

COVID-19: Practical advice around contractual and supply chain issues

The extreme circumstances and uncertainty generated by the COVID-19 outbreak continues to place severe strain on commercial relationships and supply chains. Parties are turning to mechanisms, whether contractual or otherwise, which may allow them to avoid liability for breach, renegotiate terms or delay performance. We address the most important mechanisms available under English law in an easy-to-use checklist below.

FORCE MAJEURE

Force majeure clauses are a contractual term by which the parties (or one of them) are entitled to cancel the contract or are excused from or entitled to delay performance (in whole or part) upon the happening of a specified event beyond their control. Whether you are considering declaring force majeure or have received a force majeure notice from a counterparty, the most important considerations are:

<p>Is there a force majeure clause?</p>	<p>Business critical contracts that have been put together on legal advice will often contain force majeure provisions, but less formal arrangements may not.</p>
<p>Is COVID-19 covered by the clause?</p>	<p>Force majeure has no set meaning in English law; the effect of any clause is determined by the contractual wording agreed by the parties.</p>
	<p>The wording in the clause is critical. Most force majeure clauses cater for specifically identifiable events (e.g. war involving the country of one the contracting parties).</p> <ul style="list-style-type: none"> (i) What are the specified force majeure events in the contract? (ii) Do they reference 'epidemic', 'pandemic' or government action? (iii) Is there a catch-all provision which could apply? (iv) Are any events expressly excluded from the ambit of the clause?

	<p>Analyse whether the threshold for triggering the force majeure clause has been met.</p> <p>Does the contract provide that the force majeure event must have 'prevented', 'delayed' or 'hindered' performance?</p>
Closely scrutinise causation arguments	The force majeure event (or events) must be the sole cause of a party's failure to fulfil its contractual obligations. This could be difficult to prove in complex, high value or multi-jurisdictional contractual relationships.
	In some cases this may be straightforward (e.g. change in the law making contractual performance illegal) but other instances may be less clear cut. For example, staff illness could mean a contracted service is more difficult to provide, but it might be argued that the supplier should have been able to procure staff from elsewhere.
	Force majeure declarations based on a change of economic circumstances or increased costs of contractual compliance are unlikely to succeed.
Notification	A party seeking to rely on a force majeure clause will often need to comply with notice requirements set out in the contract, which should be strictly observed.
	Any outgoing or incoming notices should precisely identify the specific force majeure event (or events) which has/have triggered the clause (travel bans, quarantine measures, etc).
Continuing obligations	Contracts can require the parties to continue to perform some of their obligations once a force majeure clause has been invoked and/or accepted, or give parties the right to terminate after a specified period of delay.
	Carefully examine the effects of the force majeure clause and mechanics of your contract to determine the nature of the parties' performance once the force majeure clause has been invoked, and plan accordingly.
Mitigation	Has the party relying on the force majeure clause taken reasonable steps to avoid the relevant event and mitigate its loss?
	Affected parties should consider whether alternative performance is possible.
Consequences of clause being valid?	The effect of a valid force majeure clause will usually be to suspend each party's contractual obligations.
	However, some contracts provide for payment to be made even if the goods/services are not produced.
	This type of clause raises potential issues. For example, does the effect of the force majeure provision render the contract void for lack of consideration, or could the clause be classed as an unfair contract term (especially relevant in consumer contracts).

Gather evidence supporting your position	Keep full and accurate records with a view to issuing/defending a future claim should there be a dispute about the operation of the force majeure clause.
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ALTERNATIVES TO FORCE MAJEURE – FRUSTRATION

Where the relevant circumstances do not fall within the scope of a force majeure clause, but a contract becomes impossible to perform as a consequence of the COVID-19 outbreak, it may still be open for a party to argue that it has been frustrated.

A contract may be discharged (and automatically terminated) by frustration upon an occurrence which makes it physically or commercially impossible to fulfil, or radically transforms performance. Frustration is a common law doctrine and available even when not specifically addressed in the contract.

Grounds for frustration

Establishing frustration is difficult as it applies in extreme scenarios. Claims of frustration rarely succeed in the English Courts, and frustration is thought to have a narrower scope than a typical force majeure clause.

However, contracts have been frustrated on the following grounds (amongst others) which may be applicable in the current circumstances:

- (i) unavailability of the subject matter of the contract,
- (ii) supervening illegality (i.e. a change in the law making performance impossible),
- (iii) an unexpected delay in performance (i.e. a delay which falls outside of what the parties could have reasonably contemplated at the time of contracting).

Delay is more likely to provide a basis for frustration where the contract specifies that time is of the essence.

Availability

Frustration will not be available where the circumstances in question are referenced in a force majeure clause. Frustration will result in the end of termination of the contract, whereas force majeure will allow it to continue.

ALTERNATIVES TO FORCE MAJEURE – ADDITIONAL CONTRACTUAL CLAUSES OF RELEVANCE

MAC and MAE clauses

A Material Adverse Change (MAC)/Material Adverse Effect (MAE) clauses entitle a party to either re-negotiate the price or not complete an agreement if certain events occur. The most common examples of these would be:

- (i) corporate sale and purchase agreements, where the price agreed for the actual sale of assets/share can be re-calculated if there has been a MAC and
- (ii) financing agreements which state there is no obligation to actually lend (or the lender can demand money back) if there has been a MAC.

Whether the COVID-19 outbreak qualifies as 'material adverse change' or has a 'material adverse effect', and the consequences of it doing so, will ultimately depend on the wording in the contract.

Change of Law clauses

Change of Law clauses may allow a party to renegotiate or terminate the contract upon a change in applicable legislation. This would be relevant when, for example, changes to legislation would mean that the goods under the contract cannot legally be exported to the customer.

Limitation / Exclusion clauses

Limitation/Exclusion clauses allow parties to limit or exclude liability for breach of contract. Where a contract has been negotiated between two businesses, it is likely that limitation of liability will be binding. There is an additional level of complexity, however, in consumer contracts where individuals have additional protection over unfair exclusion of liability.

As a more general note, businesses should be aware of the impact that some of these contractual provisions may have on banking covenants.

If you are unsure how any of the above may impact your business, please contact the Hausfeld team in London as per below.



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