

Implications on contractual obligations, force majeure and insurance

The general rule is that where a party who fails to perform contractual obligations will be in breach and incur a secondary liability, most usually in the form of damages.

Due to the impact of COVID-19 on businesses, many companies are struggling to comply with contractual obligations or are concerned that their counterparties may do so. Often, it's both.

Clearly, dialogue with the counterparty will, in most cases, be a first port of call. They may be prepared to amend the agreement, forebear on delivery (or full delivery) or provide an extension to the time for performance. There may be a cost but it is likely to be preferential to breach and an action for damages.

However, business should also consider looking in detail at the terms of the contract. There are a number of express provisions that could assist.

Changes to pricing provisions

- If it is still possible to perform the contract but performance has become more expensive in light of the current circumstances, you should check where this burden falls. There may be a pricing clause that permits you to increase the price to take account of certain unforeseen costs.
- Alternatively, there could be a provision that permits you to pass on additional costs.
- Furthermore, if the contract has specified service levels, failure to meet these may result in an automatic adjustment to the price, rather than a breach of contract.

Change in law

- Check if the contract has a clause providing for the effect of a change in law. These can be fairly common and could work to the advantage of a party struggling to comply.
- New legislation brought in by Parliament to ameliorate the effect of the pandemic has had an impact on many businesses, such as the closure of transport hubs or the requisition of certain supplies. This could trigger a change in law clause.
- The effect of this sort of provision would require a careful review of the agreement but it's possible that it could mitigate the liability of a performing party.

Material Adverse Change

- Some contracts expressly address changes in economic circumstances through what is known as a MAC clause.
- These can give a party relief if circumstances change or permit the other party to terminate the arrangement. For example it is not unusual to find a MAC if a contract provides for a split exchange and completion, giving a buyer the ability to pull out if an unexpected event has a materially adverse effect of the business.
- Again, the exact wording of the clause would need to be reviewed. The provision is likely to define what is deemed "material" or "adverse" and/or what constitutes a change.

Force Majeure

One of the key questions we have been asked to consider over the past few weeks is whether the current Covid-19 situation (and, more importantly, the restrictions put in place by the Government) is a *Force Majeure* event?

- First, this is NOT a straight yes or no answer. It will depend on a variety of factors including the contract's governing law and the specific wording of the clause.
- Unlike a number of (civil) jurisdictions, English law does not define *force majeure*, either in statute or under case law.
- Furthermore, the concept of *force majeure* will not simply be implied into a contract. In order to

rely on a *force majeure* “event”, it must be expressly contained in the contract.

- Whether a particular clause is triggered will depend entirely on the specific wording that the parties have used.

Type of clause to look out for

- It will often be labelled “*force majeure*” but not always. Look for a clause that deals with events outside the parties’ control and/or a definition that contains examples (such as wars, epidemics, pandemics etc.).
- Care should be taken to check whether the interpretation is exhaustive and limited to a list or whether the list is non-exhaustive.
- Alternatively, *force majeure* event may be defined in more general terms such as simply, “circumstances outside of the control of the parties”, with or without specific examples.
- Depending on the contract the definition could include anything from a pandemic to travel restrictions. As such, falling within the definition may depend on current policies, advice and directions and the government’s latest position. What was not a *force majeure* yesterday, may become one today.

Relying on a *force majeure* clause

- To rely on *force majeure*, you must be able to show that all of the requirements under the clause have been met.
- There must have been a *force majeure* event which has caused the affected party to be prevented, hindered or delayed (or as otherwise determined by the contract) in performing its obligations under that contract.
- The party seeking to rely on the clause must typically use some efforts (e.g. reasonable / all reasonable / best endeavours) to overcome the events.
- It is for the party seeking to rely on *force majeure* to prove that it applies and that party must also comply with any procedural requirements set out in the clause.

What happens when a *force majeure* clause is triggered?

- Again, this will depend on the specific wording used in the clause but the clause may specify the effects of *force majeure* and also who shall be liable for the costs.
- The consequences are not limited and may include suspension of contractual obligations, extensions of time to satisfy the obligations, invocation of obligations to mitigate any losses and ultimately the right to terminate the contract.

What about new contracts entered into since the start of the crisis?

- Unlike other jurisdictions it is not a requirement that the event forming the *force majeure* is unforeseeable, so, if the clause is silent on foreseeability, it is unlikely that the event would not be a *force majeure* purely on that basis.
- Moreover, as the advice and guidance relating to COVID-19 is changing regularly, it would be difficult to state what is or is not currently foreseeable.
- The safest option with any new contract being entered into is to make specific reference to COVID-19 related issues in the *force majeure* clause. That way, if the event arises (e.g. Schools not re-opening in September), it is explicitly covered. The clause can also contain specific remedies if its triggered for a particular reason (delay for some; termination for others).

What if you can still fulfil the contract but the crisis has meant that it is no longer economic to do so?

- English law does not contain an implied right to renegotiate the contract in circumstances where it is no longer economical.
- Any right to renegotiate would need to be specifically drafted in the contract, and even then, the English courts are unlikely to enforce anything they deem to be an “**agreement to agree**”.
- Therefore, in any future contracts it would be prudent to set out the specific triggers that would allow suspension or termination of the contract.

What is frustration and how can it help?

- The principle of “frustration” applies where a contract, governed by English law, becomes

impossible for the affected party to perform, and due to this frustrating event, the parties are discharged from their duties under the contract.

- The threshold to satisfy this test is **very high**, as performance must either be impossible, or the frustrating event must have made the performance of the contract result in something that is so radically different from what was originally envisaged that, in effect, it is impossible to be performed.
- Unlike a *force majeure* clause the event must NOT have been foreseen.
- However, these are unusual times and, with the high level of restrictions now imposed on UK businesses, if the contract is very specific, it might be possible to meet this threshold.
- If the contract is frustrated then the parties are completely released from their contractual obligations.

Business Insurance Cover

In these current unpredictable times, insurance cover may be at the forefront of the minds of business owners who are seeking to reduce their exposure.

Business Interruption Insurance

- The main question for the many businesses which are now closed or severely disrupted due to the nationwide lockdown, is whether their existing insurance cover includes “business interruption insurance.”
- This is a specific type of insurance which covers a business for loss of income during periods when they cannot carry out their business in the usual manner (for reasons specified in the policy).
- The insurance will generally replace certain losses sustained by the business during the period of the disruption.
- It is crucial to review the exact wording of the policy as not all policies, even those which include “business interruption insurance” will provide payments.
- For example, COVID-19 is a “notifiable disease” and some policies may include notifiable diseases, whilst other specifically exclude them.
- Alternatively, some policies provide for specific notifiable diseases only, meaning that, if policies were entered into before this virus was identified, Covid-19 will not fall within the policy wording.
- Other policies may only provide cover only where there has been an actual outbreak on or very close to the insured premises and many require actual physical damage.
- Timing of the notification to the insurers is important as is notifying the insurer of any claim. Businesses should therefore keep in touch with their insurers and brokers, and where there is a claim under a policy, it can be crucial to make that claim in a time and form stipulated under the policy.

Business interruption insurance may have been offered as an optional extra to business insurance packages, which combine a number of different policies under one premium. Most businesses purchase a package of insurance from a broker who will work with them to ensure that they have the appropriate cover for their needs. As such, “business interruption insurance” may not be a prominent clause in the policy and particular exclusions and conditions need careful review and consideration.

If you have any further questions regarding the above please contact:

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