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Renegotiating or cancelling commercial arrangements in light of COVID-19

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Introduction

The spread of COVID-19 potentially undermines the viability of a huge range of commercial arrangements, from contracts for one-off (or multiple) events to long term supply contracts. The reasons why these arrangements are put in commercial jeopardy will vary, but may include:



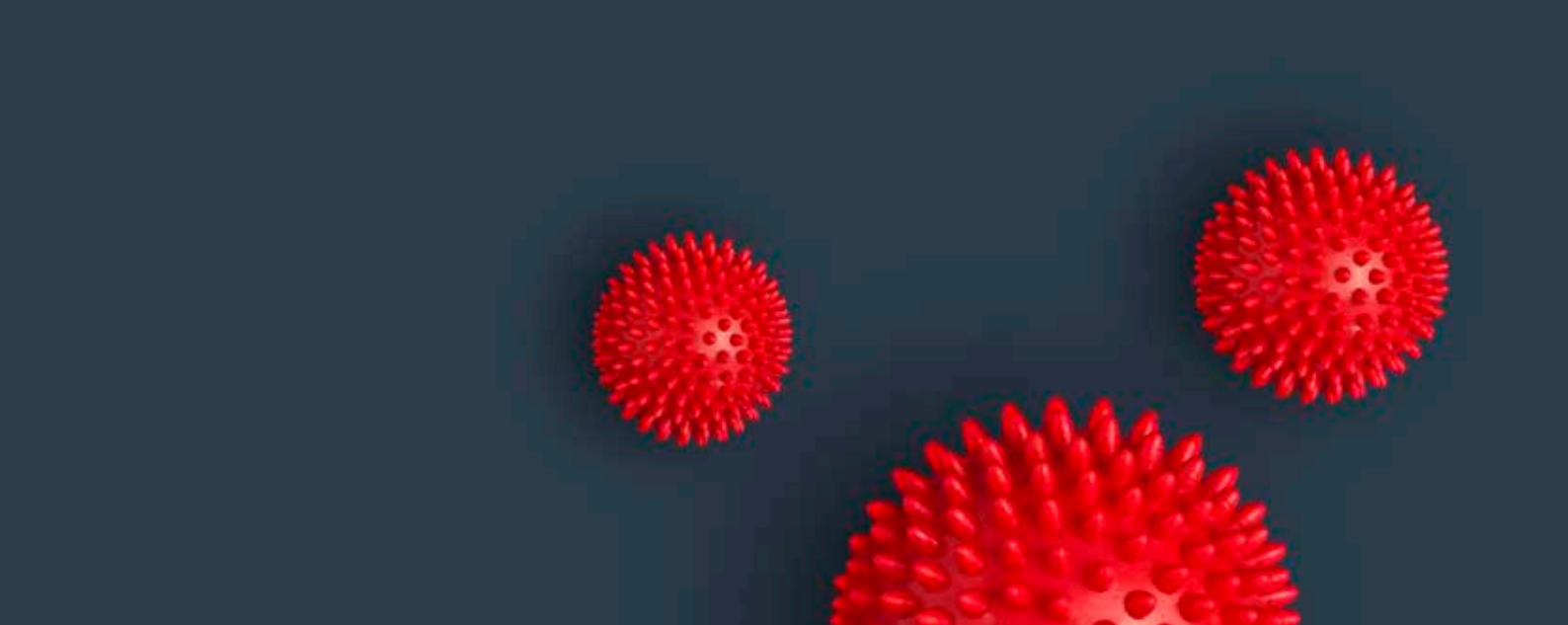
Lack of customers, employees, supplies, third party support or services.



The cancellation of the event to which the arrangements relate (for example a package tour to a sporting tournament which is cancelled).



Active state action, for example the requisite state authorisation or licence not being available, Government advice to cancel or close, a ban or the state requisition of essential facilities.



Underlying any such commercial arrangements are almost certainly contractual terms. If the existing arrangements are no longer viable, there may be two options. Firstly, cancellation which may have multiple consequences. Secondly, renegotiation, in order that the arrangements become viable for all parties.

This paper considers the contractual and other potential legal issues arising when considering cancellation or renegotiation in these circumstances.

In more detail...



Throughout this note, these blue boxes provide links to other relevant articles exploring related topics in more detail.

Visit the [cms.law COVID-19 insight page](#) for our full collection of articles.

Cancelling commercial arrangements

A major event like the COVID-19 pandemic can change (amongst much else) the commercial parameters against which parties agreed to a particular contract. For many arrangements, the parties may not object to the principles of the contract. Rather, in the new circumstances, the terms are no longer profitable; indeed they may be loss-making or potentially even be impossible to perform. Alternatively, agreed contractual time-frames may no longer be realistic. A party may be willing to proceed with the arrangements if the commercial terms can be renegotiated. That party may even be willing to accept terms that are less profitable than those agreed before the COVID-19 outbreak. But most parties will want to avoid being bound to contracts that are loss-making or have become impossible to perform.

Parties typically agree to commercial arrangements because they create value for both sides. In contrast pricing renegotiations are zero sum. By definition, a party achieving better terms does so at the expense of the counterparty. Alternatively, the parties may agree to “share the pain” and both accept less attractive terms. It is challenging to negotiate in this dynamic.

That said, the renegotiation of terms during or post a major event such as COVID-19 is not simply a matter of comparing original terms versus proposed revised terms in the abstract. During those discussions the parties will have to consider other important factors.

The relationship between the parties

A long-term relationship makes it easier to renegotiate terms, even if less attractive than those originally agreed. Mutually dependent relationships also promote collaborative behaviour; a supplier wants its customers to succeed.

Legal risk

A party seeking to renegotiate may be able to argue that COVID-19 relieves it of its contractual obligations. Each scenario differs of course, but sometimes it is helpful to point out that accepting less attractive commercial terms is better than the alternative, which may include legal action/setting the contract aside entirely, or getting nothing because the counterparty will become insolvent. However, there is also the issue of time. Even if a party is able to bear less beneficial arrangements for a short period, it may not be able to do so for weeks and months on end, which may mean things come to a head sooner given the current uncertainties around when “normality” may resume.



Renegotiation

Parties should explore less dramatic outcomes than terminating the contract. There may be relationship and commercial drivers that makes an alternative solution attractive, even if it can only be on less attractive terms than the current agreement provides.

Both parties may be concerned about the situation – one may be desperate to ensure performance by the other (e.g., supply of business critical material or services) while the other may be desperate to avoid performance (e.g., because it is no longer practical or profitable to do so). The reasons may be important to the legal risk and the likelihood of finding a compromise (e.g., the difference between not wanting to perform because you can get paid more by someone else for the same essential goods or services vs. not wanting to perform because it has become prohibitively expensive or will take longer due to the changed circumstances).

If one party is in such a strong position that it can effectively force the other to accept terms that are not in its interest – those arrangements could be rescinded down the line if the disadvantaged party is able to show that the pressure exerted went beyond normal commercial pressure and amounted to duress. This is however a difficult argument to run and the threshold to proving duress is high.



Where renegotiation is desirable, the objective will be to get to a position of relative strength but without damaging trust in the process. An otherwise resolvable situation may become contentious through the wrong approach. Take opportunities to build trust where possible. But equally, even if the circumstances appear to be uniquely challenging for your business, you should not necessarily assume that you approach any renegotiation from a position of weakness, the other side may be challenged as well, perhaps more so. So try to put yourself in the other party's shoes and understand their concerns and risks. Does the counterparty have particular (non zero-sum) concerns that can be addressed? Is there a way to share the down-sides or additional cost/risk? Accept that the solution may need to be unpalatable to both parties (but better than no solution at all).

The unique COVID-19 event and the public response has resulted in many businesses taking altruistic steps that would otherwise be against their short-term interest. In this atmosphere, attempts perceived to be taking advantage of a counterparty's difficulties caused by COVID-19 could be very destructive to a commercial relationship. They could even have reputational impact in a B2C business. In contrast, forbearance with a counterparty that is facing particular difficulties could be gratefully received and significantly strengthen a relationship.

It is important to understand the relevant legal concepts and their effect.

- Beware anticipatory breach (i.e., an unequivocal statement that you will not perform).
- Don't assume that just because the other party has not performed a particular obligation it entitles you to stop performing – or not to pay. Whether that is correct will be fact and contract specific. Many contracts require parties to continue performing even when a dispute has arisen.
- Understand the remedies available and how they impact on objectives (e.g., repudiatory breach allows a wronged party to either affirm or repudiate the contract; in some cases it may be in your interests or even essential to affirm the contract and continue to insist on performance).
- A party that agrees to new terms under duress may subsequently claim that the new agreement is invalid due to improper duress, but this is a difficult argument.
- What does the existing contract say about variation and renegotiation? No matter what it says, the parties can expressly agree to alter the terms. However, it may be important to understand whether any negotiation is proceeding within or outside the context of the existing variation provisions.
- Make sure you understand whether your renegotiation discussions are "subject to contract" (so they will not be binding until a formal contract is agreed) and/or may be treated as "without prejudice" (i.e., that they cannot be relied on or referred to in any proceedings that may later arise in respect of the matter, subject to certain limited exceptions) and, if helpful, make clear at the outset of discussions that they are.
- Where a renegotiation can be agreed, make sure to record it in writing to avoid a later dispute about what was agreed. In some cases, depending on the contract, it may be

Specific approaches to considering contract cancellation

1. Force majeure

Summary

The parties may have contractually agreed on allocation of risk for unpredictable events such as COVID-19 through the use of a force majeure clause or some other clause that limits the duty to perform or caps exposure on breach.

The legal concept of “frustration” is a rare exception to the principle of party autonomy where the common law will interfere with the terms that parties have agreed to, due to a suitably qualifying supervening event. In contrast, force majeure clauses respect the principle of party autonomy to negotiate allocation of risk for supervening events. Interpretation of force majeure clauses can intersect with the common law of frustration. For example, if the parties have expressly agreed the consequences of an event that would otherwise “frustrate” the contract, then the agreed terms are likely to be binding, rather than the contract being discharged, which is the normal consequence of frustration.

Outcomes

- Given that the doctrine of frustration only applies rarely and that its consequences are dramatic (discharge of the contract), it is often in both parties’ interest to agree to a force majeure clause (and functionally similar clauses such as Material Adverse Change clauses), to clearly agree what should happen in the relevant circumstances and delineate risk.
- These clauses should be examined extremely carefully before agreeing to any high value or long-term contract. A party should seek to renegotiate an unacceptable or unclear allocation of risk. The probability of certain events may seem remote, but COVID-19 illustrates that remote events can occur.
- Contracts may be highly prescriptive on how notice should be served on occurrence of a force majeure event. Depending on the clause, failure to serve notice correctly may prevent the serving party from relying on the force majeure event and therefore may be obliged to perform even if it is agreed that the event fell within the scope of the force majeure clause. A party that has received a potentially deficient notice should be very careful not to affirm breach of the notice provision.

Issues

Assessing whether there is a qualifying force majeure event is essentially a question of contractual interpretation and the terms agreed by the parties. The outcomes therefore depend both on the precise terms of the contract, the scenarios agreed to be force majeure events, the agreed consequences of a force majeure event occurring, and the factual circumstances of the parties. These variables make it challenging to identify common abstract principles in interpreting force majeure clauses. That said, the following points can be borne in mind.

- The precise wording of the relevant clauses is critical, and subtle differences in terms can have significant effect. Each exercise of interpretation must begin afresh.
- Force majeure events typically require that neither of the contracting parties caused the event, and that the particular event was unforeseen, or was at least unexpected, at the time the contract was agreed.
- Most case law on force majeure clauses consider whether or not one party is relieved of its contractual obligations to perform. Again, the wording is key. Certain clauses may relieve a party if performance of agreed obligations is impossible. A broader clause may relieve a party if performance is merely hindered.
- Typically, force majeure clauses will not relieve performance merely because supervening events have made the arrangements less profitable, or even uneconomical for one party. For example, a force majeure clause for a contract for a sale of goods is unlikely to be triggered merely because the seller’s preferred supplier is unavailable or even if export of relevant goods from a particular country becomes illegal, provided that an alternative source is available (even if the alternate supply channel is far more expensive for the seller).
- In common with general rules on contractual interpretation, the party wishing to rely on a force majeure clause bears the burden of proof of demonstrating that the particular event is a force majeure event.

In more detail...

- [Coronavirus and force majeure in the sports industry](#)
- [CMS Expert Guide to Force Majeure](#)



Something to consider... Crisis Control

The impact of the pandemic and lock-down on working practices, operations and, importantly, controls, raise significant fraud and other risks for businesses having to find ways to continue operating in very constrained circumstances.

- **Fraud:** With staff or even entire business units out of action, companies are having to move fast to implement new and constrained business processes just to keep operating, often led by the inexperienced and without the luxury of time to consider all the potential ramifications. For example, offshore business support services are being reduced or are otherwise operating under strained circumstances, yet they are responsible for business critical operations, like finance, IT or billing. The stress this will create can lead to increased risk of rushed, poorly considered or less rational decision-making and decisions made on the basis of incomplete or poor information. This can make companies more vulnerable to fraud and regulatory risks. Criminal actors may step up their efforts to commit fraud, knowing that businesses’ usual protections may be impeded.
- **Paper trail/record keeping:** Businesses are forced to work in ways that don’t ensure the same quality of record-keeping and paper trail for current decision-making (e.g. using ephemeral messaging and phone/video calls to keep things moving, where normally formal and permanent records would be produced). Businesses could end up in a position where they don’t have adequate records for a significant period and significant decisions, which may not be looked at sympathetically by regulators, investors, lenders and other stakeholders with the benefit of hindsight.
- **GDPR/commercially sensitive information/cybersecurity:** Controls to protect data and records (through online security, encrypted files, drives etc) may be necessarily relaxed to enable remote working and sharing of data, but this could create GDPR issues down the line, as well as risks of loss of control of commercially (or even market) sensitive information. Hackers will seek to exploit the present confusion and vulnerabilities. Increased home working and potential relaxation of cyber security policies increases the risk of accidental breaches.
- **Poaching:** Key experts within your business (especially IT or tech experts) who may now be more in demand than ever, are at risk of being poached by competitors.

These risks don’t only exist now, during the most difficult period, but may apply just as much or more once we are able to return to “normality” and when there may be an increased desire to “make up for lost time”. How businesses react and senior management communications to staff will be crucial in protecting against financial crime and regulatory breaches.

2. Frustration

Summary



Frustration is a well-established principle of contract law which means that an intervening event will cause all existing obligations under a contract to come to an end. This is a somewhat uncertain area of law.

Something to consider... Data protection

Given the enormity of the commercial issues arising in respect of COVID-19, concerns for personal data may seem a little unnecessary and pedantic. That approach however could be a serious mistake.

Firstly, the General Data Protection Regulation ("GDPR") now provides an onerous and strict regime for the regulation of personal data. In the UK the Information Commissioner's Office, the UK's data regulator, quickly followed the inception of the GDPR in May 2018 by indicating the intention to impose extremely heavy financial penalties for data breaches by British Airways of £183m and Marriott of £99m. Moreover, on top of this fining regime, the individuals concerned can bring a civil legal claim for damages in respect of the unlawful processing of their personal data.

Secondly, issues arising in respect of COVID-19 may well involve the use and disclosure not only of personal data relating to individuals but personal data concerning the health of those individuals. Such health data falls into the definition of "special category data" under GDPR and the situations where such data can be legitimately used are extremely limited. The processing of such special category data concerning an individual does not solely take place when the individual is expressly named, but whenever that individual can be identified from the data.

In the circumstances the only advisable course is to seek to avoid referring to any health data relating to any identifiable individual.

Issues



Whether a particular intervening circumstance will constitute frustration of a contract will depend on the facts and, in particular, the following:

- Whether the circumstances fall within one of the well-recognised categories of frustration events such as: the cancellation of an event to which the contract relates; the performance of the contract being rendered illegal by a change in the law; or the requisition by the state of facilities essential to the performance of the contract.
- Whether the intervening event affects the performance of all or only part of that required by the contract. The more that is affected, the greater the likelihood that the intervening event does constitute frustration. (There can be no "partial frustration" of a contract. If a contract is frustrated it falls away in its entirety.)
- Whether the intervening event was foreseen at the time of the contract and covered in the contract terms. For example, as noted above, if the intervening event was foreshadowed in a force majeure clause, it is unlikely to constitute frustration.

Outcomes



If a contract is frustrated, the starting point is that all outstanding contractual obligations arising after the moment of frustration simply fall away. However, this has been found to be subject to the equitable principle of restitution and also the terms of the Law Reform (Frustrated Contracts) Act 1943. Together these mean broadly that:

- Where a sum has been paid by one party to the other prior to the frustrating event and the paying party has received no benefit at all up to that point (no consideration), the payee is entitled to the recovery of that amount subject to some deduction in respect of the expenses of the receiving party. The amount of deduction (whether the full expenses incurred or a lesser amount) depends on the court's assessment of the justice of the case.
- Where a party has received some benefit prior to the frustrating event, the other party may recover an amount as the court considers just not exceeding the value of the benefit.

Frustration nonetheless remains a crude and blunt instrument for bringing a contract to an end. One particular problem is that there is no mechanism for a party recovering expenses incurred where there has been no pre-payment.

Another issue concerns the effectiveness of any terms in the contract which are expressed to survive termination (for example, confidentiality or non-compete provisions). Under the traditional analysis of frustration, these would come to an end with the rest of the contract. However, there is a reasonable prospect (although this is untested) that a modern court would consider that such provisions should remain in place.

3. Insurance

Summary



The insurance and re-insurance markets are there to deal with catastrophes. Coverage of both man-made and natural disasters have been considered in the English courts for many centuries. COVID-19, however, is a catastrophe new to insurers and insureds with many questions arising about coverage. Key to all coverage disputes will be a careful consideration of the applicable policy wording (including any exclusions) as well as the chain of causation.

Outcomes



- Review your policy wording, taking note of any exclusions. The status of any governmental guidance, recommendations and prohibitions may also be relevant, for example, was the event expressly prohibited (no gatherings above a certain number) or was it just discouraged? Does the policy depend on COVID-19 having been declared a pandemic? Seek advice if you are unsure about coverage.
- The burden of proving a loss falls within an exclusion will normally fall on the insurer. Check your policy wording as some policies seek to reverse this burden of proof.
- Maintain standard policies. Even if a business has had to fully suspend business operations, it is important to maintain insurance cover for standard risks. This is to protect against damage to assets such as premises, stock or IT systems which may be more vulnerable when the business is not operating as normal.

Issues



Business Interruption Insurance

Business interruption insurance traditionally covers instances where physical damage to commercial property or equipment results in the full or partial suspension of business operations. That is to say, a successful claim for business interruption losses is generally dependent on some form of physical damage to property. The scenarios envisaged include natural disasters, fires, floods and other standard risks. Dependent on policy wording however, contamination may suffice in certain circumstances, for example where a property has to be closed for deep cleaning before it may reopen.

Extensions to cover may also include governmental lockdowns or requisitioning for alternative purposes (such as the conversion of London ExCel Centre into a temporary hospital). Similarly, notifiable disease extensions may cover compulsory closure of premises or restriction of access from the date the virus is deemed a notifiable disease. This was 22 February in Scotland and 29 February in Northern Ireland. The Department of Health and Social Care in England indicated that it would register the virus as a notifiable disease under the Health Protection (Notification) Regulations 2010 on 5 March. Some policies will alternatively list the notifiable diseases that are covered, with COVID-19 unlikely to be included, but query whether SARS may suffice to cover COVID-19.

Event Cancellation Insurance

The pandemic has led to the cancellation of a multitude of music, professional sporting and other large-scale social events. Event cancellation insurance aims to cover event organisers for costs and/or loss of revenue if events do not proceed as planned due to reasons beyond their control. Whether an organisation's event cancellation insurance covers losses arising from COVID-19 cancellations will depend on the policy wording.

Policyholders should look for any exclusions for epidemics or pandemics that could prevent recovery of losses arising from COVID-19. It is common for event cancellation policies to exclude losses arising from communicable diseases leading to quarantine or restrictions on movement and/or travel advisory or warnings being issued by national bodies.

Where cover does apply, the next step will be to consider the extent to which expenses and lost profits are recoverable. The various contracts with the event venue, attendees, suppliers, catering and equipment hire will all need to be carefully considered.

In more detail...



- [Coronavirus: key insurance considerations](#)

Something to consider... dealing with UK public authorities

One striking feature of the COVID-19 crisis has been the dramatic response from the UK Government offering vast financial support to the UK economy and UK businesses. The availability of this financial support may make the difference between failure and survival for many commercial entities.

Any public authority is subject to a range of public law duties and is likely to be amenable to judicial review. That means it must act reasonably and fairly. In particular, the public sector financial support for businesses constitutes state aid under European law and this imposes additional burdens on the public authority.

In these difficult circumstances, an aggressive or litigious approach with the Government is unlikely to be attractive. However, if a public authority appears to be unfair and recalcitrant in its approach to providing support to your business, it may be helpful:

- to be apprised of the potential public law backdrop to the decision-making of the public authority and the potential for a claim in judicial review in the circumstances.
- to adopt some of the language of this public law backdrop to encourage the public authority to engage constructively with you.
- to be aware of the availability of requests for disclosure under the Freedom of Information Act 2000 against the public authority and to consider how these could be used to your advantage.
- to be mindful of the very short timeframes for bringing a judicial review challenge to a decision of a public authority (maximum 3 months) and also to be alert to when the relevant decision has been made (such that time starts running).

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