COVID-19 - Answers to Key Questions:
Managing Contract Performance Issues

As countries worldwide implement new and restrictive measures to combat the spread of COVID-19, many businesses are finding that they, or their business partners, are struggling or failing to meet existing contractual obligations.

Do the unprecedented circumstances presented by COVID-19 mean that a defaulting party will always be excused from performing its obligations? The short answer is "no". The full answer lies in the terms of the specific contract and the context of the non-performance.

We focus below on a number of important contractual considerations, concentrating on key contracts, supply chain management issues, and revenue sources. We provide you with the answers to a variety of questions we are addressing at the moment.

What practical steps should we take if trading will be disrupted in the next few weeks or months?

From a legal and risk perspective your business can take a number of steps now, designed to ensure that it is as prepared as possible to manage its contractual obligations over the coming weeks and months.

- Identify and focus on business critical contracts, focusing on revenue earning contracts, strategically important contracts, and those carrying large risks or liability exposure in relation to non-performance;
- Evaluate third party dependencies; if performance issues are likely to be with a key third party, open communication channels early and directly to discuss likely performance impact;
- Remember that your counterparties are likely facing similar challenges and concerns, so early and open dialogue may be mutually beneficial;
- Review and triage risk and contingency plans in existence in relation to your business model, adjust if necessary and take appropriate action to implement;
- If performance of the contract is regulated in any way, actively monitor directions and guidance from the relevant regulator, and check with the government department for developments;
- If you have insurance cover for business interruption, consider the policy terms carefully, these policies are likely to require you to notify of "circumstances likely to give rise to a claim";
- Keep a record of official guidance and government announcements that inform your business and contract decisions.

What does the agreement say about non-performance?

Where a written agreement exists the starting point is always to carefully review its terms and conditions in the event of non-performance or likely default. One of the purposes of a commercial contract is to manage what should happen in these events. Key provisions to look for and analyse include:

- Provisions, such as governance procedures and change control schedules, managing how parties deal with proposals to amend obligations or service levels;
- Force majeure clauses;
- Obligations to notify a likely delay or failure to perform the contract;
- Provisions dealing with suspension or termination of the contract;
- Clauses managing contract breaches;
- Clauses allocating liability and risk for contract default;
- Requirements to manage liabilities and to mitigate losses;
- Obligations to manage employees and personnel performing the contracts in accordance with applicable laws, including those associated with health and safety;
- Communications and reporting obligations;
- Subcontracts; and
- Insurance obligations.

What is the best option for our business to take in relation to our contracts?

Don't forget that this Covid-19 event will end eventually. Our collective focus will naturally be to act appropriately to preserve and protect businesses during this challenging period. Commercial contracts are designed to manage relationships, and businesses will want those key relationships to survive this period.

For many clients, the answer to these contract performance interruption issues will not be to terminate the contract, or to issue notices asserting breach of contract. Instead, developing and agreeing ways of working with other businesses during this trading period will be the appropriate course of action. Recognising that the terms of current contracts may unavoidably be departed from, it will often be sensible to focus on agreeing what contract provisions should be suspended and adjusted to take account of business disruption, and to prepare a short form amendment agreement dealing with what is agreed during this period.

What is a "force majeure" clause, and why is it relevant to the Coronavirus?

Commercial contracts will usually contain a force majeure clause. This clause typically outlines the impact for the contract of an event outside of the parties' control which prevents or impedes the normal performance of the contract. Usefully, it will often state that an affected party is not liable for non-performance due to a force majeure event. Reliance on a force majeure clause may be contingent on giving notice describing the force majeure event, or the satisfaction of other conditions.

Not all contracts contain a force majeure clause, and there is no implied or standard-form clause, nor a standard definition of a "force majeure event". The terms of the specific contract will need to be reviewed to determine whether non-performance by a party may be excused or suspended in certain circumstances, what those circumstances are, and what impact a force majeure event will have on the liability of the non-performing party. Where COVID-19 impact does qualify as a force majeure event under the terms of the agreement it will usually be necessary for the party seeking relief to be able to show that its inability to perform is caused by the COVID-19 impact, and not some other reason.

Will COVID-19 always be a force majeure event under a force majeure clause?

Not necessarily. The answer will depend on how the force majeure clause is drafted, how force majeure is defined in the contract, and what the impact of the COVID-19 event is on the particular contractual obligation. Often a force majeure definition will list the types of events included, such as an "act of god" or "political interference", and may also contain a broad 'catch-all' provision referencing other events "outside of the control" of either of the parties. There may be a real question about whether the Covid-19 impact on a particular contractual obligation will qualify as a force majeure event. Do not assume that a party is always entitled to rely on a force majeure provision in relation to a COVID-19 impact and consider any notices that you receive purporting to rely on force majeure carefully.

Is it always a good idea to activate a force majeure clause?

The consequences of a force majeure event for a party will also depend on the terms of the agreement. Often an agreement can be terminated unilaterally, without liability, once a force majeure event has prevented contractual performance for a specified period of time, for example. In many outsourcing agreements, force majeure clauses allow customers to appoint third parties to perform the contracts during the force majeure period.

It may be a better course of action firstly to see if you can agree an interim amendment to an agreement to take account of changed trading conditions, rather than to activate a force majeure clause in certain circumstances.

When is non-performance a material or fundamental breach of the contract?

Whether failure to perform a term of an agreement is a material or fundamental breach will depend on the specific circumstances in each case, and the terms of the contract. Certain terms in a contract may be so important to the parties that a failure to perform them will amount to a repudiatory breach, giving the innocent party the right to terminate the contract. The terms of the specific contract will need to be carefully considered to assess whether non-performance of any obligation is likely to amount to a material or repudiatory breach, giving rise to a right to terminate or to another remedy.

When might a contract be considered to be frustrated?

A contract may be discharged or terminated on the grounds of frustration when something occurs after entering into it that is not the fault of any of the parties to it, which makes it physically or commercially impossible to perform it, or which changes performance into a completely different obligation to what the parties intended when the contract was concluded.

Examples of the types of circumstances that could potentially amount to frustration of a contract include the unavailability of goods required to perform the contract or a change in the law or circumstances which makes performance of the contract illegal. All of the facts and circumstances of each specific case will need to be considered to determine whether this doctrine potentially applies, and the test for establishing its application is extremely high. Care should be taken if you are attempting to invoke this, as the other party may try to assert that you are terminating the contract in an illegal manner.

What about insurance cover?

Again, our message is to read the fine print. It is important to review the terms of any insurance cover held by your business at this time, particularly in terms of business interruption. Where a business suffers, or expects to suffer, losses as a result of COVID-19, the terms of any insurance cover held should be checked to see if these losses are likely to be covered and to determine whether any specific obligations to notify the insurer of an actual or potential claim, to consult with it prior to taking certain actions or to mitigate losses, apply.

Summary: It is important to prioritise and take appropriate action to manage key contracts when trading circumstances depart from the norm.

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