CORONAVIRUS: MANAGING THE RISK OF BREACH OF CONTRACT

Posted on 19/03/2020

Category: Uncategorized
Tag: cat-covid19

by
André Figueiredo - Partner and head of the Capital Markets practice.
João Tiago Morais Antunes - Partner in the corporate and financial litigation practice.
Duarte Schmidt Lino Partner and co-head of the Corporate M&A practice.

The fast spread of Covid-19(Coronavirus) throughout the world and the impact of the administrative measures to contain its spread represent a growing challenge for companies and individuals alike. The main focus is clearly to ensure the safety of workers and employees. However, another big

challenges that businesses will face is the impact of the Coronavirus on their ability to comply with their contractual obligations and to businesses that are the other parties to their contracts.

Companies must evaluate the extent to which the Coronavirus may prevent compliance with their contractual obligations and the mechanisms available to them to react if the other parties default. This analysis must follow a dual approach: firstly, under the terms of each contract and, secondly, under the general rules applicable on a supplementary basis.

Depending on the contractual terms that apply, a breach could amount to an event of default or, alternatively, meet the conditions of clauses protecting the non-defaulting party. These clauses include moratoriums and suspension of the duty to comply, and clauses allowing for termination under certain circumstances falling outside the breaching party's control, such as *force majeure* and MAC – material adverse change – clauses.

On a supplementary basis, it is important to consider whether any general provisions of Portuguese civil law apply and what useful guidance they provide in these situations. In particular and in the first instance, a party to a contract is bound by an ancillary obligation to inform the other party of any current or potential impossibility to comply with its obligations. This may lead to an advance default declaration and, depending on the specific case, early maturity, default, or even definitive breach.

It is also important to look at whether the failure to perform obligations due to the existing pandemic can be considered a *force majeure* event, that is, an event resulting from unpredictable, exceptional and abnormal circumstances. If it is indeed a case of *force majeure*, the impacted party is released from having to perform its obligations. However, for this to happen, the performance of the obligation must have become objectively impossible, not only more burdensome. However, it is arguable that, in certain cases, the *excessive burden of performance* may be equated with objective impossibility. If it is actually a case of impossibility, the general rules of change in circumstances may come into play. In certain exceptional cases, these rules allow for the impacted party to ask for either the termination of the contract, or its modification.

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 for any loss or damage that the delay in performing the obligation causes to the other party.

As an ultimate remedy, both the definitive breach of obligations and a situation in which it would not be equitable to maintain the contract in force (due to an abnormal and exceptional change in circumstances) could grant the right to terminate the contractual relationship.

There are certain pre-emptive measures businesses should consider in this context to mitigate any risks arising from an incapability to comply with obligations, either its own or those of the other party. Important measures include: (i) analysing the content of the contracts in force to see if they have clauses on events of *force majeure*, (ii) reviewing the scope and consequences of those clauses, and (iii) checking whether there are notification obligations in the event of a material adverse change with an impact on the economic activity of the parties. Businesses should also consider whether it is likely they will be able to comply with their obligations in good time. This includes, for instance, the expected breach of obligations to maintain financial ratios.

Businesses should also evaluate the extent and scope of cross-default clauses set out in contracts, in particular, in financing agreements, and any applicable cure periods or other similar contractual mechanisms that could mitigate the consequences of breaches.

A sound pre-emptive approach would include confirming whether insurance policies cover situations of pandemics and events of *force majeure* and, if so, what actions are required to ensure claims are successful.

Finally, businesses should keep a detailed record of the current and potential impacts of the spread of Coronavirus on their operations and on the performance of its contractual duties. They should also keep a comprehensive record of all communications exchanged with the other parties as this could ultimately be useful in any future disputes.

For more information here.

PLMJ Transformative Legal Experts

Av. Fontes Pereira de Melo, 43
1050-119 Lisboa, Portugal
T. (+351) 213 197 300
F: (+351) 213 197 400
www.plmj.com/en/