

What Should I Do if Government Lockdowns or Supply Shortages Mean that I Can No Longer Supply a Client with Goods or Services Under a Contract?

by Joseph Lewin

In these unprecedented times, many contracts are increasingly under strain. The economic effects of the COVID-19 pandemic have caused shocks throughout the global economy and have led to government interventions that would previously have been considered unimaginable.

As a result of the pandemic and governmental containment efforts, many businesses are struggling to remain productive, to retain staff, to obtain necessary materials, to transport, or to sell their goods and services. This has had the result of creating supply line shortages across many sectors, and, in some cases, such as in the case of governmental lock downs, has rendered it impossible to supply agreed services or goods.

The result is that many businesses are finding themselves in a position where they are not able to carry out their contractual obligations in a timely or cost effective manner and, in some extreme cases, unable to perform them at all.

Despite this the obligations remain in place, and customers (many of whom have their own clients to consider) will in many cases be seeking to make sure that they are protected by seeking to enforce those obligations to the extent possible.

Dorsey has created the following briefing, setting out the most basic steps that businesses finding themselves caught in such a position can take.

1. Discuss with the Counterparty

First, a discussion with the counterparty may provide reassurance. If the customer is prepared to be sensible, then contingencies can be put in place to help mitigate the risk of breakdowns in supply and performance.

Be careful in the approach to the counterparty. A statement to the effect that your business will not be able to perform the contract could be interpreted as a repudiatory

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breach in itself.

If such negotiation is possible and the counterparty is willing to listen, it is important to keep the terms of the agreement under review and make sure that you do not waive any rights or accidentally agree to vary the agreements.

Be sure that any newly negotiated terms are properly incorporated into the agreement, so that your business does not find itself inadvertently in breach of the agreement.

2. Review the Agreement

If discussion fails or is not possible, then the next step is to carefully consider the terms governing the supply of goods and services.

The following are common clauses that might be found in a contract for the supply of goods or services that might assist:

The Terms governing the provision of the goods or services

First, take time to review the terms of the agreement which detail the services and goods to be provided, to see whether you would actually be in breach of the agreement if you fail to supply to the normal standards, and if there is any leeway given.

Key things to look for include:

- Does the contract allow for any flexibility in what can be provided? What are the minimum obligations that you are really obliged to perform? If it is possible to meet those, then, even if you are not performing in line with expectations, it would still be possible to avoid breaching the agreement.
- What time limits does the contract put in place for provision of the services? Is 'time of the essence' in meeting your obligations? If it is, and you are unable to perform these obligations in time, it will be a breach of contract.
- Are you required to make only 'reasonable endeavours' or 'best endeavours' to perform, or to mitigate any failure to meet obligations due to unforeseen events?
- Are there any exclusions of or limits on your liability in the event that you breach the contract?

It is important to continue to adhere to these obligations so far as possible and be aware of the potential consequences of not doing so.

Force Majeure clauses

Some contracts contain a clause dealing with "force majeure" events: specific events - which are beyond the parties' control - that may excuse a party from being required to carry out contractual obligations. A common example of a specified event would be natural disaster.

If your contract does contain such a clause, review it closely. The legal effect of a force majeure clause depends on its express wording, which will set out the types of events

that it covers, what the effect of those events needs to be, and the consequences for the contract of one occurring.

In particular, consider whether the clause refers specifically to an epidemic/pandemic, or to other relevant events which have occurred as a result of the pandemic, e.g. the government action which has prevented contractual performance.

If the clause does cover such an event, and you are able to demonstrate that it is that event that has meant that you are unable to perform the contract, then you may be entitled to make use of it.

The effect of such a clause varies, but typically in the case of short term suspension of performance they will allow the affected party to suspend performance, without terminating the agreement.

If your contract does not contain such a clause, then the law will not imply one, and you will need to consider other options. One of these options, frustration, is dealt with below.

Force majeure clauses are typically complex. If you are unsure whether there is a force majeure clause in your contract, or are unclear on its scope and whether it would cover the current pandemic, it is important to seek legal advice.

Material Adverse Change or Change of Law clauses

Some contracts contain clauses that protect the parties in the event of a significant economic or legal change that stops short of a force majeure-type event. Such clauses are typically called “material adverse change” clauses or “change of law” clauses.

Depending on the wording of such a clause, the restrictions and measures implemented by the government due to COVID-19 could fall into this category. If your contract does include one, examine it carefully and see whether it would assist, for example by allowing suspension of performance, giving additional time, or allowing you to pass on unanticipated costs.

Termination rights

Finally, if there is no way to avoid a breach of the contract, it may be better simply to terminate it.

Agreements will often contain a standalone termination clause which will give one or both of the parties a right to terminate before the end of the contractual term. Such clauses will describe the procedure and requirements for termination.

These clauses will usually tell you the time framework for terminating the agreement, the specified events which mean the agreement can be terminated, and the method of terminating (e.g. in writing, and whether specified information should be included in the termination notice). Your company may find it preferable to start the termination process as early as possible to avoid being locked, for a longer period than necessary, into an

agreement it cannot perform.

However, remember that this step, once taken, is a permanent one. Unlike suspension, once the contract has been terminated, it can only be restarted by agreement.

Notice provisions

If there is a helpful clause in the agreement, such as those described above, it is important to review any notice provisions. There may be requirements for parties to provide notice of their reliance on certain clauses within given timeframes, or other notice requirements which must be strictly adhered to.

Failing to provide proper notice could mean the notice is deemed invalid and result in you breaching the contract or losing the ability to rely on the clause in question. If in doubt, it is best to seek legal advice.

3. Frustration / Illegality

If there are no contractual provisions that assist in the circumstances, then, if it is possible to show that, through no fault of either party, you have become incapable of providing the agreed services or goods because the circumstances in which the performance is called for would render the contractual term “radically different” from that which was originally undertaken in the agreement, then the doctrine of Frustration may assist. If you can show that the frustration of the contract was not contemplated by either party when entering into the agreement, and that the associated risk was therefore not accounted for, then the contract will be discharged through frustration.

The effect of frustration is different to a force majeure clause. Whereas force majeure clauses usually suspend performance of a contract (depending on the wording), frustration will discharge a contract: ending it completely.

Businesses may prefer that existing contractual obligations can be revived quickly rather than the whole agreement terminated.

However, businesses should note that historically frustration has been granted in only limited and extreme circumstances.

Similar to frustration is the doctrine of Illegality. This may be applicable in circumstances where new COVID-19 legislation has made performance of the contract illegal. As with frustration, the whole contract would be discharged in these circumstances.

4. Keep Records

Thorough records of the decisions you are intending to take, and the discussions that have led to those decisions, should be maintained. The clauses referred to above will commonly include duties to mitigate and it will be important to show the steps made to

attempt to mitigate any consequences of COVID-19.

Keep in mind that such discussions may in the future be required to be disclosed in legal proceedings. If businesses are concerned to protect such discussions, advice should be sought early from a lawyer. Legal advice sought and given is highly likely to be protected by the rules on privilege.

As always, if you are unsure whether your company may be to rely on a contractual provision, or would like to discuss any of the topics covered in this checklist, please call us.

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