



CORONAVIRUS (COVID-19): KEY CONSIDERATIONS AND IMPLICATIONS FOR ENGLISH LAW-GOVERNED CONTRACTS

MARCH 2020

Weil

CORONAVIRUS (COVID-19): OVERVIEW OF KEY LEGAL AND COMMERCIAL ISSUES ARISING FROM ENGLISH LAW-GOVERNED CONTRACTS

MAC CLAUSES

- Permit a party to terminate an agreement or call an event of default where there has been a material adverse change or effect. These clauses normally require a high threshold to be met before they can be triggered and examples of MAC provisions being triggered in the context of globally significant events (including epidemic or pandemic events) are rare.
- It is difficult to envisage circumstances where the COVID-19 outbreak would, in isolation, trigger a MAC that has been drafted on market standard terms in commercial contracts. However, the precise phrasing of the MAC provision and the specific circumstances and factual matrix impacting the counterparty will be crucial and, for some businesses, the long term economic impact of the outbreak may give contractual counterparties grounds to assert a MAC to its business, financial conditions or operations in due course.

FORCE MAJEURE CLAUSES

- Relieve a party from the consequences of a failure to comply with a contractual obligation where that failure is due to the occurrence of an event outside its control, and may enable a party to terminate the contract without liability.
- Absent an express force majeure clause, force majeure will not be arguable under English law. Even where there is an express clause, it will be a matter of construction as to whether coronavirus-related issues are covered. For new contracts, parties may therefore want to expressly include (or exclude) coronavirus-related events.

FRUSTRATION

- Can be relied on if something occurs after contract formation, which is not due to either party's fault, that makes it physically or commercially impossible to fulfil, or renders a party's obligation radically different from that undertaken when the contract was entered into. The doctrine is narrow and will not be available, among other things, if the circumstances were foreseeable.
- Whether a party can invoke frustration as a result of the COVID-19 outbreak will turn on the time of contract formation, the length and intensity of the disruption to the contract arising from the outbreak, and whether this can be overcome with time or not. For example, a contract for the supply of goods may be frustrated if travel restrictions have made it impossible for the supplier to deliver the goods by a certain date where time is of the essence.

RENEGOTIATION RIGHTS

- English law takes a very restrictive approach to "renegotiation" rights which must be express and cannot be implied into a contract. More generally, parties may of course jointly agree to renegotiate and vary contractual terms at any time, subject to the terms of the underlying contract and other formalities.

MAC/ MAE CLAUSES

MAC PROVISIONS PERMIT A PARTY TO TERMINATE AN AGREEMENT (OR, IN CERTAIN CONTEXTS, TO CALL AN EVENT OF DEFAULT) WHERE THERE HAS BEEN A “MATERIAL ADVERSE CHANGE” (MAC) OR A “MATERIAL ADVERSE EFFECT” (MAE). THEY NORMALLY REQUIRE A HIGH THRESHOLD BEFORE THEY CAN BE INVOKED

- Examples of MAC provisions being triggered in the context of globally significant events (including epidemic or pandemic events) are rare. Often these events are among the items expressly carved out of MAC clauses.
- A typical MAC is defined as any development, event, condition, fact etc. that has caused, or would reasonably be expected to cause, a material adverse change to the business, assets, financial condition or results of operations of a party, excluding certain broader risks. Common exclusions include effects related to general economic or other market conditions and any pandemic, epidemic, natural disaster or act of God.
- Events of a generic, sectoral or global nature are therefore unlikely, alone, to be sufficient to establish a MAC. It is therefore difficult to envisage circumstances where the coronavirus outbreak, alone, would trigger a ‘typical’ MAC clause (particularly in circumstances where The World Health Organisation declared the coronavirus outbreak as a ‘pandemic’ on 11 March 2020). However, the specific factual matrix applicable to the counterparties will be highly relevant and contracts should be considered on a case-by-case basis with particular attention to any bespoke drafting or exceptions expressly included in a MAC clause.
- However, on a long term basis, the economic the impact of the COVID-19 outbreak could generate negative consequences for businesses significant enough to constitute a MAC to their business, financial conditions or operations. If so, the English courts will adopt a restrictive approach and require a high threshold to be met before finding that a MAC has occurred. Generally speaking:
 - MAC provisions will be construed in accordance with usual principles of contractual interpretation, i.e. interpreting the precise words used.
 - To be “material”, the adverse change must substantially affect the party’s ability to perform the transaction in question (e.g. where a MAC provision relates to a borrower’s financial condition only, this means the borrower’s ability to repay the loan).
 - The change in question cannot be temporary or transitory.
 - A party cannot found a MAC on the basis of circumstances of which it was aware at the time of the agreement, although it may do so where conditions worsen in a way that makes them materially different in nature.

FORCE MAJEURE

A FORCE MAJEURE CLAUSE TYPICALLY RELIEVES ONE OR MORE PARTIES FROM THE CONSEQUENCES OF FAILING TO PERFORM ITS OBLIGATIONS UNDER A CONTRACT WHERE THAT FAILURE IS DUE TO THE OCCURRENCE OF EVENTS OUTSIDE ITS CONTROL. THE CLAUSE MAY ALLOW FOR SUSPENSION OR TERMINATION OF ALL OR PART OF THOSE OBLIGATIONS WITHOUT LIABILITY.

- Absent an express force majeure clause, force majeure (including as a result of COVID-19-related events) will not be arguable under English law. Force majeure is not recognised as a standalone principle of English law. It is not defined, either in statute or under case law, and therefore the concept of force majeure will not be implied into a contract.
- This means that the parties can only rely on force majeure if it is expressly covered in the contract. Even where there is an express clause, it will be a matter of construction as to whether coronavirus-related issues are covered and therefore the scope of and protection afforded by the clause will depend on its precise drafting.
- In the event of a dispute as to the scope of the clause, the English courts will apply the usual principles of contractual interpretation and will construe force majeure clauses restrictively. Contracts should be considered on a case-by-case basis with particular attention to any bespoke or non-exhaustive list of events that are often included in a force majeure clause. In particular, it should be considered if there is specific reference to an epidemic, pandemic or contagious disease, noting The World Health Organisation's declaration of the coronavirus outbreak as a 'Public Health Emergency of International Concern' in January 2020, and as a 'pandemic' on 11 March 2020. Additional factors to consider may change as and when the UK Government starts mandating quarantine and/or isolation, among other things.
- Unlike the position with frustration, a force majeure clause can cover existing or foreseeable events. For new contracts, parties may therefore want to expressly include (or exclude) coronavirus-related events.
- Unlike England, many legal systems have specific legislative definitions of force majeure, which apply whether or not the contract contains an express force majeure clause. In those cases, where force majeure is codified in a civil code, governments can legislate to deem that a certain event constitutes force majeure. For example, we have seen the government of the People's Republic of China do this in response to COVID-19. As a result, the China Council for The Promotion of International Trade has been issuing force majeure certificates to companies that claim they are unable to meet their contractual obligations to protect them from potential breach of contract claims by counterparties. However, these certificates would not automatically satisfy the "test" for force majeure for a contract governed by English law, among others. At best, these certificates may provide evidentiary support for the affected party's force majeure claim.

FRUSTRATION

IN THE ABSENCE OF AN EXPRESS FORCE MAJEURE CLAUSE IN ENGLISH LAW GOVERNED CONTRACTS, THE COMMON LAW DOCTRINE OF FRUSTRATION MAY APPLY IN CERTAIN RESTRICTED CIRCUMSTANCES WHERE PERFORMANCE OF THE CONTRACT HAS BECOME IMPOSSIBLE.

- A contract may be discharged on the ground of frustration when something occurs after the formation of the contract which renders it physically or commercially impossible to fulfil the contract, or transforms the obligation to perform into a radically different obligation from that undertaken at the moment of entry into the contract.
- There is no single or universal test recognised by the English courts for when the doctrine of frustration can be applied. Typically, the courts will adopt a broad approach taking account of all the facts and circumstances of the case although, generally, a frustrating event is an event which:
 - Occurs after the contract has been formed.
 - Is so fundamental as to be regarded as going to the root of the contract and as entirely beyond what was contemplated by the parties when they entered the contract.
 - Is not due to the fault of either party.
 - Renders further contractual performance impossible, illegal or makes it radically different from that contemplated by the parties at the time of the contract.
- The relevant test is a very difficult one to meet and it follows that it is likely to be very difficult to argue frustration in circumstances where COVID-19 has impacted performance of a contract. In particular, it cannot be used: (i) where the parties have contractually agreed the consequences of the supervening event (for example by the use of a force majeure clause), (ii) where an alternative method of performance is possible, (iii) because performance has become more expensive, or (iv) because a party has been let down by one of its suppliers
- Nevertheless, the doctrine might apply in certain situations brought about by the COVID-19 outbreak. As the broader situation develops, including as a result of any measures implemented by the UK Government seeking to restrict the outbreak which make it impossible to perform certain contracts, it may become easier for parties to argue that a contract has been frustrated such that the parties are discharged from further performance of their obligations thereunder.

RENEGOTIATION OF CONTRACTUAL TERMS

IN THE CURRENT CLIMATE, MANY CONTRACTUAL COUNTERPARTIES WILL WANT TO TAKE PRACTICAL STEPS TO RENEGOTIATE CONTRACTUAL TERMS. CERTAIN CONTRACTS MAY PROVIDE EXPRESSLY FOR SUCH RENEGOTIATION RIGHTS, WHEREAS MANY WILL BE SILENT ON THE POINT.

- **Renegotiation rights:** unlike many civil law jurisdictions, English law is very restrictive on “renegotiation” rights, and it follows that such a right would need to be express and could not be implied into the contract. Even where such rights do exist expressly, the English courts tend to construe them narrowly.
- **Joint rights to agree to amend or vary a contract:** typically, parties to an English law governed contract may agree to vary its terms by mutual agreement, provided that consideration is given (or the variation agreement is executed as a deed), and any additional necessary formalities are complied with.
- **Unilateral rights to amend or vary a contract:** unless the parties have expressly agreed that one party should have such a right, a unilateral notification by one party to the other cannot constitute a variation of the contract. Even if a contract does give a party the unilateral right to vary obligations under the contract, the party's exercise of the right may be subject to:
 - **Unfair Contract Terms Act 1977:** a clause that allows a party to perform in a way that is substantially different to what was reasonably expected may be void unless it passes the test of reasonableness under section 3(2)(b).
 - **Proper exercise of discretion:** the English courts may imply a term that such a right must not be exercised capriciously, arbitrarily or for an improper purpose. Where a contract confers a discretionary power on one of the parties to the contract, the courts will usually imply a limit to the exercise of the discretion along these lines.
 - **Consumer contracts:** a party's ability to reserve rights to provide products that are different from those advertised or marketed, or to change any of the terms on which they are provided, is very difficult under the Consumer Rights Act 2015 and associated legislation.

OTHER CONTRACTUAL TERMS

PARTIES SHOULD ALSO BE MINDFUL OF ADDITIONAL CONTRACTUAL TERMS THAT MAY BE IMPACTED AS A RESULT OF THE COVID-19 OUTBREAK. PLEASE NOTE THAT THIS LIST IS INDICATIVE ONLY AND IS NOT EXHAUSTIVE:

- **Renegotiation (where possible):** parties should consider whether the underlying logistics relating to performance of the contract may have changed as a result of the COVID-19 outbreak. If so, or if future change is likely, commercial terms may need to be renegotiated to reflect, among other things, customs and excise procedures and tariffs, supply chain impacts or restrictions on movement of people.
- **Representations, warranties and undertakings:** parties should consider existing contracts, and particularly contracts that contain repeating representations, warranties and/or undertakings (for example, the COVID-19 outbreak may have rendered certain representations untrue, such as representations that there is no default under a material contract, or no material contract which cannot be performed). In those circumstances, disclosure and waivers may be required. Where contracts are currently being negotiated, parties may consider carve-outs and/or qualifications, together with limitations on liability and/or disclosures.
- **Invalid terms:** often contracts will contain a boilerplate severance clause that seeks to ensure that an agreement will continue to be enforceable even if one of its terms is found to be illegal, invalid or unenforceable. This could become crucial if legislation is passed by any government seeking to restrict the outbreak which results in certain contractual provisions becoming illegal or unenforceable. If so, parties may need to amend the relevant clauses or consider severing them from the agreement. Severance is generally available under English contract law, even in a contract with no severance clause. The contract will survive if it is possible to fix the problem simply by deleting text and the deletions would not transform the parties' commercial bargain into something else.
- **Conditions precedent:** parties should consider whether CPs can be satisfied in light of the outbreak. For example, parties should consider whether they can satisfy CPs requiring compliance with data security and IT between signing and completion in light of widespread employee work-from-home policies. In addition, the closure of various governmental offices globally as a result of the outbreak may impact the timing of a parties' ability to satisfy regulatory approvals required pursuant to commercial transactions.
- **Remedies:** parties should consider if damages would be an effective remedy if a contract cannot be performed as a result of the COVID-19 outbreak. If not, parties may consider bespoke drafting (or variation of existing drafting) to provide for specific performance, an obligation upon the parties to re-negotiate in specific circumstances, or an agreed variation procedure.

PRACTICAL STEPS TO CONSIDER NOW

- Assess the extent to which the performance of any contractual obligations may be affected by the COVID-19 outbreak.
- Consider whether insurance policies expressly cover the COVID-19 outbreak or its repercussions.
- Consider any rights expressly provided relevant contracts, including any steps that are required to preserve them. For example, often contracts will contain notice requirements which are prerequisites to exercising a force majeure clause, insurance protections or other rights.
- In a supply chain or multi-contract context, identify if different laws apply to different points of the chain or transaction and what that means in relation to the overall performance of the contract.
- Take reasonable steps to work around or mitigate the identified risks, including by discussing these with the relevant counterparties in good time.
- Keep detailed records of how the consequences of the coronavirus outbreak are impacting performance of the contract, which may be crucial if a dispute later arises.
- Where a party has potentially reasonable grounds upon which to assert force majeure, frustration or MAC, it may consider using this as leverage to reach commercial solutions to other issues.

The Weil team continues to operate a full service capability ready to assist you to manage the complex and evolving issues impacting our clients during this uncertain period. Please contact your usual Weil contact if you would like to discuss further (details below).

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