



Supply contracts and force majeure

Updated as of 26 March 2020

Coronavirus is causing disruption to international travel and shipments. Levels of consumer spending, production and investment are also down, due to virus-related risks. All of these factors adversely impact supply chains, which can result in businesses being unable to fulfil their contractual obligations.

Businesses need to consider how best to address the challenges.

What is the first step in preparing a Coronavirus action plan?

Where a business has commercial contracts which are likely to be impacted by the Coronavirus outbreak, the first step should be to assess the business's rights and obligations under those contracts. This will likely involve:

- Identifying the performance obligations, covenants, indemnities, termination clauses and other material provisions in all contracts which are likely to be impacted by the Coronavirus
- Analysing the potential consequences of breaching the contract
- Flagging any notice requirements which may need to be actioned and the related timescales
- Reviewing the financial history of the contract and running a range of financial projections (from 'business as usual', through to 'worst case scenario') in order to assess potential exposure
- Considering whether there are ways in which identified risks can be mitigated
- Identifying where any proactive steps can be taken to address potential future problems

Once a business has carried out an assessment of its likely exposure, it can use this information to formulate an action plan and decide how best to manage communications with customers, suppliers and lenders.

Can existing contracts be renegotiated or terminated?

If businesses are facing difficulties in fulfilling their contractual obligations, it should be considered whether it is possible to renegotiate those obligations. Customers may be open to extending dates for performance and adjusting the contract price in order to retain the contractual relationship for the future.

Where a contract cannot be renegotiated, liability can be avoided if the termination provisions enable the applicable party to terminate the contract before that party defaults on its obligations.

Can force majeure clauses be invoked as a result of the Coronavirus outbreak?

A force majeure clause provides for what happens when events occur which are beyond the control of a contracting party, after they enter into the contract. There is no set list of events which will be deemed to be 'force majeure' but the clauses usually cover events such as natural disasters, outbreaks of war and strikes.

Whilst there is useful case law relating to the interpretation of force majeure clauses, the English courts typically focus on the actual words used in the clause. This makes it difficult to say definitively whether the Coronavirus outbreak will always be covered by a force majeure clause. However, the courts will likely be influenced by the World Health Organisation's declaration that this virus outbreak is a global health emergency.

Even if a force majeure clause can be invoked, the effect will depend on the language used because there are a number of different types of force majeure provisions including:

- provisions which excuse a party from non-performance;
- provisions which adjust the commercial terms;
- provisions which terminate (or allow for termination of) the contract.

In addition to checking the exact wording of the force majeure clause, a party wishing to invoke such a clause will need to consider:

- whether the Coronavirus outbreak actually prevented, hindered or delayed the performance of the contract
- whether the circumstances were unforeseeable and out of the control of the party seeking to rely on the clause
- where there are any alternative ways of performing the applicable obligations and whether steps could be taken to avoid or mitigate the consequences of the Coronavirus outbreak
- whether notice is required in order to invoke the force majeure clause and what needs to be included in that notice

What other options are available if core supply chains are disrupted?

In the short-term, if core supply chains are disrupted, businesses will need to consider whether there are any other available sources of supply, or alternative ways of doing business which could help mitigate the impact of the disrupted supply.

Whilst of little comfort at this stage, the Coronavirus outbreak will help businesses to identify supply chain vulnerabilities to enable these to be better addressed in the future. It is often the case that businesses are

unaware of their full supply chain (from original manufacturer through to direct supplier), and only know the identity of their direct suppliers. This can cause problems in detecting supply chain weaknesses as businesses are unable to identify the ultimate source of their products and whether those manufacturers are all based in one relatively small geographic area.

What steps can be taken to reduce the financial burden?

In addition to addressing supply chain issues and reviewing contractual provisions such as termination and force majeure, businesses should also consider what steps can be taken to reduce the financial burden of the Coronavirus outbreak. These can include:

- renegotiating lending terms
- reducing overheads
- reviewing insurance policies to identify whether a claim could be made for business interruption
- applying for bridging or emergency funding