Coronavirus/COVID-19: Implications for Commercial and Financial Contracts

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The outbreak of coronavirus (also known as COVID-19) is reportedly impacting global manufacturing, transportation and cross-border supply chains underpinning many aspects of international trade and commerce. Some companies are asserting that the outbreak constitutes a *force majeure* event or gives rise to another legal basis excusing nonperformance under commercial contracts. We are advising clients on numerous legal issues relating to the outbreak, such as proper disclosure by public companies of the impact of the outbreak on the company. Furthermore, companies that are negotiating commercial agreements today should proactively consider the appropriate allocation of risk and consequences of further business deterioration resulting from the coronavirus outbreak.

The impact of the virus on a particular business and under a particular contract will be fact-specific. For companies that are considering issuing *force majeure* notices as well as the companies that are receiving them, it is important to review the relevant agreement together with a company's other material agreements to ascertain all rights and obligations. Notices may need to be given within defined time periods. Also, the terms of the agreements and the applicable law govern the scope of potential defenses to nonperformance. An assessment of available insurance coverage should also be performed, and insurance claims should be made on a timely basis. We provide below a summary of the relevant principles and possible steps in evaluating these issues.

Exposure Assessment and Action Plan

Parties to commercial agreements impacted by the coronavirus outbreak should promptly analyze their rights and obligations. This entails:

- identifying key provisions of material contracts that may be affected by the recent events (*e.g.*, representations/warranties, covenants, termination rights, conditions, *force majeure* clauses or "change in law" clauses);
- identifying notice requirements that have been or may be triggered;
- considering whether there are alternative means to perform contractual obligations or proactive steps that can be taken anticipating the potential future effects of the outbreak;
- analyzing the potential consequences of a breach and/or default;
- managing communications with counterparties, bearing in mind the importance of global coordination of local relationships to ensure a consistent approach; and
- understanding local regulatory actions and restrictions, including reviewing *existing* regulations (*e.g.*, on health and safety) and monitoring *new* edicts in real time to determine whether they require the company to take steps or make decisions that may affect contractual commitments.

Commercial agreements may provide for a range of potential consequences arising from the outbreak, including performance and/or cost relief for the affected party, liability for damages and termination. Financing agreements often include potentially relevant notice obligations to lenders and events of default — most commonly tied to a material adverse event affecting the borrower or, in some instances, its parent or supplier(s). There may be additional nuances under the laws of particular jurisdictions.

In addition, for public companies, the effects of the outbreak of coronavirus could raise disclosure and other securities and legal concerns about the impact of the virus on the

particular company's financial performance or financial guidance, depending on the particular situation and jurisdiction at issue.

We describe below time-sensitive considerations concerning contractual notices and insurance coverage and provide further background on potentially applicable legal principles such as *force majeure*, frustration, hardship and material adverse events.

Notices:

In the immediate term, many contracts require that any party who seeks to assert *force majeure* as a basis for suspending performance must provide notice to its counterparty.

Failure to send such notices "promptly" or, in some cases, within a certain number of days, may result in arguments that the *force majeure* defense was waived or have other adverse consequences.

Some contracts further provide that the continuation of a *force majeure* event for a certain period of time (*e.g.*, 90 to 180 days) may give rise to a right of termination. In other scenarios, *force majeure* may give rise only to a suspension of the required performance.

Impact on other agreements:

Parties seeking to invoke, or who are faced with, a declaration of *force majeure* should also consider the effect of such a declaration on other agreements or legal obligations, *e.g.*, financing agreements and disclosure obligations. Many financial agreements include representations regarding, or covenants to provide notice of, material litigation, material events that could lead to a material litigation or anticipated loss outside of the ordinary course of business. An interruption of business also may constitute an event of default, either expressly or through its impact on financial or other covenants.

Insurance coverage:

Whether insurance may cover losses arising out of a party's inability to meet its obligations due to the coronavirus outbreak also should be considered.

- Many commercial property insurance policies provide business interruption coverage; though, as a prerequisite to coverage, these policies frequently require direct physical loss to property of the insured, its customers or its suppliers.
- Certain specialized insurance products — such as *force majeure* insurance, trade disruption insurance, political risk insurance or performance bonds — may offer an avenue of relief.
- In all events, coverage will be determined by a policy's specific terms and conditions, which should be carefully evaluated. Particular attention should be given to the applicable policy's notice provisions.

Force Majeure and Similar Doctrines

Any assertion of *force majeure* must be analyzed under the terms of the agreement, which may or may not contain a *force majeure* clause defining the contours and consequences of any excuse for nonperformance. In addition, the *force majeure* event must be analyzed under the governing law of the contract to determine the availability and scope of such a defense.

When contracts are governed by New York, English or Hong Kong law, parties should take into account the following considerations:

- whether the parties' agreement expressly provides for suspension or discharge of performance based on *force majeure*;
- whether notice is required before declaring *force majeure* and in what form;
- in the coronavirus context, the extent to which the viral outbreak prevented, hindered or delayed the performance of the contract;
- whether reasonable expectations were frustrated and the circumstances were unforeseeable or out of the parties' control; and
- potential alternative means for performing obligations and steps to avoid or mitigate the coronavirus outbreak and its consequences.

Similar considerations apply under contracts governed by German and French law. German law does not explicitly regulate the results of a *force majeure* event, and parties, accordingly, often agree on *force majeure* clauses. For contracts governed by French law where the contract is silent, *force majeure* is nonetheless regulated by the Civil Code and occurs when a party's performance is prevented by an event beyond its control, which could not reasonably have been foreseen at the time the contract was executed and whose effects could not be avoided by appropriate measures. Relevant considerations include whether:

- the party owing the obligation had agreed to bear the risk of a *force majeure* event;
- the resulting delay justifies termination of the contract; and
- the party seeking to assert *force majeure* should have performed the agreement prior to the *force majeure* event.

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Frustration and Hardship

If an event falls short of constituting a *force majeure* event, but nonetheless makes it more onerous — or impossible — for one party to perform its obligations, the availability of relief varies significantly across jurisdictions.

Under New York, English or Hong Kong law, the potential application of the defenses of "frustration" and/or "impossibility" is limited and requires considering (a) whether the subject matter of the contract or the means of performance have been destroyed such that performance is rendered objectively impossible, and (b) whether the central purpose of the contract has been frustrated or the contract has become radically different from what was contemplated by the parties at the time when it was agreed and therefore physically or commercially impossible to fulfill. Frustration cases under English law are rarely successful. A recent High Court of England judgment concluded that Brexit would not frustrate the European Medicines Agency's 25-year lease of premises in Canary Wharf, London, despite the fact that the agency would be forced to relocate its premises to an EU Member State.[1]

Some civil law jurisdictions provide an excuse for performance in the event of hardship (*imprévision*) under the Civil Code. Under German law, performance may be excused if it has become impossible, which is difficult to demonstrate. A party may also demand adaption of a contract or potentially even terminate a contract if it can show that none of the parties explicitly or impliedly agreed to bear the risk of the occurrence of a material unforeseen event. Under French law, relevant questions include whether the change of circumstances was unforeseeable at the time of the conclusion of the contract and if it rendered performance excessively onerous. Depending on the terms of the agreement, the applicable law may trigger a right to renegotiate the contract and give the power to arbitrators and judges to modify the contract.

Certain types of contracts may be governed by the United Nations Convention on Contracts for the International Sale of Goods or a Uniform Commercial Code under U.S. law. Article 79 of the CISG may excuse performance where the failure to perform was due to an unforeseeable impediment beyond the party's control that it could not have overcome. The U.C.C. provides a potential excuse where performance has been made "impracticable" by the occurrence of an event "the nonoccurrence of which was a basic assumption on which the contract was made." N.Y. U.C.C. Section 2-615(a). In all cases, however, the particular contract's terms may alter the applicability of these doctrines.

Material Adverse Change or Material Adverse Effect

Some agreements allocate risk among the parties if events occur that could reasonably be expected to result in a material adverse change (MAC) or material adverse effect (MAE) on the business or its prospects. The occurrence of a MAC or MAE may give one party a right to avoid performance under the agreement or even to terminate the agreement. Other agreements may require notice to the counterparty of any circumstance that could constitute a MAC or MAE, which may include (a) breach or nonperformance of, or any default under, related contractual obligations; (b) awareness of threatened material litigation or arbitration; (c) any situation materially impacting the ability of the party to perform its obligations under the agreement; or (d) any situation materially impacting operations or financial performance.

Conclusion

In order to assess the impact of the coronavirus outbreak on a particular business and its contractual relationships, a fact-specific analysis is required. Concerned companies should undertake a review with their counsel of the rights and obligations under their various agreements, financing instruments and applicable law, including with respect to notice requirements, the potential impact on other agreements, insurance coverage and disclosure.

[1] *Canary Wharf (BP4) T1 Ltd v European Medicines Agency* [2019] EWHC 335 (Ch).

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