

THE CONTRACT LAW AFTERMATH OF SEPTEMBER 11: FORCE MAJEURE AND “MAC” CLAUSES RE-EXAMINED

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While the terrorist attacks of September 11th had an obvious tragic effect on human life, some of the other effects of the attacks were less obvious. The terrorist attacks have forced contracting parties to rethink their contract provisions, particularly their force majeure clauses. After the attacks, parties almost immediately began asking whether their existing force majeure provisions would be sufficient to protect them in a situation such as that which occurred on September 11, 2001. Lawyers involved in drafting such provisions have gone back to the drafting table in hopes of providing their clients with adequate assurance that they are protected in the event of a terrorist attack.

How Force Majeure Clauses Work

Force majeure clauses in contracts serve the purpose of excusing a party from performing its obligations under the contract if the failure to perform is caused by certain enumerated events. The types of events that give rise to excused performance are usually events that are beyond the control of the non-performing party and which cause a hardship for the party. The premise for excusing performance is that since a party could not predict and prepare for such an event it would be inequitable to force the party to perform during the occurrence of such an event. The occurrence of a force majeure event would not necessarily excuse performance of the contract entirely, but may excuse performance during the continued existence of the force majeure event and for a reasonable amount of time thereafter. Additionally, the party that is excused from performing its usual obligations under the contract may have other obligations imposed upon it due to the occurrence of the force majeure event, such as an obligation to notify the other party of the occurrence of the event and an affirmative obligation to use good faith efforts to mitigate the impact of the event.

There are standard events that appear in most force majeure clauses. A standard force majeure provision will excuse a failure of performance that is caused by or arises out of acts of God or the elements, acts of war, acts of certain third parties such as suppliers and carriers, shortages of raw materials and supplies, riots and civil disturbances. Other force majeure events are highly negotiated between the contracting parties and may be specific to the type of contract and the type of services being provided by and to the parties.

Are Standard Force Majeure Clauses Enough?

As parties found their ability to perform contract obligations hampered by the events of September 11th, or alternatively, as they discovered that their counterpart was not performing under a contract due to the terrorist attacks, they have increasingly turned to their force majeure provisions to examine whether the lack of performance was excused by the terrorist attacks.

Most often the parties have turned to the phrase “act of war” (which appears almost without exception in a force majeure clause) as an exception to performance of the contract. However, reliance upon the phrase “act of war” may be misplaced when the actual event preventing contract performance was one performed by terrorists.

Reliance upon the phrase “act of war” may turn in part upon the immediate pronouncement by President George Bush on September 11th that the terrorist acts were an “act of war” against the United States. However, despite President Bush’s description of the attacks, the United States was not itself at war at the time of the attacks. Additionally, there is significant case law developed over the past twenty-five years (mostly in the insurance law area) which indicates that courts will narrowly construe the phrase “act of war” to mean hostilities between entities with significant attributes of sovereignty. Indeed, we commonly think of war as occurring between nations, rather than as something propelled by a group of insurgents. Courts have also rejected the acts of guerilla groups as acts of “war” for insurance purposes. Acts performed by a group of terrorists, rather than a sovereign entity, will most likely not be construed as an act of war. This means that the “act of war” exception to performance of contract obligations may not be applicable to acts of terrorism.

There are also other events enumerated in force majeure clauses that most likely will not excuse performance of contract obligations due to terrorist attacks. Words such as “insurrection” and “hostilities”, which seem rather generic and prone to broad interpretation, have in fact not been broadly interpreted by courts examining their meaning in insurance cases. Courts have interpreted the term “hostilities” as narrowly as the term “war.” And courts have interpreted “insurrection” as a violent uprising for the specific purpose of overthrowing the existing government; violence without such an intent, regardless of whether achievement of the intended purpose was realistic or not, will not suffice as an insurrection. Again, these standard force majeure events may not be applicable to acts of terrorism.

Drafting Changes

In order to protect our clients, the simplest drafting change to standard force majeure provisions may be to include “acts of terrorism” as an enumerated force majeure event. The phrase “acts of terrorism” may be further qualified by adding the language “whether actual or threatened.” Expanding the definition of terrorism to include *threatened acts of terrorism* is helpful to clients since we have seen that the false alarms reported after the September 11th attacks were often just as prohibitive to the flow of business as the actual attacks. Making the *threat* of terrorism a force majeure event also allows clients to err on the side of safety (for example, closing shop for a number of days following a bomb or biological scare to completely search a building) rather than risk the lives and well-being of employees due to the potential threat of lawsuits if a contract is not completed on time.

The term “terrorism” has become a household word for U.S. citizens since September 11th, but it is not a word that has been interpreted and subject to judicial scrutiny. Without the additional comfort of judicial interpretation, it may be necessary to broaden force majeure provisions beyond the addition of an “acts of terrorism” phrase. Another phrase that has emerged more frequently in force majeure provisions is “acts of a public enemy.” It may also be possible to provide clients with protection by adding the phrase “or other causes similar to those

enumerated” at the end of the list of force majeure events. This “catch-all” phrase should help capture events that are related to the type of events specified but which defy exact definition.

A corollary of the terrorist attacks has been the threat of biological warfare; stories of the proliferation of anthrax dominated the headlines for weeks and the fear of other biological threats also loom large. We have learned of businesses being evacuated and mail and machinery being quarantined while medical testing is performed to evaluate the biological risks to humans. As a result of the changing face of warfare, the terms “epidemics” and “quarantines” may also be appropriate additions to the list of enumerated force majeure events.

As always, we should also be expanding our force majeure provisions to address the particular needs of our clients. Clients who produce and provide products intended for consumption may benefit from a force majeure event such as “the threat or actual existence of a condition that may affect the integrity of [the product].” Such a clause may be particularly helpful due to the recent biological warfare scares. This clause may also be useful for clients who produce other types of products the integrity or composition of which may be compromised by chemical or other changes in surrounding conditions. This additional force majeure event may also serve to broaden a client’s protection against more than organized terrorist attacks. If, for example, a biological attack was not the work of terrorists, but rather was the plot of a deranged individual, such a clause may excuse a failure in performance that otherwise may not be covered by the enumerated force majeure events.

Other Contract Changes

Force majeure provisions are not the only contract provisions that are being reexamined in light of the recent terrorist attacks; material adverse change provisions in acquisition and merger agreements are also being revisited. Material adverse change provisions provide an escape hatch for a potential acquirer, allowing it to pull out of a contemplated transaction if certain material adverse changes occur between the signing of the contract and the closing of the deal.

Although USA Networks Inc. agreed in July, 2001 to merge with National Leisure Group, Inc., a cruise and vacation company, after the terrorist attacks USA Networks sued National Leisure in an attempt to void their proposed merger. USA Networks claimed that the September 11th terrorist attacks, as well as National Leisure’s loss of a large client, had triggered the material adverse change clause contained in their merger agreement. The lawsuit, which was filed by USA Networks on October 3rd, would have provided the first judicial interpretation of whether the terrorist attacks are justification for ending a merger pursuant to a material adverse change clause.

At the end of October, USA Networks agreed to settle the suit. The week prior to settlement, National Leisure’s sales rebounded to pre-attack levels and it was expected that National Leisure would post a large percentage gain over its year 2000 sales. It has been speculated that National Leisure’s gain in sales may have prompted USA Networks to settle the dispute, since a high-profile Delaware case from earlier this year held that a material adverse change clause is not triggered by a *temporary* decline in business.

After the attacks Berkshire Hathaway Inc. pulled out of a deal to purchase \$500 million in bonds from Finova Group Inc. Berkshire cited two provisions in the tender offer as the basis for its withdrawal, an “act of war” clause and a market closure clause. The war clause allowed Berkshire to pull out of the deal upon the “commencement of a war or armed hostilities or other national or international calamity directly or indirectly involving the United States”. The other clause allowed the offer to be withdrawn upon “any general suspension of trading in securities on any national securities exchange.” On the Monday following the attacks, after the four-day closure of the U.S. markets, Berkshire Hathaway withdrew from the Finova tender offer.

In its October 10, 2001 edition, the *Wall Street Journal* reported that investment bankers and law firms alike have begun expanding their material adverse change clauses to include such events as “acts of terrorism” and stock exchange closures within the category of events that allows a party to walk away from a deal without liability. Conversely, some corporate sellers are insisting that these events be explicitly identified as the types of events that *will not* allow a buyer to renege on the deal. Again, in light of the recent attacks, buyers and sellers are being forced to reconsider their contract language and now regard terrorism as a potential “deal breaker.”

Conclusion

We have the ability to protect our clients by drafting broader, and, in light of recent events, more appropriate, force majeure clauses – clauses that reflect the new era of warfare. Without such protection, our clients may be forced to perform their contractual obligations when the business world has been disrupted by terrorist acts. If our clients are unable to perform under such circumstances, they could be faced with a claim for breach of contract and potential liability for damages. Due to the unfortunate events of September 11th, we have seen first hand how acts of terrorism can wreak havoc on the commercial world. The occurrence of terrorism is unpredictable. What is predictable is that our clients may benefit from a terrorism clause in their force majeure provisions and that as diligent attorneys we can help provide our clients with that protection.