



CONTRACTUAL AGREEMENTS

MARCH 2020

It is very unlikely that anyone 12 months ago would have predicted that in the first three months of 2020, the world would have seen a new global pandemic resulting in some of the tightest restrictions on social interaction and personal freedom of movement ever implemented, with the majority of Europe and other major countries in some form of lockdown and borders closed.

The Coronavirus (COVID-19) pandemic continues to change the way in which we conduct our day to day business and, as that change occurs, businesses need to consider existing contracts and whether the situation means that it may potentially not be able to fulfil its obligations and if so, what are its options.

It is key that businesses conduct a review of their contractual obligations so that they are aware of where the pressure points are (or may be, given that this crisis is evolving at pace) and can react quickly and pre-emptively to changing events. Businesses who do not do this may find that they are caught unaware by provisions in contracts, which are triggered as a result of the pandemic, and may have a significant impact on their business.

A business may have contracts governed by the laws of many different jurisdictions and the implications may not be the same in all of those jurisdictions. This guide does not purport to cover the laws of any jurisdiction which Collas Crill does not practice. Local advice in those jurisdictions will need to be obtained.

We will consider three main concepts which businesses will need to consider, i.e. *force majeure*, frustration and material adverse change/effect.

Do not assume you don't have to perform your obligations

It is a foundation of contract law that parties will be held to the obligations which they agreed to in the contract. For example, in Jersey, this has been described as a 'sacred principle'.

As a result, you must assume that, irrespective of the current crisis, a business will be required to perform its contractual obligations.

However, there are some qualifications to this principle which may come into play as a result of the Coronavirus (COVID-19) pandemic.

Is there a *force majeure* clause?

Many contracts contain what is known as a '*force majeure*' clause. The aim of these is usually to provide that, when a certain event occurs, it will result in a relaxation of the requirement to perform (for example, a suspension while the event continues) or, in certain

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circumstances, may give a right to terminate the contract. These are usually unforeseen events which are beyond either of the parties' control, such as 'Acts of God'.

It is important to note that this is a contractual remedy and as a result, whether or not a *force majeure* clause can be used during these times will depend on how the clause is drafted. Some may be drafted very widely, while others will contain very limited circumstances. Typical examples are natural disasters and terrorist acts but *may* include pandemics.

Each contract will be different and a detailed review of the provisions will be key to determine whether or not the Coronavirus (COVID-19) pandemic will result in a *force majeure* clause being capable of being activated, whether by the business itself or by a counterparty.

If a business does seek to use a *force majeure* clause, it may have detailed provisions of how that clause needs to be activated, such as a requirement to give notice in writing that a *force majeure* event has occurred and the provisions have been activated.

If those provisions are not followed precisely, then a business may not be able to rely on the *force majeure* provisions, and it would still be expected to perform its contractual obligations as otherwise set out in the contract.

My *force majeure* clause does not cover this – what now?

In most common law jurisdictions, including Cayman and the BVI, where a contract is 'frustrated' then the parties to a contract may in certain circumstances terminate that contract with immediate effect.

'Frustration' occurs where, through no fault of either party, the obligations under the contract are incapable of being performed '*because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract*' (*Davis Contractors Ltd v Fareham Urban District Council* [1956] AC 696).

Case law has indicated that the standard of proof is a very high one and a court will not lightly find that a contract has been frustrated. For example, just because a situation has caused or may cause additional burden or hardship, or even a delay in performance, will not in itself be enough to frustrate the contract.

In Jersey, which is not a common law jurisdiction, the courts have on rare occasion applied a similar doctrine, but only where performance is rendered absolutely impossible. For example, in *Hotel de France (Jersey) Limited v The Chartered Institute of Bankers (1995, unreported)*, a hotel fire made the room booked for a conference unusable. That room had been specifically chosen to cater for the needs of the Institute and it was held that was a fundamental term of the contract. As that term could not be fulfilled as a result of the fire, the parties were entitled to terminate the contract.

Each case will need to be determined on its facts but one point to note is that, in general, the standard of proof will be higher than that contained in a typical *force majeure* clause. In future, businesses are advised to ensure that any *force majeure* clause is drafted widely enough to cover events such as the Coronavirus (COVID-19) pandemic.

Material Adverse Change or Effect (MAC)

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This is a key provision which businesses need to be aware of in their contractual documentation. The effects of provisions relating to MAC can be serious.

These provisions can permeate throughout a contract, ranging for example, from provisions in a loan agreement saying that a company may obtain other forms of financing provided that it does not result in a MAC, or alternatively the mere existence of a MAC can result in a default or other contractual remedy, such as the ability of the other party to pull out of a transaction.

What will constitute a MAC? Again, this depends upon the specific drafting of the provision in the contract. A typical clause is likely to provide for a material adverse effect on the business, operations and financial condition of the company or the ability of the company to perform its obligations. Further, this clause is often not objectively drafted but is expressed to be an event which *in the opinion of the counterparty* has that material adverse effect, meaning that a company may have no control whatsoever over whether the provision applies.

The consequences of these clauses, if invoked, could be severe. If a lender were to invoke this clause against a borrower, thereby putting that borrower into default and requiring it to immediately repay the loan owed, that borrower may have no option but to enter into an insolvent process.

To date, MAC clauses have been rarely invoked and some counterparties (such as banks in the UK) have indicated that for the moment, they are looking to support businesses as much as possible. However, the Coronavirus (COVID-19) pandemic is proving to be a unique set of circumstances and, as time goes on without an end to the pandemic and the easing of restrictions on day to day life and business, this situation may change. Dialogue with counterparties will therefore be key.

What should I do?

- Work out what your obligations are – conduct, or instruct lawyers to conduct, an audit of the contracts you are party to and determine what your ongoing obligations are and when they are to be performed.
- How does the current situation impact my ability to perform? Is it the case that the obligations are impossible to perform at all, more onerous or have to be delayed?
- Take advice – we can advise you on what options are available to you. In most cases, the earlier that action is taken on a pre-emptive basis, the easier it will be for businesses to continue.
- Talk to your counterparties – all businesses are affected by the current situation and it may be easier to come to an agreement simply by discussions, to come up with mutually agreeable amendments to contractual terms (for example, paying a reduced price because of extended delivery times).

How Collas Crill can help you

Collas Crill prides itself on being easy to do business with. We take a hands-on approach and are here to help you and your business in these uncertain times.

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We are able to advise you on any contractual implications which might arise as a result of the current pandemic, such as conducting a contract review through to negotiating and documenting any amended contractual terms with counterparties.

Please feel free to reach out to any of the contacts listed in this briefing or any of your usual Collas Crill contacts.

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