 2d 258 (E.D. N.Y. 2012); *Tug Blarney, LLC v. Ridge Contracting, Inc.*, 14 F. Supp. 3d 1255, 1276 (D. Alaska 2014).

(12) Scope - Catch-All

- **Common catch-all language** is inserted in the finite events list and indicated by words such as:
 - "including [without limitation]";
 - "other events [whether similar or dissimilar] to the foregoing";
 - "other events beyond the [reasonable] control of the seller"; or
 - "acts of God"⁽³¹⁾

(31) An act of God has been defined as "[a]n overwhelming, unpreventable event caused exclusively by forces of nature, such as an earthquake, flood, or tornado, without the interference of any human agency." Black's Law Dictionary 37 (8th ed. 1999). For example, accidents are not included in this class.

(12) Scope - Catch-All

Catch-all Caveat: Ejusdem Generis Maxim

- A force majeure catch-all clause can be subject to and limited by the legal maxim of **ejusdem generis** depending on the jurisdiction.

- Under this doctrine:

General words following a list of specific items are not given expansive meaning but are deemed to include **only items of the same or similar type, class or nature.**⁽³²⁾

(32) See, e.g., *TEC Olmos, LLC v. ConocoPhillips Co.*, 555 S.W.3d 176, 185 (Tex. Ct. App. 2018); *Stepnicka v. Grant Park 2 LLC*, 2013 Ill. App. 113229, 29 (Ill. App. Ct. 2013); *National v. Hyatt Regency Washington*, 894 A.2d 471, 476 (D.C. 2006).

(12) Scope - Catch-All

Catch-all Caveat: Ejusdem Generis Maxim

- Application of this doctrine is not mandatory and can be challenged if the intent of the parties can be proven to be different.

- To try to override this rule and establish intent, parties will include language such as:

"[specific list]; and (x) other **similar or dissimilar** events beyond the [reasonable] control of the Seller."

(12) Scope - Catch-All

Catch-all Caveat: Eiusdem Generis Maxim

- This rule can also be countered by the **internal order** of the provision, since *eiusdem generis* only applies when the general catch-all clause **follows** the specific listing of events.⁽³³⁾
- If the catch-all phrase is **first in order** then the rule will not apply. For example:
"[excuse] any events beyond the [reasonable] control of the seller, including but not limited to A, B, and C."

(33) See e.g., *Eastern Air Lines, v. McDonnell Douglas Corp.*, 532 F.2d 957, 989 n.90 (5th Cir. 1976); *Excelsior Motor Mfg. Supply Co. v. Sound Equipment, Inc.*, 73 F.2d 725, 728 (7th Cir. 1934).

(12) Scope - Catch-All

Catch-all Caveat: Common Law or Statutory Defenses

- Another tactic of a force majeure party is to **insert** common law defenses into the force majeure provision, essentially a **non-allocation of risk**:
"The parties shall be excused from any failures or delays in performance under this Agreement if such performance is impossible or commercially impracticable or in the event of a frustration of purpose, as a direct result of any [unforeseen] event or cause beyond the reasonable control of the affected party."

(12) Scope - Catch-All

Catch-all Caveat: Common Law or Statutory Defenses

- To minimize the risk that common law and statutory defenses would be permitted as **gap fillers** in cases where the contract clause does not cover the category of event at issue⁽³⁴⁾ — especially where the category is not discussed as part of the negotiation — consider including an **exclusivity provision** in the contract to rebut these defenses.

(34) Discussed in Part 1 of these materials.

(12) Scope - Catch-All

Catch-all Caveat: Common Law and Statutory Defenses

▪ Example:

"The foregoing force majeure provisions are intended to be exclusive and a party shall be fully liable for any other failure or delay in performance of any kind or nature notwithstanding the circumstances; and to the fullest extent not prohibited by applicable law, the parties intend that any common law or statutory defenses based on impossibility, frustration of purpose, impracticability or any similar doctrine shall be and are hereby disclaimed."

(13) Foreseeability of Events

Foreseeability of Force Majeure Events:

- In the **absence** of clear language, US courts in general:
 - **Do read in** a foreseeability requirement when analyzing **catch-all** language;
 - **Do not read in** a foreseeability requirement when analyzing a **specific list** of force majeure events - so that all listed events are covered whether or not foreseeable. ⁽³⁶⁾

(36) See, e.g., *InterPetroil Bermuda Ltd. v. Kaiser Aluminum Int'l Corp.*, 719 F.2d 992, 1000 (9th Cir. 1983), *supra*; *Eastern Air Lines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957, 992 (5th Cir. 1976); *In re Mona Lisa at Celebration, LLC*, 436 B.R. 179, 194 (Bankr. M.D. Fla. 2010), *supra*; *Veath v. Specialty Grains, Inc.*, 190 Ill. App. 3d 787, 797-98 (1989); *Harper v. N. Lancaster, LLC*, 132 N.E.3d 555, at *1 (2019); *Kyocera Corp v. Hemlock Semiconductor, LLC*, 886 N.W.2d 445, 451 (Mich. Ct. App., 2015); *PPG Indus., Inc. v. Shell Oil Co.*, 919 F.2d 17, 19 (5th Cir. 1990).

(13) Foreseeability of Events

Foreseeability of Force Majeure Events:

- It is entirely possible by contract to **relieve** a party by contract from force majeure events **whether or not** such events were foreseeable.⁽³⁵⁾
- Consider expressly including or removing the foreseeability factor in the clause: (1) If **Buyer**, require that **all events not be foreseeable** whether listed or general; (2) If **Seller**, **exclude foreseeability** to broaden the scope of force majeure events, so the events are covered whether foreseeable or not.

(35) *In re Mona Lisa at Celebration, LLC*, 436 B.R. 179, 194 (Bankr. M.D. Fla. 2010); *Stein v. Paradigm Mirasol, LLC*, 586 F.3d 849 (11th Cir.2009).

(14) Objective Test - Force Majeure Status

Authoritative Confirmation: To determine the occurrence of a force majeure event, the parties may provide for **objective and neutral confirmation** of the event to avoid dispute. For example, requiring as a precondition:

- **Official declarations** of the existence of a epidemic or pandemic by a neutral authority such as the World Health Organization (WHO) or the US Center for Disease Control (CDC), including data from the affected region of the Seller.
- Declarations of a **state of emergency** or similar formal actions by a governmental authority.

(14) Objective Test - Force Majeure Status

- **Specific objective metrics** relevant to the industry or transaction between the parties.
- More detailed provisions for the type of **government orders or regulations** constituting a force majeure relevant to the parties, such as bans on the access to or importation of critical materials or technology, or governmental sanctions on essential upstream suppliers.

(14) Objective Test - Force Majeure Status

Expedited Discovery:

- Provide for a **formal expedited discovery and disclosure process** between Seller and Buyer to establish the relevant facts and circumstances justifying the occurrence of the force majeure and whether such event was outside of the control of the Seller in the particular case under the standards established in the contract.
- This could include production of documents, site inspections, interviews or depositions and the retention of experts.

(14) Objective Test - Force Majeure Status

Expedited Arbitration or Other Proceedings:

- The parties may consider including an **alternative dispute resolution** mechanism to force (i) expedited mediation and (ii) if required, expedited arbitration or other proceedings for a binding determination by a neutral arbitrator or expert or other third party as to whether or not a noticed event **qualifies** as a "force majeure" under the terms of the contract clause.

(14) Objective Test - Force Majeure Status

Example:

"Any controversy or claim regarding whether any event or occurrence comes within the definition of 'Force Majeure Event' hereunder shall be settled by expedited arbitration administered by the American Arbitration Association in accordance with its Commercial Arbitration Rules and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof. Time is of the essence for any arbitration under this section and arbitration hearings shall take place within [30] days of filing and awards rendered within [60] days of filing. Arbitrator(s) shall agree to these limits prior to accepting appointment."

(15) Notice of Event

- The contract should state **the manner and timing in which the Seller must deliver notice to buyer** of the occurrence of a qualifying force majeure event.
- Seller usually must:
 - give written notice of the qualifying force majeure event within a specified time [number of days, "reasonable time", "promptly"]; and
 - describe in detail the cause and nature of the claimed force majeure event and the period of time the occurrence is expected to continue.

(15) Notice of Event

Example:

"Seller shall give written notice to the other party within [_____] calendar days of the occurrence of a Force Majeure Event, stating the nature and extent of the event, detailing its effects on Seller's performance, and providing a good faith estimate of the period of time the occurrence is expected to continue. Seller acknowledges and agrees that in the absence of such written notice to Buyer, Buyer shall not be deemed to have actual or constructive knowledge of the occurrence of a Force Majeure Event, or the effects of such event on Seller's obligations hereunder."

V. MITIGATION AND REMEDIES



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(16) Mitigation in General

General Rule: No Liability for Seller. Unless the contract provides otherwise:

- The force majeure clause will **suspend** or **excuse** the Seller's performance for as long as a force majeure event prevents performance.
- Seller is **not liable** for:
 - Additional costs incurred by Buyer as a result of the delay, or
 - any liquidated or other damages for the failure to perform.

(16) Mitigation in General

- **Mitigation:** The force majeure clause however should expressly require Seller to undertake mitigation efforts to:
 - take precautionary measures to **minimize** the adverse effects of an otherwise unavoidable force majeure event⁽³⁷⁾; and
 - make efforts to **end the delay** in its performance and resume performance after the event has occurred.

(37) Assuming that the failure to take such precautionary measures does not eliminate the event from the force majeure clause outright. See *McDevitt & Street Co. v. Marriott Corp.*, 713 F. Supp. 906 (E.D. Va. 1989), *order aff'd in part, rev'd in part on other grounds*, 911 F.2d 723 (4th Cir. 1990) (court denied a contractor's claim for an extension of time because the contractor failed to take precautionary actions that could have prevented weather damage caused by a hurricane).

(16) Mitigation in General

- The standard for the extent and type of **mitigation measures** varies but is most commonly generic.
- **Example:** "Seller shall use all [necessary/best/commercially reasonable] efforts to end the failure or delay [as soon as reasonable/ possible/practicable] and ensure the effects of the Force Majeure Event are minimized."

(16) Mitigation in General

- US courts in their interpretation of these modifiers such as "commercially reasonable" are **inconsistent** and frequently very **fact specific**.^(38 - 39)

(38 - 39) E.g., *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14 (Del. Ch. 2001) (no consensus established by the courts). Note that in some jurisdictions "naked" best efforts clauses without specific performance metrics may not be enforceable. See, e.g., *Ehringer v. McData Servs. Corp.*, 646 F.3d 321, 327 (5th Cir. 2011)(Texas); *Gentieu v. Tony Stone Images/Chicago, Inc.*, 255 F. Supp. 2d 838, 867 (N.D. Ill. 2003)(Illinois). Note that in such instances the courts discard the clause entirely, rather substituting another standard of performance. In this regard the law in New York is also still evolving. See, e.g., *Hard Rock Cafe Int'l, (USA), Inc. v. Hard Rock Hotel Holdings, LLC*, 2011 U.S. Dist. LEXIS 76897 (S.D.N.Y. July 11, 2011).

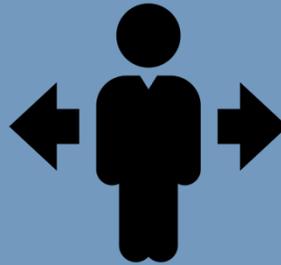
(16) Mitigation in General

- **Mitigation Caveats:** A Buyer should be **wary of general or "naked" mitigation standards**. They can be ambiguous by design and invite certain litigation and uncertain outcomes if and when a force majeure event occurs.
- **More Detailed Provisions:** It is essential for Buyer and other parties on the receiving end of a force majeure provision [especially in connection with transactions involving critical components and materials] to carefully consider and draft more specific mitigation provisions suited for the particular transaction.

(17) Breach for Failure to Mitigate

- Note that **failure** of the Seller to **mitigate** pursuant to the contract is a separate actionable **breach of contract**.
- Possible alternatives in addition to direct legal action by the Buyer include (i) immediate **termination** rights or (ii) **removal of the protections** of the force majeure clause either prospectively or retroactively, triggering a further legal action for underlying breach relating to the force majeure event.
- Make such rights **express** in the force majeure clause to avoid challenge. #

Enter: The T_0 Dilemma



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(18) Potential Mitigation Outcomes

- During the **mitigation period**, three outcomes are possible:
 - (1) Seller will **satisfy** its mitigation obligations and **end** the delay in a timely matter (in which case Seller is not liable for breach and the contract can proceed as contemplated);
 - (2) Seller will **satisfy** its mitigation obligation, but is **unable to end** the delay (in which case Seller is still not liable for breach but buyer can exercise remedy rights);
 - (3) Seller will **fail** to satisfy its mitigation obligation and end the delay (in which case Seller is liable for breach and Buyer can exercise remedy rights).

(18) T_0 Dilemma

- At T_0 (the time at which the force majeure event occurs and performance is first delayed) Buyer cannot know which of these scenarios will come to pass.



- All of the risk at T_0 sits with the Buyer:** A force majeure has occurred; performance of Seller is delayed or excused; Buyer does not know if Seller will be able to resume or if Seller will be liable for any failure to comply.

(19) T_0 Buyer Non-Performance

- The general common law rule is that if the Seller fails to perform under force majeure, Buyer has the **right to suspend** its own performance during the period of non-performance, and may be **discharged from its duties** to perform if the failure of the Seller to perform is not curable.⁽⁴⁰⁾
- This rule does not apply if the Buyer has **assumed the risk** of performance in spite of the failure of the Seller to perform. Buyer also must pay for any completed or substantial performance by Seller.⁽⁴¹⁾

(40) Restatement 2d of Contracts, § 237, 268(1).

(41) Restatement 2d of Contracts, § 268(2).

(19) T₀ Buyer Non-Performance

- Note that **Section 2–616** of the Uniform Commercial Code provides that a declaration of force majeure by Seller gives the Buyer the right to terminate its **reciprocal obligations** by written notice to the Seller.⁽⁴²⁾
- This includes the right to refuse any tender of performance by Seller during the force majeure period, but does not necessarily permit the Buyer to **enter into other long-term supply agreements** and then **refuse performance** by Seller after the force majeure ends.⁽⁴³⁾

(42) U.C.C. § 2-616(1), (3).

(43) *PT Kaltim Prima Coal v. AES Barbers Point, Inc.*, 180 F. Supp. 2d 475, 484 (S.D.N.Y. 2001).

(20) T₀ Rights of Buyer

To avoid assumption of risk, the contract could include express rights of Buyer **effective at T₀**. For example:

- **Suspension or discharge** of specified Buyer obligations, including (i) purchase or requirements obligations, and (ii) a right to refuse Seller's performance without notice and consent.
- Right of Buyer to **cover** in the market and **cancel open purchase orders** without penalty.
- Suspension of **exclusive dealing** or **non-competition** restrictions.
- **Immediate** termination of the contract by Buyer.

(21) Buyer Rights - Additional Rights

Additional Buyer Rights:

- Depending on the type of transaction between Seller and Buyer, the Buyer also should consider other **additional express rights** and remedies in the contract as necessary to minimize any damages from the force majeure and maximize its freedom to operate.
- The following are a nonexclusive list of **possible options** to be considered in appropriate circumstances.

(22) Buyer Rights - Reorganize Operations

Reorganization of Sourcing Function:

- Require Seller to **reorganize or shift its operations** as required to permit full or partial performance of its obligations under the contract.
- In the case of **COVID-19** for example, requiring reorganization of Seller operations to (i) allow employees to work in a "socially distanced" manner and (ii) take other steps required to comply with applicable regulations or orders.

(23) Buyer Rights - Sourcing Alternatives

Supply Chain Sourcing by Seller:

- Seller will be required to purchase substitute component and raw material from alternative suppliers at the Buyer prices required under the contract.
- **Example:**
"During the period of any Force Majeure Event, Buyer may require Seller to provide goods from other sources in quality, quantities and at a time requested by Buyer and at the prices paid by Buyer under this Agreement."

(24) Buyer Rights - Higher Cost Reimbursement

Seller Reimbursement:

- Seller will be required to reimburse Buyer for its purchase of substitute component and raw material from alternative suppliers at **pricing and costs** that are **higher** than the Buyer prices in the contract.
- In the alternative, the parties can agree to **share the risk**: for example, by requiring Seller to reimburse 60 percent of the **price differential**.

(24) Buyer Rights - Higher Cost Reimbursement

- **Example:**

"During the period of any Force Majeure Event, Buyer may purchase the Components from other sources without liability to Seller, and **Seller shall reimburse Buyer** for [all] **or** [____ percent of all]* additional [commercially reasonable] costs and expenses incurred by Buyer in obtaining such substitute Components, including but not limited to any pricing differentials and costs of redesign and tooling and other incidental costs, [provided that the aggregate maximum reimbursable amount shall not exceed \$[____]] or [maximum percentage above Buyer pricing]."

*[In the alternative].

(25) Buyer Rights - Changes in Terms

- **Changes in Terms:**

- The financial or other terms and conditions of the sale by Seller including pricing will be **modified** in the event of a force majeure to compensate the Buyer for the delay, shifting some or all of the risk to Seller.
- This for example can include price reductions linked to the length of the delay in performance.

(25) Buyer Rights - Changes in Terms

- **Example - Adjustment in Price:**

"In the event of a Force Majeure event, the purchase price for Machine shall be reduced as follows:

Force Majeure Period of up to 4 weeks	0% of Purchase Price
Force Majeure Period of 5 Weeks	1% of Purchase Price
Force Majeure Period of 6 Weeks	2% of Purchase Price
Force Majeure Period of 7 Weeks	3% of Purchase Price
Force Majeure Period of 6 Weeks	4% of Purchase Price
Force Majeure Period of more than 6 Weeks	Buyer may cancel order

(25) Buyer Rights - Changes in Terms

- **Example - Tolling of Performance Obligations:**

"Subject and in addition to the other rights of Buyer, any event of Force Majeure will defer and suspend the dates and computation of any time periods of performance by Seller under this Agreement until such Force Majeure event is concluded."

(26) Buyer Rights - BC/DR Plan

Business Continuity Plan:

- Seller shall be required to enter into and comply with a business continuity - disaster recovery (**BC/DR**) plan that is acceptable to Buyer.
- **Example:** "[Seller general mitigation language], including full compliance with and initiation of the procedures of the business continuity and disaster recovery plan set forth on Exhibit __ ("Plan"), which Plan may be updated by [the parties][Buyer] from time to time."

(27) Buyer Step-In Rights - Manufacturing

Step-In Manufacturing Rights:

Right of Buyer to **step-in** and **control** the **manufacturing and supply functions** of Seller products in the event of a **force majeure** or **other triggering event**. The following is indicative only of this type of clause:

(1) **Triggering Events:** Triggering events could include for example an epidemic failure rate [high percentage of defective components] or the intentional breach of Seller. The right would be immediately applicable upon the trigger and exercised by the Buyer upon notice.

(27) Buyer Step-In Rights - Manufacturing

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(27) Buyer Step-In Rights - Manufacturing

(2) **Direct Performance:** The Seller manufacturing and supply functions would be directly performed by Buyer or its affiliates or third party subcontractors.

(3) **Required Disclosures:** Seller would be required to disclose and deliver to Buyer and its subcontractors the designs, processes, specifications, tooling and materials used by Seller and necessary to manufacture and supply the applicable product or products.

(4) **Raw Materials:** Buyer or its subcontractor also would have the right to purchase raw materials and other parts inventories held by Seller at a price to be determined.

(27) Buyer Step-In Rights - Manufacturing

(5) **IP License:** In addition to or in lieu of direct performance rights, Seller would grant Buyer and its subcontractors a **nonexclusive manufacturing IP license**, effective as of the triggering event:

- to use the designs, processes, specifications, tooling and materials of Seller and other IP rights to manufacture or have made, sell and distribute the products; and
- to incorporate the manufactured products as components into Buyer's products for later sale or distribution.

(27) Buyer Step-In Rights - Manufacturing

(6) **Royalties:** The IP license would include a right of sublicense and would either be royalty-free or at a negotiated rate [subject to offset for any Buyer claims].

(7) **Escrows:** All necessary designs, specifications and other IP for the products could be placed into a third party escrow and updated to permit Buyer access upon the triggering event.

(8) **Confidentiality:** The use of the Seller IP by the Buyer or its subcontractors would be subject to standard **confidentiality** restrictions.

(27) Buyer Step-In Rights - Manufacturing

(9) **Technical Support:** Seller personnel also could be required to provide a reasonable level of technical consulting support to Buyer and its subcontractors for a stated time period following trigger.

(10) **Access to Suppliers and Subcontractors:** Buyer would have the additional right to directly access subcontractors and third party suppliers of Seller to perform the manufacturing and supply functions for the products [discussed further below].

(27) Buyer Step-In Rights - Manufacturing

(11) **Period of Step-In Rights:** The term of the manufacturing step-in rights and license could be for the period of the force majeure or triggering event plus a reasonable additional transition period, or could continue for the remaining term of the contract.

(12) **Termination with Survival:** Buyer also could have the right of termination of the contract with survival of the manufacturing step-in rights and license for a stated time period.

(28) Step-In Rights - Upstream Suppliers

Step-In Supplier Rights: Right of Buyer to access critical components and materials from upstream suppliers of Seller in the event of force majeure or other triggering event.

The following is indicative only of this type of clause:

- **Direct Purchase:** Buyer would have the direct right to purchase critical components and materials ("components") from upstream suppliers and subcontractors of Seller.

(28) Step-In Rights - Upstream Suppliers

- **Components:** This right could be for components and materials in general, or only for those made by a limited number or even a single third party supplier. This also would include components specifically designed for Buyer.
- **Disclosure of Sourcing:** Seller would disclose in writing to Buyer the identity and all relevant information concerning each supplier or subcontractor supplying the relevant components to Seller for use in manufacturing Buyer products, to be updated regularly.

(28) Step-In Rights - Upstream Suppliers

- **Agreements:** Seller would also provide Buyer with copies of all supply agreements and exhibits including pricing, as updated from time to time.
- **Required Upstream Terms:** The supply agreement between Seller and its upstream supplier or subcontractor would require the following:
 - (i) All supply agreements must be in writing.
 - (ii) Buyer would be a third party beneficiary of the supply agreement with the right but not the obligation to directly enforce such terms including the right of purchase the components directly from the supplier or subcontractor.

(29) Buyer Rights - Termination

Termination Right for Nonperformance:

- Buyer has the right to terminate the contract if Seller's **non-performance continues** for a specified period of time.
- This is particularly important [for example] where Buyer is subject to exclusivity or non-compete provisions obligating it to use Seller as its sole supplier.

(29) Buyer Rights - Termination

- **Example:**

"In the event that the Seller's failure or delay remains uncured for a period of [_____] days following written notice given by Seller of force majeure under this Section, the Buyer may terminate this Agreement and cancel all outstanding orders in its sole discretion upon [_____] days' written notice without penalty."

(29) Buyer Rights - Termination

- **Termination for Convenience:**

- The contract can provide for **termination for convenience** upon X days' notice.
- If **mutual** this obviously offers a **backdoor** out of a contract with a party who is unable to perform for force majeure or any other reason.

(29) Buyer Rights - Termination

Termination Right upon Force Majeure:

- An immediate unilateral right of Buyer to bail out at T_0 .
- **Example:**
"In the event of any Force Majeure Event or any notice by Seller of such Event, the Buyer may immediately and unilaterally terminate this Agreement and cancel all outstanding orders, by written notice in its sole discretion and without liability."

(30) Efficient Breach - Defensive Drafting

Efficient Breach:

- Under common law a contract party has the power to unilaterally breach an agreement, subject to its liability to the other party for damages from the breach (an "**efficient**" or "**economic**" breach).⁽⁴⁴⁾
- If the scope of the force majeure clause does **not excuse** the Seller and common defenses have been waived or are not applicable, an efficient breach may be a legitimate **option** for Seller.

(44) E.g., *159 MP Corp. v. Redbridge Bedford, LLC*, 33 N.Y.3d 353, 369 (N.Y. 2019) (efficient breach as part of the freedom to contract and considered to be social beneficial; penalties or punitive damages not applicable).

(30) Efficient Breach - Defensive Drafting

- The problems for the Buyer in an **efficient breach** can be manifold:
 - If Seller and Buyer are in a complex supply chain relationship, Buyer is immediately **deprived of the necessary resources** of the contract needed to discharge its own downstream obligations.
 - While the concept of efficient breach contemplates a plaintiff such as Buyer will be **made whole** through damages, this may not be true in fact.

(30) Efficient Breach - Defensive Drafting

- This is particularly the case if the contract contains boilerplate exclusions of **consequential damages** and **lost profits** or revenues in a limitation of liabilities clause.
- A standard **consequential damages clause** standing alone generally will shield Seller from liability claims arising from separate agreements between Buyer and third parties, including its downstream customers.⁽⁴⁵⁾

(45) *E.g., Compania Embotelladora Del Pacifico, S.A. v Pepsi Cola Co.*, 650 F. Supp. 2d 314 (S.D.N.Y. 2009).

(30) Efficient Breach - Defensive Drafting

- For remaining losses or damages not barred by the consequential damages provision, many enterprise-level limitation of liabilities clauses also contain **capped liability** provisions that may be a fraction of total damages incurred in fact from a Seller breach.⁽⁴⁶⁾

(46) For example, 1X revenues from the last 12 months or \$X. Note that the usual carve-outs such as fraud or breach of confidentiality or IP provisions would not be applicable to a straight efficient breach.

(30) Efficient Breach - Defensive Drafting

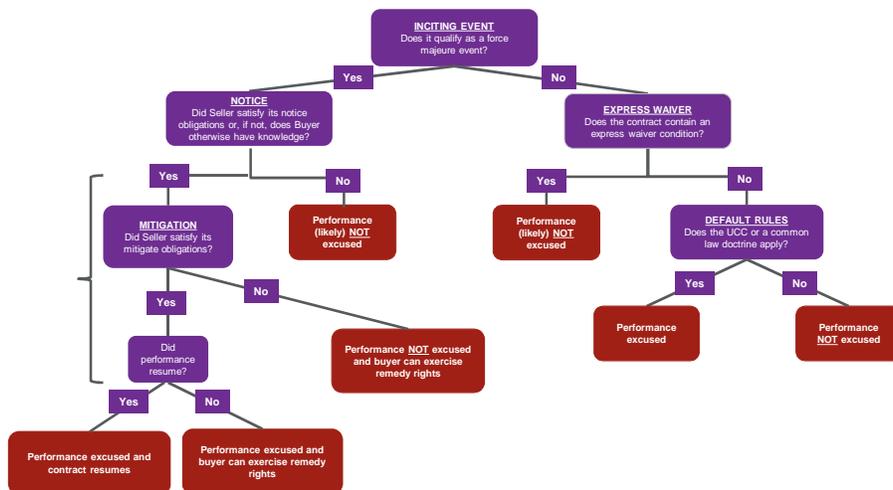
Buyer should consider the following additional tactical drafting choices depending on the terms of the existing contract to anticipate an **efficient breach** situation:

- **Specific carve-outs** from the limitation of liabilities clause for (i) any **intentional breach** of contract by the Seller [including any efficient breach] and (ii) any **breach** by the Seller of the **force majeure clause** specifically.
- The carve-out should include the **consequential damages** and **lost profits** exclusions, which would then subject the breaching Seller to unlimited damages.

(30) Efficient Breach - Defensive Drafting

- Include intentional breach and breach of the force majeure clause in the **indemnification and defense** provisions of the contract, to require Seller to fund and pay for any downstream third party claims arising from the breach.
- Depending on the positioning of the Buyer, Buyer may consider broader indemnification and defense provisions for any **third party claims** against Buyer caused by the Seller's **force majeure**, even if without fault, as pure risk allocation as between the parties. ##

Redux: General Flowchart of Force Majeure Clause



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Thank you.

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