

C L I F F O R D

C H A N C E

CORONAVIRUS, CONTRACTS, SUPPLY CHAINS AND THE THREAT OF DISPUTES

There is huge uncertainty as to the course that Coronavirus will take, but uncertainty is not a justification for companies and their directors to ignore the threat posed by the virus. Planning must include how to handle existing transactions that may be at risk from the virus, as well as the protections required in transactions being negotiated now. In this briefing, we look at issues in English law.

The economic and financial threat posed by Coronavirus (Covid-19) passed largely under the radar in the first couple of months of the outbreak. That threat is now well and truly on the table. Central governments, central banks, and others are putting in place plans as to how they will respond in various scenarios – the UK’s “reasonable worst case scenario” is that 80% of the population may be infected and that 20% of employees may be away from work at any one time. For the vast majority of people, the virus will be mild and short-term, but even these individuals may have caring and other responsibilities for more vulnerable relatives who suffer more serious consequences.

Governments plan at a macro-level economically. Businesses operate at a micro-level, and cannot expect governments to do their planning for them. Many businesses have, quite properly, started their planning process by laying down procedures designed to protect their staff. These might, for example, include bans on business (or even personal) travel to affected areas, attendance at large events and self-quarantine procedures.

Measures of this sort are important, but they are not enough. Companies need to consider how the spread of the virus may affect the conduct of their underlying business and what they can do about it. This is not easy – there is huge uncertainty – but uncertainty does not absolve directors of the need to try to protect their companies as best they can. Regulated industries may also need to consider their regulators’ requirements, such as resilience.

Future transactions

Perhaps the easiest area is transactions being negotiated now. How might coronavirus affect your company’s ability to perform its obligations? For example, are you dependent on suppliers who might themselves be affected, or is the risk confined to the availability of staff? Is the risk one of timing (you will be able to perform, perhaps later than intended but not affecting the viability of the transaction as a whole), or is the risk more fundamental than that?

Once the risks have been identified, the next step is to consider what protections are required in the contract for the transaction. For example, if the potential is for delay, at what point should delay have financial consequences and when should a party have the right to pull out altogether?

If you are thinking about this, your counterparties will (or should be) doing so, too. How will they be affected, and what protections will they want?

Past transactions

Talk to your counterparty. For transactions already agreed, the most obvious point is to discuss with your counterparty the potential impact of the virus. A discussion in advance as to what contingencies the parties might need to build in, even if the risk seems remote at the moment, is likely to be preferable to an unpleasant surprise later on. What comfort do you need, or can you get, that your counterparty will be able to perform its side of the bargain?

What does the contract say? The agreement covering the transaction is likely to be the starting point.

Force majeure. Does the contract contain a force majeure clause? If not, a clause will not be implied, nor is there an overriding principle as a matter of English law. Whether and, if so, how a force majeure clause applies will depend upon its specific drafting. The spread of coronavirus will be an event beyond the parties' control, but it may not have been outside the parties' contemplation if the contract was entered into in, say, February 2020. The clause may require (reasonable) steps to be taken to mitigate the consequences of the virus and, ultimately, it may allow suspension of performance or the termination of the contract. Force majeure clauses invariably require a link between the event and the inability to perform the contract – coronavirus can't be used as an excuse to walk away from an onerous contract. If a party does decide to rely on a force majeure clause, it would be wise to ensure that it retains the evidence upon which it acted (eg copies of governmental announcements). See our [checklist](#) on force majeure clauses.

Changes in law. Some contracts may also protect parties against changes of law, and allow claims for additional time and unforeseen costs. Coronavirus controls imposed by law may fall within this type of clause.

MAC. Financial contracts often contain material adverse change (MAC) clauses that allow a financial institution to call an event of default or refuse to perform if the counterparty is subject to a material adverse change. Again, whether and how this applies will depend upon the wording, but clauses usually pose the question of whether an event has had, or will have, a material effect on the ability of a party to perform its obligations under the contract.

Notices. Whether a contract contains a force majeure, change in law, a MAC clause or another applicable clause, it may require notice to be given to the other party, perhaps within a certain period of the event in question occurring. Notice provisions must be complied with strictly.

Frustration. If the contract has nothing of relevance (and, perhaps, in any event), the general law may come into play. A contract can be frustrated if the circumstances render it incapable of performance or because the circumstances render performance radically different from what was contemplated by the parties at the time they entered into the contract. We may be some distance from this yet but, for example, if performance is required at a specific time in a specific place, frustration may be worth exploring further.

Illegality. The forced closure of factories and offices or a prohibition on travel could also bring into play the doctrine of illegality in the place of performance. For example, if it is illegal for the factory in which a product is to be manufactured to do so because workplaces are required to close, English law may absolve the party from its obligation.

Limitations on liability. Even if the contract has nothing direct to say about coronavirus, the contract may contain limitations on, or exclusions of, liability. Clauses of this sort might cap, even exclude, a party's ability to recover from a counterparty (or its obligation to pay to a counterparty) losses caused by coronavirus complications.

The final question will be when non-performance gives a right to terminate the contract, whether for breach or otherwise. For example, is time of performance of the essence of the contract such that any delay entitles the other party to terminate the contract immediately? If delay does not automatically give a right to terminate, what delay will be so serious as to have that effect? What should be done to avoid waiving inadvertently any right of termination?

General issues

Companies will want to check what insurance cover they have that might cover coronavirus. If a company does have insurance cover, the policy is likely to contain notification requirements, which must be complied with strictly. Insurance companies are seldom tolerant of breach even of the smallest of small print. For more on insurance see our briefing [here](#).

If the worst comes to the worst, how are disputes to be handled? Who should handle communications? At what stage is it prudent to cover all discussions with the counterparty under the rubric "without prejudice"? When should an edict be sent to discourage employees from putting finger to a keyboard in a manner that might be unhelpful? Ultimately, what are the relevant dispute resolution means, and is it prudent to be the first into court in order, for example, to forestall the counterparty taking proceedings in an unacceptable court?

Conclusion

Coronavirus's impact on economies generally and on particular transactions is not easy to predict. This does not, however, absolve company directors of the need to plan. The worst may not happen, but those who come out best after a catastrophe are inevitably those who have thought about it most in advance. Panglossian optimism is, at this stage, hard to justify.

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