CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.

The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

Legal Aspects

Coronavirus and Contractual Obligations: What Businesses Need to Know

James Crayton and Gwendoline Davis

James Crayton
Partner
Head of Commercial
Walker Morris

Gwendoline Davies
Partner
(FCIArb) Head of Commercial Dispute Resolution
Walker Morris

Biography

James Crayton is a Partner and Head of Commercial in the Commercial Department of Walker Morris (https://www.walkermorris.co.uk). James advises on the full spectrum of commercial arrangements, and acts for a broad range of national and international clients across a variety of sectors, with particular expertise in the pharma, food, logistics and manufacturing industries. His practice covers all type of commercial contracts with focus on supply agreements for both goods and services, logistics services contracts, framework agreements and joint ventures.

James works hard to understand the real drivers of any deal for his clients, and always approaches every instruction by understanding the importance of the contract to the wider business of his client. His experience includes acting for clients on multi-billion dollar deals all the way through to much small day-to-day trading contracts, and he brings the same level of focus and insight to each instruction.

Gwendoline Davies is a Partner, and head of the Commercial Dispute Resolution Group at Walker Morris (https://www.walkermorris.co.uk), and joined from City firm, Herbert Smith Freehills.

Ranked as a leading individual and in the top tier for commercial dispute work for a number of years, Gwendoline is a highly respected litigator and has been involved in several reported cases. The Chambers Guide to the Legal Profession describes Gwendoline as "first-class" and "a star litigator who is very commercial and responds very quickly no matter what time or time zone."

Her clients come from multiple industries and business sectors and include major corporates and leading financial institutions. She has more than 30 years of experience of representing clients in their most complex and important disputes. Her practice includes company and commercial disputes, trading disputes, regulatory matters, internal investigations and domestic and international arbitration.

She is an accredited mediator with the Centre for Dispute Resolution, a Fellow of the Chartered Institute of Arbitrators and a member of the International Bar Association.

Gwendoline is ranked as a leading individual in her field by independent guides to the profession: Chambers & Partners, Legal 500 and Best Lawyers. In 2018 she received the Hall of Fame accolade by the Legal 500 which highlights individuals who have received constant praise by their clients and have been recognized by The Legal 500 as one of the elite leading lawyers for six consecutive years or more.

Gwendoline is also endorsed by 'The Best Lawyers in the United Kingdom' directory for litigation.

Keywords Commercial contracts, Contractual obligations, Commercial litigation, Coronavirus, Contracts, Common law, Frustration, Force majeure, Supply chain
Paper type Research, Opinion

Abstract

The spread of COVID-19, commonly referred to as the coronavirus, is an exceptional event that's becoming an increasing public and workplace priority. In this article the authors offer essential legal and practical advice for businesses concerned about Coronavirus.


CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.
The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

What is the commercial context?

By the end of February 2020, new cases of Coronavirus/COVID-19 reported outside China exceeded new cases in China. Despite international efforts to contain the virus, the World Health Organization has formally declared the outbreak to be a public health emergency of international concern. In Europe, Italy has issued guidelines advising all over 75s to stay at home; the Louvre in Paris has closed; MIPIM (the international real estate event of the calendar) has been cancelled; and France and Switzerland have banned mass gatherings. In the UK, sporting events have been postponed and cancelled; and schools and offices have closed.

Quite apart from those suffering with or succumbed to the illness, there is no doubt that the human impact of this virus is significant, and is being felt increasingly close to home. But what about the impact on businesses?

It is estimated that some 60 million people in China have faced travel restrictions and around 55 companies in Shanghai alone reported in mid-February that their global operations had been affected – largely by a shortage of manufacturing workers[1]. With businesses around the world being heavily reliant on trade with China, and with existing supply chain inventory now becoming depleted or exhausted, economies and businesses across the world are starting to experience the knock-on effects.

The Port of Los Angeles, the busiest port in the US, expects to report a 25% drop in business for February 2020[2] and the US Central Bank has slashed interest rates in the face of mounting concerns about the economic impact of the virus. In the UK, JCB has halted its production line and cut staff working hours because a shortage of components from China has meant that production forecasts cannot be fulfilled. Fiat Chrysler has warned that some of its European plants could be forced to cease production and Nissan has closed a factory in Japan. These are just a few recent examples of the countless reported incidences in which the Coronavirus is impacting international trade.

Apart from the impact on individual businesses, there are a number of factors which, together, mean that the worldwide economic impact of Coronavirus is likely to be more severe than has been the case with other, past epidemics: increased globalisation over recent years; the growth of China's economy to more than 16% of global GDP; China's output amounting to around a quarter of the world's manufacturing; China's dominance in certain industries (including high technology, electronics and robotics, automotive components and production, pharmaceuticals, and second tier supplies such as batteries and other underlying components); downward pressure on costs; increased outsourcing; and so on.

Over the coming weeks, therefore, businesses are likely to become increasingly concerned about the impact of the Coronavirus on their supply chain arrangements and commercial viability.

Whether or not contracts or common law remedies allow parties flexibility within, or the ability to terminate, arrangements which are affected by the virus, and by the resultant economic climate, will be key.


CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.
The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

What do businesses need to know?

Frustration

The English common law doctrine of frustration provides that, on the occurrence of a 'frustrating event', parties are no longer bound to perform their obligations and a contract is therefore effectively terminated.

A frustrating event is one which: occurs after the contract has been formed; is so fundamental as to go to the root of the contract; is neither party's fault; and renders further performance impossible, illegal or makes it radically different from that which was contemplated by the parties at the time the contract was made.

Importantly, however, the doctrine operates within very narrow confines and the courts will not lightly relieve parties of their contractual obligations.

In particular, frustration is not available where a contract has otherwise made express provision for the consequences of the occurrence of the event in question; where an alternative means of performing the contract is possible; or if the contract merely becomes more expensive or less commercially viable to perform. The bar for a successful frustration claim is high.

In addition, because no one party is at fault in an incidence of frustration, neither party may claim damages, and if a party incurred obligations before the time of frustration, it remains bound to perform them[3].

It is possible, however, in light of the scale of the outbreak and the unique underlying economic context, that the impact of the Coronavirus could, depending on the facts of individual cases, found successful frustration claims.

Force majeure

Where frustration does not apply or cannot be established, an express force majeure clause may otherwise excuse one or more parties from performance of a contract following the occurrence of certain events which are outside a party's control. There are some important points to note:

- A force majeure provision cannot be implied – an express clause will be required.

- A force majeure clause may have a variety of consequences. For example, it may enable the parties to terminate the contract altogether; it may allow the contract or liability under it to be suspended while the force majeure event continues; it may provide for the adjustment of certain terms as a result of changing economic or market conditions; and/or it may allow for the extension of contractual deadlines.

- The China Council for the Promotion of International Trade has reportedly been issuing 'force majeure certificates', which seek to shield companies not performing contractual duties from liability by 'proving' force majeure. Businesses should note, however, that such certificates in themselves are not


CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.
The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

conclusive in the English courts, and the usual components of a force majeure claim will still need to be established:

- The burden of proof is on the party seeking to rely on the force majeure clause.

- The term 'force majeure' has no recognised meaning in English law and should therefore be expressly defined in the contract. Commercial contracts typically define exceptional events such as 'acts of God', natural disasters, terrorism, strikes, government acts, building collapse, fire, and the like as force majeure events. Clauses vary as to whether they are 'exhaustive' (where all the events that could count as force majeure are listed), or 'non-exhaustive' (where the events listed are illustrative examples of the types of circumstances outside the control of the parties that may count as force majeure). The International Chamber of Commerce includes epidemics within its sample exhaustive force majeure clause – a fact which may be of evidential value in cases where there is a 'catch all' provision within the clause and there is a dispute about whether the Coronavirus is caught.

- Depending on the wording of the clause, a party seeking to rely on a force majeure clause may need to prove that it has taken all possible or reasonable steps to prevent or mitigate the effect of the force majeure event.

- Force majeure provisions also often include specific notification requirements and/or timescales which, if not strictly complied with, may prevent an affected party relying on the clause altogether.

- Finally, following a recent Court of Appeal case[4], to successfully rely on a force majeure clause a party must be able to prove not only that the event in question caused the contractual breach/non-performance, but also that it was the only A party cannot invoke force majeure if it would not otherwise have been ready, willing and able to perform its contractual duties if the exceptional event had not occurred.

What practical advice arises?

Where, as a result of the impact of the Coronavirus, a business wishes to extricate itself from, or avoid potential breach of, or re-negotiate the terms of, a contractual arrangement, frustration or force majeure might well assist. Neither of these are necessarily easy options, however, and specialist legal advice will be required.

The following practical tips represent good practice generally, when it comes to anticipating, attempting to cater for, and reacting to an uncertain and ever-changing commercial marketplace.


CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.
The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

In terms of existing arrangements:

- Parties concerned about the potential effects of the Coronavirus on any aspect of their business or supply chain should undertake an urgent contract review. As well as checking for the existence and terms of any force majeure provisions, parties may wish to confirm the existence and implications of any other contractual provisions which may assist. These might include (non-exhaustively) break clauses, price adjustment clauses, variation/no-oral modification clauses[5], limitation/exclusion of liability clauses[6], dispute resolution clauses[7], material adverse change clauses, and the like.

- When reviewing existing contracts, parties should note that what appears, on the face of it, to be a force majeure clause, may in fact be an exception or exclusion clause; or it may be a clause which covers contractual frustration. Each of these types of provision has different legal and practical implications, and specialist advice will be needed.

- Where supply chain or other contractual issues do arise, parties should consider commercial and reputational risks, alongside legal issues. For example, in such exceptional circumstances, parties may wish to consider being flexible about restructuring deals or debts so as to preserve relationships, even where there is no legal right or obligation to do so.

- Any business wishing to invoke force majeure (or to ascertain the validity of any force majeure claim made against it) should ensure compliance with any specific notification or other contractual requirements and time-scales.

- It will be prudent for any party wishing to rely on or to rebut a force majeure claim to keep clear records of all relevant factual and economic evidence as the effects of the virus unfold.

- Parties should also consider the potential for alternative ways of performing affected contractual obligations and/or for mitigating any loss or damage.

- As well as primary contractual arrangements, parties should check their various insurance contracts. In some cases, invoking or receiving a force majeure or a frustration claim can impact insurance policies. In particular, parties should ascertain any notification requirements.

- Finally, businesses should also consider their duty of care to employees (and, potentially, to visitors). Employers should monitor the development of the outbreak and government advice carefully, and should take proportionate action. Failure to do so could expose the business to employment contract claims, negligence actions, health and safety/regulatory claim and/or could invalidate insurance policies.

In terms of new arrangements:

- Parties should seek to specify the kind of events that they consider to be within the scope of force majeure. They should be defined precisely and,


CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.
The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

where relevant, should capture industry-specific, as well as more general, risks.

- The English courts do not look favourably on reliance on force majeure clauses to escape contractual obligations that have simply become more expensive or difficult to perform. Parties can, however, negotiate and expressly provide for a clause of this kind.

- To offer flexibility, parties should consider including within the contract a specified time period after which the contract terminates automatically; or providing for one or more of the parties to have an option to terminate; or both.

- Parties should consider providing for the terminating party to have some form of redress, for example if goods or services have already been paid for at the time of the force majeure event.

- Customers should consider seeking provisions which give them priority in the event that a force majeure event impacts on the supplier's ability to supply – so that the customer is first in the queue for scarce resources in a time of force majeure, and is first to have supply recommenced following the end of the force majeure event.

- Where parties are part of a supply chain, complexities can arise where each contract in the chain has different terms and/or is subject to different governing laws. When negotiating new deals, parties should aim for consistency and suitability across the chain, wherever that is possible and bargaining position allows.

- An appropriate ADR (alternative dispute resolution) clause should be considered so as to come into play in the event of dispute over force majeure or similar clauses and frustration arguments.

In conclusion

Relying on a purported force majeure or similar clause, or attempting a frustration claim, is not an easy, nor by any means a guaranteed, 'get out' for contracting parties when times get tough. By far the better advice is to try to anticipate, at the point of drafting, the types of circumstances in which the parties may require flexibility to renegotiate key terms; may wish to extricate themselves entirely from the arrangements; and/or may wish to avoid or limit liability for any breach or non-performance, and then to cater for those eventualities in the contract.

Other commercial issues which the Coronavirus has highlighted to businesses are the risks of becoming overly dependent on any one source or country of origin for vital supplies, and the delicate balance which should be struck between cost and the supply chain resilience that comes from shoring-up with increased inventory.

Undertaking an end-to-end review of the supply network will help businesses to determine the right level of redundancy to build into their chain, so as to offer

CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.

The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

maximum flexibility and facilitate business continuity in the face of Coronavirus or any other unexpected and significant event. Contracts which tie parties into exclusivity need to be carefully considered in this context.

If you would like any further advice or assistance in relation to any of the issues raised in this briefing, please do not hesitate to contact James or Gwendoline, who will be very happy to help.

Reference

1 The Manufacturer, 25 February 2020
2 Financial Times, 2 March 2020
3 The Law Reform (Frustrated Contracts) Act 1943 does, however, provide some limited scope for parties to recover monies paid under the contract prior to the frustration.
4 Classic Maritime Inc v Limbungan Makmur [2019] EWCA Civ 1102
5 https://www.walkermorris.co.uk/publications/anti-variation-clauses-valid-after-all/
6 https://www.walkermorris.co.uk/publications/disputes-matter-summer-2018/excluding-liability-effectively/
7 https://www.walkermorris.co.uk/publications/disputes-matter-autumn-winter-2019/ensuring-effective-dispute-resolution/