COVID-19 ALERT:
GOVERNMENT GUIDANCE ON RESPONSIBLE CONTRACTUAL BEHAVIOUR

MAY 2020

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On 7 May 2020, the Cabinet Office released a document entitled "Guidance on responsible contractual behaviour in the performance and enforcement of contracts impacted by the COVID-19 emergency." This alert builds on our analysis of the key considerations and implications for English law-governed contracts and the impact of COVID-19 on civil procedure in England & Wales to summarise the key take-aways from this latest government guidance and to consider its implications upon counterparties in England.

Warning of the risk of a "plethora of disputes", the guidance seeks to encourage all counterparties to act responsibly and fairly in the "national interest" when performing and enforcing contractual obligations in order to support the response to the COVID-19 crisis and, more broadly, to protect the economy.

The guidance was released as the Bank of England cautioned that the UK economy was heading towards its sharpest recession on record, with GDP predicted to shrink by 14% in 2020 and unemployment to rise above 9%.

Guidance overview

- **The guidance is non-statutory and non-binding** and does not affect the legal rights of parties to English law contracts. It does, however, encourage a broad concept of "fairness" to govern contractual relations for the duration of the COVID-19 crisis.
- **The guidance applies to all individuals, businesses and public authorities** (but does not apply in Wales, Scotland or Northern Ireland).
- **The guidance relates to all existing contracts which are "materially impacted" by the COVID-19 crisis**, but expressly excludes financial market transactions and agreements which are, by nature, speculative as to the risks associated with COVID-19.
- The purpose of the guidance is to: (i) **encourage the maintenance of contractual performance** where possible; (ii) **ensure that cash flow is maintained**; (iii) ensure those contracts where performance is not possible **do not result in costly disputes and avoidable insolvencies**; and (iv) ensure that contractual and economic activity is **preserved and can continue in a sustainable manner post-crisis**.
- The guidance applies with immediate effect and the government will review it on or before 30 June 2019.
- In the weeks since its publication, there has been significant discussion as to the practical implications of this guidance, but the general consensus is that the guidance is unlikely to significantly change party behaviour in the coming weeks and months.

"Responsible and fair" contractual behaviour

- Although the guidance expressly states that it does not override specific contractual terms, it provides a number of examples of the kind of behaviour which would be considered "responsible and fair", including *"being reasonable and proportionate in responding to performance issues and enforcing contracts (including dealing with any disputes), acting in a spirit of co-operation and aiming to achieve practical, just and equitable contractual outcomes having regard to the impact on the other party (or parties), the availability of financial resources, the protection of public health and the national interest."*
- The guidance provides fifteen examples of circumstances in which "responsible and fair" behaviour is encouraged. These circumstances include where:
  - relief is sought for impaired contractual performance;
  - extensions of time, substitutions or alternative performance and compensation are proposed;
  - claims are made relating to *force majeure*, frustration, change in law, relief event, delay event and compensation event;
  - claims are made for damages, including under liquidated damages provisions; and
  - requests are made for the returning of deposits or part payments.

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- In setting out these examples, the guidance recognises that counterparties may sometimes find it impossible to properly perform contracts due to COVID-19 and encourages counterparties to consider the macroeconomic circumstances before exercising strict legal rights.
- Although the guidance does not introduce a duty of "good faith" into English contract law by encouraging parties to act "fairly" and "in the spirit of co-operation", it does appear to recommend that parties should engage in "good faith" conduct by not seeking to use the COVID-19 crisis as an opportunity to profiteer or engage in sharp-practice. However, the guidance does not prohibit parties from seeking contractual relief where it is available and opportunistic conduct will still not amount to an actionable breach of contract.
- Where contractual rights and obligations are enforced by counterparties, the guidance reinforces the CPR's emphasis on the use of alternative dispute resolution by suggesting that parties *"seek to resolve any emerging contractual issues responsibly – through negotiation, mediation or other alternative or fast-track dispute resolution – before these escalate into formal intractable disputes."*

Practical implications

- As noted above, the guidance does not have the force of law and will not override parties' legal rights and obligations as set out in the relevant agreement. As a consequence, the courts will continue to apply the law as it stands, and the wording of a contract will remain the starting point for the interpretation of rights and obligations. There will be no new "national interest" threshold for successfully bringing claims.
- Moreover, although the optimistic message of the guidance is appealing from a broader perspective, it is difficult to imagine how, aside from some obvious examples, behaviour will be impacted on an individual micro-level where directors continue to owe duties to act in the best interests of their company and not their counterparty.
- However, where a dispute emerges in respect of a contract which has been materially impacted by COVID-19, parties may seek to rely upon the guidance in order to assert pressure on their counterparties.
- If a contract contains express terms relating to "fairness" or "reasonableness", the guidance could assist in establishing what is "fair" or "reasonable" conduct during the COVID-19 crisis. This could apply where, for example, a bank has a "reasonable discretion" to call an event of default, or where a landlord is contractually obliged to "act fairly" when considering rent reductions.
- The guidance is also likely be referred to by third parties during alternative dispute resolution procedures such as mediation, in which the mediator may emphasise the special importance of parties acting responsibly during this unprecedented period.
- Finally, it is possible that, if there are concerns that parties are not acting as recommended, this guidance may ultimately give rise to further intervention from the government, including through legislation. That said, there are no indications from the government that any emergency legislation will be introduced in order to enshrine this guidance into law.

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Our Dispute Resolution team is available to discuss any of these issues with you and answer any specific questions you may have. If you would like more information about the topics raised in this briefing, please speak to your regular contact at Weil or to any of the authors listed below.

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