



DISPUTE RESOLUTION AND ARBITRATION

# Coronavirus: Managing the risk of breach of contract

The rapid spread of COVID-19 (Coronavirus) throughout the world and the impact of administrative measures to contain it represent a growing challenge for the management of companies.

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On 11 March 2020, the World Health Organization declared the existence of a pandemic. The main focus is now to guarantee the safety of workers and employees. However, the potential repercussions for the activities of companies – in the short and medium term – are vast, complex and, in certain cases, they conflict with each other.

PLMJ has created a multidisciplinary team dedicated to analysing the problems facing businesses. This team will share its thoughts, some technical, some practical, which it believes will contribute to finding solutions to mitigate the risks and relieve the pressure that businesses are under.

Businesses must assess the extent to which the impact of the Coronavirus could affect their ability to comply with the contractual obligations they have assumed. They must also evaluate the mechanisms available to them to react if the other party breaches a contract. This analysis should have a double focus: (i) on the contract the parties have made with each other, and (ii) on the legal rules that apply to it on a supplementary basis.

Depending on the terms of the contract in question, the breach could amount to an event of default. Alternatively, the breach could meet the conditions of clauses that protect the non-defaulting party. These clauses include moratoriums and suspension of the duty to perform. They also include clauses that make it possible to terminate the contract if there are events outside the control of party under an obligation to perform. Examples include force majeure clauses and MAC (material adverse change) clauses.

On a supplementary basis and depending on the law specifically applicable to the situation in question, it is important to consider whether any general provisions of the civil law apply. In particular:

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- The party under an obligation to perform is bound by an ancillary obligation, imposed by good-faith, to inform the other party of any current or potential impossibility to comply with the obligations undertaken.
- In complying with this obligation, the party under an obligation to perform must be aware that this communication could amount to an advance declaration of non-compliance. Depending on the specific case, this could lead to the early maturity of the obligation to perform, to default, or even to definitive breach.
- Not performing the obligation on its due date may constitute unlawful conduct. In this case, however, the party under an obligation to perform may, depending on the circumstances of the case, prove that it is not at fault for the breach. If it succeeds, it will escape the duty to compensate.

- In general, one should always ask whether the failure to perform obligations because of the existing pandemic can be considered as resulting from a “case of force majeure”. This is because the unpredictable, exceptional and abnormal nature of the situation could lead to the termination of the obligation. As a consequence, the party in question would be released from having to perform their obligation towards the other party.

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- However, to produce those effects, the performance of the obligation must have become objectively impossible, and not only “more onerous”. If this situation occurs, it can give rise only to the application of the rules on a change in circumstances. In exceptional cases, these rules allow the party prejudiced by the change to ask for either (i) the termination of the contract, or (ii) its modification based on equity.
- Impossibility is not to be confused with greater difficulty in performing. Nonetheless, in certain cases, one could also consider whether the excessive burden of performance should be equated with impossibility.
- However, if the impossibility of performing obligations is temporary, the obligations should simply be suspended for the duration of the impediment. During this period, the party under an obligation to perform is not liable (because it is facing a “force majeure event”) for any loss or damage that the delay in performing the obligation causes to the other party.
- On the other hand, depending on the distribution of risk in the contract, in some scenarios, it might be legitimate to invoke non-compliance in face of the breach by the other party or, in certain cases, their insolvency.
- On the basis of the specific circumstances of the contract, there may be a duty to mitigate the damage resulting from the breach. It may also be possible to consider whether some blame lies with the non-breaching party that could influence the amount due as compensation.
- As an ultimate remedy, both the definitive breach of obligation and the unenforceability of maintaining the contractual relationship could grant the right to terminate the contract.
- When the party subject to an obligation performs its obligation, but the other party (i) does not accept the performance and/or (ii) does not do all the acts necessary for the performance, precisely because of the COVID-19 pandemic, one can consider the existence of a default by the other party. This would mean the risk of a possible impossibility to perform the obligation to pass to the other party. In these situations, in addition to not being relieved of its own duty to comply with the contract, the other party may also have to compensate the party under an obligation to perform for the expenditure incurred in offering to perform and/or in storing the object in question.

In this context, we have identified some practical actions that companies can take against the background of the current pandemic:

- Analyse the content of the contracts in force to ascertain whether they have clauses relating to events of force majeure, and review the scope and consequences of those clauses.
  - Check whether there are obligations to give notice in the event of a material adverse change with an impact on the economic activity of one of the parties or in case of a probable inability to perform a contract in due time, including the expected breach of obligations to maintain financial ratios.
  - Evaluate the extent and scope of cross-default clauses set out in contracts, in particular, in financing agreements. In this context, companies should also assess any cure periods or other similar contractual mechanisms that could mitigate the consequences of breaches (request for waivers or alteration of the contract).
  - Identify the law applicable to the contractual relationship in question and the legal mechanisms existing in this legal system that could be invoked.
- Keep a detailed record of the impacts that the Coronavirus is having on the company and on the performance of its contractual obligations. Companies should also keep a record of all communications that are exchanged between the parties (which can be useful in any future dispute).
  - Check whether the insurance policies they have taken out cover situations of pandemics and/or events of force majeure. If so, they should also check what actions they should take to ensure claims can be made successfully under those policies. ■

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