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COVID-19 and force majeure

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Introduction

The coronavirus (COVID-19) outbreak is having a damaging impact on commercial activities around the world. Restrictions on travel and gatherings have either been imposed (e.g. in China and Italy) or are at least being considered as next steps (by pretty much all governments). Some businesses have already taken steps to limit business travel and participation in meetings and social events.

The impact of COVID-19 on business is even more complicated than it would otherwise have been, given: (i) the background of uncertainty around what a Brexit deal might look like and whether there will be one at all, and (ii) an oil production dispute between OPEC and Russia causing an unprecedented dive in oil prices and stock market losses. Reduction in demand in some areas (travel, hospitality) is off-set in other areas (streaming of video on Netflix, sale of hand cleanser), but clearly there are losers.

It is also a moving feast, so that by the time you read this, any of the above could have moved markedly on, in one direction or another. What we do know is that as people struggle to get to work, and commerce becomes more difficult to carry out, parties will find it more difficult: (a) to perform their obligations; and (b) to get performance from their counterparties.

What happens when a borrower says to its bank that it cannot repay a loan because the COVID-19 outbreak has meant it is unable to earn income? What if the hotel can no longer host your conference because of an outbreak amongst guests? What if movement of goods across a particular border is stopped or slowed to a crawl?

Consider the governing law

The governing law of your contract will be key, because it determines the likely interpretation of the contract and the potential legal remedies available. Most commercial contracts will state what the governing law is. If it doesn't, then there are rules that will help determine this. We expect that most contracts involving Jersey or Guernsey entities and people will be subject to Jersey, Guernsey or English law, but equally, there will be a huge diversity of relevant legal systems with e.g. Cayman law trusts, Swiss facility documents, French SPAs, Hong Kong law service contracts and New York law financial instruments.

Local legal advice will therefore be important.

Examine the contract

Each contract will need to be looked at individually. Identify the relevant terms and assess the facts. Do they constitute a breach of the contract (or if COVID-19 keeps heading in the same direction, is a breach likely?). A lot of sophisticated financial contracts provide that a material adverse change ("MAC") in the circumstances of the debtor (or upon its ability to perform its obligations) constitutes an event of default. It will be a question of interpreting both the contract and the effect of COVID-19 on the particular obligor concerned, to determine whether the MAC clause (or a similar contractual provision) might have been tripped.

Force Majeure

For any contract, one should check whether it contains a *force majeure* clause, and if it does, identify whether it is one that seeks to define what *force majeure* means in a list, or whether it contains examples of what force majeure can mean, or if there is no definition at all.

They come in various shapes and sizes, but a *force majeure* clause normally excuses non-performance by a party of its obligations under a contract if an event occurs which is outside of that party's reasonable control, and where the effect of that event is that the party can no longer perform its obligations. The clause commonly suspends the obligation to perform while the particular force majeure event continues. This means that the contract still continues to exist, but a *force majeure* clause will often go on to allow one or possibly both parties to cancel the contract if the circumstances persist for a particular period of time.

This makes sense, as commercial arrangements cannot be suspended indefinitely. Typically a *force majeure* clause will require the inhibited party to take reasonable steps to try and prevent or at least lessen the effects the *force majeure* event has on its ability to deliver or perform. It will also usually provide that the non-performing party won't incur any liability to the other because of its non-performance and nor does liability arise if a party exercises its right to cancel the contract.

However, it can get complicated if the contract is valuable and the party prevented from delivering on its obligations by the *force majeure* event wants to "wait it out" in the hope the *force majeure* event expires. The other party may not want to wait, and it can therefore be either party that seeks to treat the contract as at an end.

Is COVID-19 a force majeure event?

The question becomes: is COVID-19 a *force majeure* event? Predictably, the answer is that it depends.

It depends partly on the wording of the *force majeure* clause in the contract, especially its scope.

Contracts customarily list specific events like natural disasters, earthquakes and floods, fire, riots and other cases of civil unrest, acts of war and terrorism. That list changes over time, with terrorism being added to war, and the 2004 Boxing Day tsunami may have resulted in tsunamis being specified more widely as a kind of natural disaster. The fairly recent 2009 H1N1 influenza (swine flu) pandemic (generally understood to mean the worldwide spread of an infectious disease affecting an exceptionally high proportion of the population within a short period) may mean that disease/pandemic/generic health event wording is specified in more recent contracts.

COVID-19 appears to fit the 'pandemic' description, or perhaps the WHO has to declare it one before it so qualifies. These things can change quickly, remembering that what might not be a *force majeure* event today, may well be one tomorrow, because the impact of COVID-19 is ever-changing and is not a discrete, confined event like a fire. Similarly, it depends upon the nature of the contract concerned. Only those obligations made illegal or impossible or commercially impracticable by the disease are going to be relevant.

Follow the notification procedure

If a review of a contract shows that COVID-19 could be interpreted as a *force majeure* event, then a party wishing to rely on that clause to excuse its non-performance should follow all formalities prescribed under the contract for doing so. For instance, it would likely be required to deliver a written notice to the other party stating its view that the clause has been triggered. Parties should also keep detailed records of the interruption to their business and details of the factors leading to impossibility.

The existence (or not) of a *force majeure* clause is not necessarily the only potentially important consideration. We have already mentioned the "material adverse event/effect/change" clause. This is usually defined to mean an event that has a material adverse effect on the business or financial condition of a party or on the ability of the party to meet its obligations. COVID-19 could have such an effect, depending on the individual circumstances of that party.

A borrower may have an obligation to notify its lender when it becomes aware of a material adverse event. An event or circumstance that occurs and in the opinion of the lender has or is reasonably likely to have a material adverse effect is often an event of default, and can permit the lender to demand repayment of the loan.

Despite this, it is not clear that lenders will want to trigger wholesale defaults caused by COVID-19. Already, the UK press is reporting (at time or writing) that banks are offering personal customers and SMEs flexibility on mortgage repayments, increased overdrafts and credit card limits, and relief on cash advance fees. Quite how the banks will police these offers and determine who qualifies due to COVID-19 causes, specifically, is not yet clear.

At a commercial level, banks are also likely to look at customer circumstances on a case-by-case basis. Parties to any type of contract should explore other options such as renegotiating by mutual agreement, perhaps delaying performance, rescheduling or reducing burden or speed of delivery; even if the starting position might be to demand full performance; and then seek to negotiate a compromise from there. There may be contracts of supply or service where it will suit both parties to negotiate amendments to a deal arrived at prior to the emergence of COVID-19.

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Résolution

Résolution is a [Jersey] law remedy based upon the principle that every contract has an implied term to the effect that failure to perform entitles an innocent party to terminate the contract. The failure must however be of a fundamental term. In the Hotel de France v CIB (1995) case, the Chartered Institute of Bankers had contracted for the use of a particular room venue within the hotel for their dinner, and a fire at the hotel meant that it was not possible to use that room. Other rooms were available but the court decided that use of the selected room was "a fundamental term". The contract did not contain a written *force majeure* clause, but was interpreted by the court as one that was impacted by a force majeure event, making it impossible for the hotel to perform the contract and allowing the CIB to treat the contract as at an end.

Accordingly, even without a *force majeure* clause in a contract, there may be mileage, given the right factual circumstances, in arguing an effect much like the fire in the Hotel de France case – i.e. that a person is denied enjoyment of a fundamental term of the contract by virtue of COVID-19. Perhaps the most obvious circumstance, given the virus affects humans (either because they get the disease or because they have to be confined due to preventative measures) is where a contract is one for personal services – e.g. one contracts for the services of a particular artist, musician, intellect, artisan, adviser, athlete, personality or performer.

Other advice

- **Consider the facts.** Is the other party similarly affected by COVID-19, directly or indirectly? Is an event or service impossible to perform? Remember that mere difficulty of performance, or increased cost of performance, or the contract being less lucrative (renting a venue to put on a show that now may sell poorly) will not in and of itself, be sufficient to invoke *force majeure*.
- **Consider the contract.** The terms of each contract and its governing legal context should be considered in its own right.
- **Monitor the situation.** Governmental steps to ban gatherings or travel or other steps that have an impact upon your ability to perform may go toward justifying relief.
- **Check whether you are insured.** The most likely alternative source of relief is being able to claim on business interruption cover.
- **Renegotiate**. Parties may find themselves on both sides of the problem in the sense that they may be waiting on performance of supplier 1 in order to service the needs of customer A, and customer A may need to delay receipt of the service or payment for it, or both.

Economic substance

Recent legislation in all of our jurisdictions means that companies need to demonstrate substance in the islands. That includes holding an appropriate number of board meetings within the relevant jurisdiction in order to meet the economic substance rules. The failure of Flybe in the UK, growing restrictions on crossing borders (Italy/China) or self-isolation consequences of doing so and simple reluctance to transit through airports means that flying to hold board meetings is unwelcome for new reasons. We can help by providing alternate director services and are ready to continue to assist with substance queries.

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