

## Covid-19 Contractual Considerations

**This briefing contains general information, not legal advice. If you are affected by any of these issues you should obtain legal advice regarding your particular situation.**

It seems likely that most businesses will be affected by this virus before it dies out, with staff off sick, self-isolating, caring for family members, or unable to undertake business travel, and inward supplies of components and materials affected by similar problems at suppliers.

Companies in supplier roles may find that work and deliveries become impossible, while those in customer roles may find cash-flow issues or a lack of accounts staff resulting in late payments to suppliers.

It would be nice to think that everyone will work co-operatively towards achieving the best outcomes possible in the circumstances, but many businesses are going to experience severe financial stress and may be desperate either to enforce contracts rigidly or to escape from them. And no doubt there will be some who will simply seek to exploit the situation.

### What is the issue?

A company that breaches its contract will be liable for a large part of the financial consequences, and may give the other party the right to terminate the contract if it wants to. In some cases, termination could be more serious than the financial liability.

Example: Company A's failure to deliver a key product, component or service on time could affect an entire project, leading to a claim that is out of all proportion to the value of the contract. Or its customer might cancel the order, switch to a different supplier, claim for the increase in price and for any disruption the delay has caused, and leave Company A with partially completed - and now worthless - products on its hands.

The extent of a party's liability will depend on the contract. Some contracts do not limit liability at all, leaving only the basic legal rules to limit the scope of a party's liability but not its extent. A professionally prepared contract will usually limit both the scope and the extent, but these are subject to quite technical rules so they may not mean what they appear to say, and in some cases they may not have any effect at all.

Differences in liability provisions can lead to a "liability squeeze". This occurs where Company A breaches its contract with Company B, putting Company B in breach of its contract with Company C, and Company A's liability to Company B is far more limited than Company B's liability to Company C. This "squeeze" could leave Company B facing disastrous losses.

## But is it a breach of contract when the virus is to blame?

It depends on what the contract says. Where the commitment is along the lines of “*Party-X will use reasonable endeavours to deliver ...*”, then being badly affected by the virus might let it off the hook to some extent. But where the commitment is along the lines of “*Party-X shall deliver ...*”, it is likely to be a breach of contract unless a “*force majeure*” or similar clause covers the situation.

The wording of the *force majeure* clause will be critical, but context will be important too. For example, the clause may not cover the impact of the virus where it had already started to take hold before the contract was signed. And *force majeure* clauses will usually only help the affected party if it can show that it would have performed the contract properly had it not been for the impact of the virus. They aren’t get-out-of-jail-free cards.

If the clause does help, the contract will determine how it helps. Some contracts simply allow the affected party more time to perform its obligations. Others provide for price adjustments, and yet others allow the other party to terminate all or part of the contract if it wants to.

Many *force majeure* clauses include a notice procedure which the affected party has to follow if it wants to rely on the clause, and it is important to follow that procedure exactly. But this can cause additional problems. For example, a common requirement is that the affected party has to give notice as soon as it becomes aware of the virus’ impact on its ability to perform the contract, so that the other party can attempt to minimise the expected disruption. But the affected party will need to assess the situation carefully, because if it gives notice when the clause doesn’t provide protection, the notice itself may give the other party grounds to terminate the contract and claim compensation straight away, without waiting to see whether the affected party does actually fail to perform the contract on time. Yet this assessment must not delay the giving of the notice. As there will be many other demands on everyone’s time, the best approach is an early review of contracts and ongoing monitoring of the situation.

## What is to be done?

All is not lost. The next few weeks can be used to avoid or reduce potential problems.

The first step should be a risk assessment of your live contracts, so that you can identify which ones present the greatest financial risk and focus attention and resources on those.

A risk assessment is not the same as calculating a contract’s financial value:

- It should focus not on the value of the contract when it is performed properly, but on the consequences of the various breaches which the virus could cause.
- It needs to take account of the actual losses that could realistically occur, how likely it is that they will occur, how the contract limits that potential liability, and how effective those limits are likely to be. After all, a worst-case scenario of a claim for £10m might not be as bad as it appears if in fact the claim is much more likely to be in the region of £1m and/or the contract effectively limits that liability to £250k.

These assessments require sound commercial and legal judgement.

Having identified those contracts which pose the greatest risk, the next step is to determine a strategy for dealing with each one. With some, it might be possible to re-negotiate them, in which case legal support will be needed to capture the new arrangement as there are complicated rules around contract variations.

With others, it might be better to look for ways to terminate them, although this is a very serious step that could have unforeseen consequences, and legal advice should be obtained first.

For the rest, the risk assessment will show which contracts need to take priority in terms of

performance.

Finally, the fallout from this virus is likely to include many more legal disputes than is usual, so it would be sensible to plan for them in order to maximise the chances of a good outcome and to minimise the likelihood of expensive and uncertain court proceedings. These plans should include:

- Good record-keeping, so that you can back up your claims
- Careful communication - every word and comma of every email will be argued over, so be careful to say exactly what you mean and avoid saying the wrong thing - customer- and supplier-facing staff will need briefing and supervising
- A dispute-management process.

These steps are important for all disputes, but they are especially important where claims might be covered by insurance. Insurers will be keener than ever to avoid pay-outs if they can, simply because of the huge scale of the problem, so it is more important than ever to avoid doing anything that might jeopardise the cover.

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