LOEB & LOEB LLP

COVID-19

March 13, 2020

The Legal Side of Mitigating COVID-19 Business Disruptions

As COVID-19 continues to spread, companies are evaluating how to protect the continuity of their business operations. Companies should take at least the following steps to plan for and mitigate business disruptions:

1. Review **existing contracts** and applicable law to determine how they apply to COVID-19.
2. When entering into **new contracts**, do not rely on boilerplate; rather, carefully draft relevant provisions in light of COVID-19 to address your specific situation/point of view.
3. Consider how COVID-19 will impact not only traditional contracts, but also the **terms of offers** you have made or are planning to make to the public, such as **sweepstakes, contests and other promotional offers**.
4. Take a **cautious approach to termination**. Consider the domino effects of any termination, as well as whether a suspension or "make good" would work in place of a termination.
5. Review the business continuity plan and disaster recovery (BCP/DR) provisions in your contracts to **understand how BCP/DR applies to you**. Review key vendors' current plans to determine whether those plans meet contractual requirements and will be sufficient if their services are disrupted.
6. Review **insurance policies** to determine whether they cover disruptions caused by COVID-19.

1. Review existing contracts and applicable law to determine whether they apply to COVID-19.

Many contracts will include a "force majeure" clause, which attempts to deal with unforeseeable circumstances that prevent a party from fulfilling its obligations. New York courts construe force majeure clauses narrowly, and frequently require the event causing the failure to perform to have been "unforeseeable" unless otherwise specifically stated in the provision.

However, while many force majeure clauses look the same, some have small and subtle, yet consequential, differences, which ultimately may be the determining factor in whether or not you are covered. We encourage you to read these provisions carefully, keeping in mind the specific language and the specific factual scenario that led to the failure to perform.

First, check whether a force majeure event includes the outbreak of a disease. If it does, consider whether such an outbreak is defined as a "pandemic" (which impacts the world) or an "epidemic" (which impacts a region). Each specific word will have a different impact on how the clause is ultimately interpreted.

If the clause does not include the outbreak of a disease as a force majeure event, there still may be other events resulting from COVID-19 that could qualify as force majeure events. For instance, many force majeure clauses identify unexpected and unavoidable government actions as force majeure

events. As such, a government-imposed quarantine or closure of transportation systems in response to COVID-19 that impacts a party's ability to perform may serve to immunize a company from its failure to perform.

One limiting factor in invoking a force majeure provision is that the clause is often written to apply only where a party's performance is "impossible." Given that many of the current event cancellations are precautionary (meaning that people are canceling events out of the fear of something happening, rather than because of something actually happening), the question will likely arise whether such a cancellation would be excused.

In some states, if the contract does not contain a force majeure clause, a party impacted by COVID-19 may still be able to excuse its obligations by terminating the contract under the doctrine of frustration. Generally, the threshold for canceling a contract on this basis is high, and requires that the party bringing the claim prove either that an unforeseen event makes performance impossible (not merely more difficult or expensive) or that the circumstances around the original purpose of the contract have so changed that performance has become impossible.

As a final note, be careful when asserting suspension or termination due to force majeure or frustration, as failing to perform based on an incorrect assertion may amount to a breach of the contract.

2. When entering into new contracts, do not rely on boilerplate; instead, carefully draft relevant provisions in light of COVID-19 to address your specific situation/point of view.

While it may be too late to change existing contracts, companies can be proactive by taking COVID-19 into account. Note that contracts entered into now will likely be held to a much higher standard, as a disruption due to COVID-19 is no longer unforeseeable.

When drafting or reviewing a force majeure provision, keep in mind that your needs will likely differ depending on your position—for example, whether you are the client on the buy side or the vendor on the sell side. For instance, while contracts often identify specific events that constitute an event of force majeure or "act of God," as stated above, words like "pandemic" or "epidemic" may be too narrow if you are a vendor or too broad if you are a client, especially if it turns out that a formal determination has not been made in the relevant geography. (This may be a moot point for COVID-19, given that the World Health Organization on March 11 declared COVID-19 a pandemic). In any event, terms like "virus/disease outbreak" may give a vendor more leeway (or a client too much leeway), if/when the contract is ultimately interpreted. If you are a client, it is important that your provision be comprehensive enough that a force majeure event does not merely "prevent" your vendor's performance, but also requires that your vendor's performance would be substantially more dangerous, costly or time-consuming (as many events are being canceled due not to an actual occurrence of COVID-19 but rather to the threat of a COVID-19 outbreak).

In addition, if you are the client under the contract, you will generally prefer to define a force majeure event narrowly, with limitations on when force majeure applies, to avoid vendors invoking the clause too freely. Elements to consider when drafting the clause include (a) whether there are conditions that would prevent the client from performing, thus necessitating the clause to be mutual; (b) given that we know a disease-related disturbance is likely, what other specific events would have to happen in order for the vendor to be deemed not responsible (e.g., a government shutdown, government-imposed quarantines, a city requiring an event to be canceled, airlines refusing to fly); (c) if the vendor fails to perform, whether you would want the entire contract to be terminated, or merely the portion of the services

that were impossible to perform; and (d) whether you would benefit from a suspension of the contract for a limited amount of time.

Conversely, if you are the vendor under the contract, you will generally prefer to define a force majeure event as broadly as possible to cover any unforeseen circumstance. Certainly you would prefer the agreement to be suspended until such time as services can be performed and with no payments being refunded to the client.

Sponsors, properties, production companies and talent may also want to carefully look at these provisions in pending or future contracts in order to fully address the issues that arise in those contexts (as further detailed in Section 4, below).

3. Consider how COVID-19 will impact not only traditional contracts, but also the terms of offers you have made or are planning to make to the public, such as sweepstakes, contests and other promotional offers.

If your company is currently running or plans to run promotional offers, such as sweepstakes or contests where the rewards involve events (e.g., tickets to concerts) or providing the winner with a travel package (e.g., a cruise to Italy), COVID-19 may prevent your company from being able to fulfill these rewards. If your company does plan to fulfill rewards, consider whether doing so could put the health of the winner (or others) at risk or create potential PR and liability issues. COVID-19 may also impact fulfillment of promotional offers not involving events or travel. For example, if a promotional offer involves providing a large number of winners with certain goods (e.g., electronics manufactured in China), disruptions in the supply chain caused by COVID-19 may make obtaining those goods prohibitively expensive or impossible. Finally, is there an in-store component to the promotion, or some other way that consumers will be interacting directly with other people? If so, you may want to provide for the right to have this method canceled or modified.

In short, for any active promotional offers that may be impacted by COVID-19, you may want to develop backup plans to address any disruptions, and address these issues in your terms and conditions, possibly with "substitution" provisions.

4. Take a cautious approach to termination. Consider the domino effects of any termination, as well as whether a suspension or "make good" would work in place of a termination.

Some contracts will allow a company to terminate for any reason ("convenience"), for a party's failure to perform ("breach") and/or if a force majeure event occurs. Companies should be cautious exercising these rights, considering the impact on the rest of the business and the company's relationship with the other party and any third parties. For example, if you are a sponsor and terminate your sponsorship agreement now, will that company want you as a sponsor in the future? If you are a vendor and refuse to refund compensation to a client now, will the client want to hire you later?

A client terminating a vendor contract should assess the impact not only of the costs of finding a replacement vendor, but also of the loss of any efficiencies the existing vendor may bring to the client's operations. The vendor may be integrated into the client's various business lines, performing business tasks that may need to be performed in-house if the vendor is terminated. As an alternative to termination, the client may want to consider pushing the nonperforming vendor to waive fees during the suspension of services or provide a "make good."

Vendors deciding whether to terminate a contract with a client due to a force majeure event may want to consider how that decision will be perceived by others in the market. If a vendor terminates its contract with one client, other clients may become concerned that

the vendor will terminate their contracts or that the vendor is not financially sound, and start looking for replacement vendors.

In addition, before terminating any contracts, the company will want to review how the contract addresses compensation after termination.

Additionally, in sponsorship agreements, often the language provides that the sponsor will get an agreed-upon make good (or perhaps a pro rata refund or credit) in the event the sponsor loses benefits due to a force majeure event. In light of many of the league suspensions (e.g., NBA, MLB, NHL) due to COVID-19, sponsors may be in a "wait and see" position for now, but should proactively look to their agreements and consider whether make goods will work if/when the applicable sports season resumes, and if not, whether a pro rata refund (or credit) would be more appropriate.

Also, in the context of production agreements, care should be taken to consider who should bear the cost of a canceled production—whether due to the producer canceling or the talent refusing to show due to COVID-19 concerns. This issue will often be addressed via a separate business discussion and reliance on the relationship of the parties (as opposed to adherence to specific legal language).

5. Review BCP/DR provisions in your contracts to understand how they apply to you. Review key vendors' current plans to determine whether those plans meet contractual requirements and/or are sufficient if their services are disrupted.

Business Continuity Plans and Disaster Recovery Plans are documents that outline how a business will continue operating during an unplanned disruption in service and recover from the disruption. Business Continuity Plans are concerned with keeping business operations running—perhaps in another location or by using different tools and processes—after a disaster has struck. Disaster Recovery Plans are concerned with restoring normal business operations after the disaster happens. Not all companies have these types of documents prepared, but if they did not have them before COVID-19 became widespread, they are likely now in the process of developing plans to address the issue.

To the extent that vendors are providing mission-critical services, you may want to be proactive and reach out to confirm that the vendors are meeting their contractual obligations under those plans. If vendors do not have BCP/DR plans or obligations in their contract with you, you may want to ask them (1) if they have BCP/DRs; (2) whether these BCP/DRs would address service disruptions caused by COVID-19; and (3) how they are preparing to ensure that their services will not be impacted by COVID-19. Ask the vendors if they have recently tested the plans and how they have remediated any problems that were identified by those tests. All new contracts should require BCP/DR provisions requiring that vendors maintain and regularly test an agreed-upon BCP/DR.

Additionally, you may want to review your company's BCP/DR to determine whether it addresses disruptions caused by COVID-19 and has the flexibility to utilize the BCP/DR of a key vendor that suffers a COVID-19 disruption. If it does not, you may want to update your company's infrastructure.

6. Review insurance policies to determine whether they cover disruptions caused by COVID-19.

Companies may want to check their commercial insurance policies to determine whether they would cover losses stemming from vendors' failure to perform under an agreement due to COVID-19. The policies may cover business interruptions or contingent business interruptions (disruptions caused by vendors). However, frequently these policies require that direct physical damage or loss occur for payout to happen. In addition, many policies have specific exclusions for outbreaks of diseases

or require the purchase of additional endorsements to cover claims relating to disease outbreaks. For instance, event venues often require that entities booking their space carry cancellation insurance, but these policies typically exclude coverage for outbreaks of diseases. Marsh (a leading insurance broker and risk management company) has clarified that after March 31 COVID-19 will be deemed an act of God uninsurable under many of the policies it sells on behalf of carriers.

Your company's commercial insurance broker will be able to advise on whether your company's policy covers outbreaks of diseases, and can help you purchase this coverage if your company wants to buy it. Note, however, that the insurer likely cannot backdate a policy, and that pricing for these policies may have increased due to the COVID-19 outbreak.

Related Professionals

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6269 REV2 03-18-2020