

# Coronavirus (COVID-19) Crisis

## *Force Majeure under the 2002 ISDA Master Agreement*

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### INTRODUCTION

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In the wake of the September 11<sup>th</sup> Terrorist Attacks, the International Swaps and Derivatives Association included a Force Majeure Clause when publishing their 2002 ISDA Master Agreement. Thankfully, this clause has remained untested since then, but the novel Coronavirus outbreak has created unfortunate circumstances that may give rise to situations where this clause is put into effect.

Businesses the world over have needed to move swiftly and in an unprecedented manner to implement their business continuity plans. Personnel across all sectors are now working from home, leaving behind their multi-screen displays and T3 internet connections.<sup>1</sup> All the while schools and daycares have closed, forcing parents to manage their workload while simultaneously finding time to care for, educate, and entertain their children. It is becoming commonplace to hear a screaming child in the background on the daily conference call.

All of this creates inefficiencies, gaps, and the potential for increased operational failures on both the buy and sell side.

It is critical at times like these that hedge fund and asset managers (“**Managers**”) understand the implications of the Force



Majeure provisions in their 2002 ISDA Master Agreement (the “Agreement”) and prepare for circumstances where it may be invoked. Proper use of the provisions may allow Managers to temporarily excuse the performance of their obligations, affording them crucial time to take remedial action in order to avoid Termination Events from occurring.

This article focuses exclusively on the Force Majeure provisions in the 2002 ISDA Master Agreement. For other agreements impacted by the COVID-19 outbreak, please see our recent article, “*Coronavirus Crisis (COVID-19), Key Concerns for Hedge Fund and Asset Managers with Respect to Trading*” [available here](#). Further, for Managers still operating under the 1992 ISDA Master Agreement, please contact your counsel to determine whether Force Majeure clauses were inserted via the ISDA Illegality/Force Majeure Protocol amendments or bi-lateral amendments.

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<sup>1</sup> <https://www.bnnbloomberg.ca/traders-dread-getting-sent-home-as-markets-move-faster-than-wifi-1.1409762>

## Force Majeure under New York Law

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As the application of Force Majeure to derivative contracts under the 2002 ISDA Master Agreement has remained untested, careful consideration must be given to the treatment of these clauses under New York Law.

Force Majeure clauses are interpreted narrowly in the State of New York, limiting the party to excuse their performance only in the circumstances specifically enumerated in the provision.<sup>2</sup> If the provision includes a catch-all phrase, such as the words “including but not limited to”, or “and other acts of God”, the courts will look to expand the language only to events similar or synonymous to those listed.<sup>3</sup>

## Force Majeure under the 2002 ISDA Master Agreement

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The 2002 ISDA Master Agreement does not enumerate exhaustively situations in which a party may excuse their liability, confining the definition to situations and acts of state which are out of the party’s control and render the obligation either impossible and/or impractical. It should be noted here that the application of Force Majeure remains fact-specific and will ultimately be subject to a court decision. The following examples are therefore illustrative but not conclusive.

### Impossibility

Situations such as a government quarantine or the extension of a Banking Holiday may render your obligations under the Agreement impossible to perform. Impossibility may only be used in circumstances where the measures are so restrictive that they preclude you from fulfilling your obligations by any means necessary. It is therefore a high threshold to satisfy, but given the circumstances, it also gives rise to the clearest examples.

### Impracticability

Impracticability may occur if offices in a region are closed based on a government recommendation which does not carry with it the force of law.<sup>4</sup> In this situation, it is *possible*, yet very well *impractical*, for one of the two parties to satisfy their obligations by ignoring Public Health and Safety concerns and heading to the office. As governments continue to gravitate to more restrictive measures to contain the virus’ spread, the ability to invoke impracticability as a ground for a Force Majeure defense may become possible to satisfy.

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<sup>2</sup> *Kel Kim Corp. v. Cent. Markets, Inc.*, 70 N.Y.2d 900, 902, 519 N.E.2d 295, at para. 6, *Drummond Coal Sales, Inc. v. Kinder Morgan Operating LP* at para 20.

<sup>3</sup> *Ibid* at para 20.

<sup>4</sup> ISDA Recording: COVID-19 and Discussion (<https://www.isda.org/2020/03/04/recording-isda-call-covid-19-update-and-discussion/>).

## **Actions to Undertake when Invoking Force Majeure**

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### **Reasonable Efforts**

To rely on the Force Majeure provision, the affected party must undertake all reasonable efforts to try and fulfill their obligations. Once again, it is difficult to determine at the onset what would be deemed all reasonable efforts in the circumstances. Engaging in business continuity planning, reviewing your operating lines, and informing internal as well as external stakeholders on the potential impact a Force Majeure Event may have on your operations would be excellent places to start.

### **Give Notice when the Event Occurs**

The obligation to give notice of a Force Majeure Event requires the Office in question to use all reasonable efforts to contact the counterparty, inform them of the nature of the event, and give all information regarding the situation as the other party may reasonably require.

## **Effect of Invoking Force Majeure**

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### **Deferral of Obligations**

Invoking Force Majeure does not excuse you from your obligations indefinitely; it simply defers the payment or delivery to a maximum of eight local business days following the day that would have been the first local business day if the Force Majeure Event had not occurred. In other words, it is due eight local business days following the day after payment would have otherwise been due, regardless of whether the government quarantine or another Force Majeure Event has ceased to be in effect. In situations where the event forming the basis of the Force Majeure terminates earlier than the aforementioned period, the payment or delivery will be deferred to the first local business day following the cessation of the Force Majeure Event. Managers should therefore be prepared to act immediately and perform the obligation throughout the course of the event as its cessation will be difficult to forecast in advance.

## **Conclusion**

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As governments continue to institute measures to decrease the virus' spread, the likelihood of being able to invoke Force Majeure to excuse the performance of your obligations and consequently avoid a termination event will increase. Managers should act now by reviewing the provisions in their ISDA Agreement and seeking out guidance where appropriate. The best course of action, at present, is to be proactive in implementing your Business Continuity Plan and identify weaknesses that may lead to invoking the provisions. Managers should also have a strategy in place to perform their obligations immediately following the cessation of the Force Majeure Event, or at worst, be able to act following the end of the eight local business day deferral period.

## Contact

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## About the Firm

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