Keep calm in uncertain times: Know your commercial obligations before you act

31 JULY 2020

CATEGORY:
ARTICLE

Click here to read more insights on how we can weather the coronavirus outbreak with you.

Imagine the following situations:

- You, as a landlord, have signed a tenancy agreement with a tenant for rental of a commercial property for a fixed term. However, the tenant has decided to break the lease and does not intend to honour the remainder of the rental period; or
- You, as a manufacturer, are contractually obliged to deliver your goods by a certain date. However, your supplier's factory premises have remained closed for weeks, and you are unable to manufacture your goods without your supplies; or
- You, as a distributor, are facing a large stockpile in your factory, with none of your retailers willing to take the goods as previously agreed, due to the poor retail sales.

Sound familiar? Unfortunately, these situations have become an increasingly common occurrence in the midst of the COVID-19 pandemic and continues as businesses recover from the effects.. Ever since the World Health Organization declared the COVID-19 viral disease as a pandemic, countries around the world implemented increasingly stricter border controls, stay home notices and lockdowns, in a bid to curb the spread of the virus. In certain countries, retail shops and restaurants were closed so as to prevent people from gathering. With such strict measures in place, it is inevitable that there were disruptions to businesses and severe economic repercussions that are still ongoing. Amidst these trying times, it is important for us to keep calm and collected, and to be aware of our contractual rights and obligations.

One of the most commonly asked questions now is whether a party is able to claim that the COVID-19 pandemic amounts to a force majeure event, so as to absolve itself of the performance under the contract(s) to which it is a party. Before jumping the gun and invoking the force majeure clause, it is important to consider whether the party invoking the force majeure clause has exhausted all available options to continue performing the contract. Normally, a party who wishes to rely on a force majeure clause has to show that it has taken reasonable steps to avoid or mitigate the occurrence and consequence(s) of the event. This is because terminating a contract as a result of force majeure is not as of right but a matter of last resort, and a party will not be allowed to invoke a force majeure clause unless it has exhausted all available options. For instance, if a party is able to find alternative sources of labour, albeit at a higher cost and rendering the contract less profitable, it will have to proceed with this option. If a party invokes a force majeure clause when it is not entitled to, this may be regarded as a repudiation of the contract, and that party may have to compensate for losses stemming from such repudiation.

The duty to mitigate losses is also relevant when assessing damages in cases involving a breach of contract. As a general principle, a claimant will be barred from recovering losses that could have been reasonably avoided. If a claimant fails to take reasonable steps to mitigate its losses, this could reduce the amount of damages the claimant is entitled to recover as a result of the breach of contract. Thus, when faced with a breach of contract, the claimant should not adopt a wait-and-see approach, or worse, sit back and do nothing. For example, in the first situation above, the landlord will have to take active steps to look for a tenant to take over the premises for the remainder of the rental period. In the second scenario, the manufacturer will be obliged to mitigate its losses by finding an alternative supplier to provide the necessary supplies. Likewise, the distributor in the third case will also be obliged to source for other retailers who are willing to take the goods. It is also important to keep a contemporaneous note of all the mitigating measures that have been taken, as the question of whether a claimant has taken reasonable steps to mitigate its losses is highly fact-sensitive.

Even as the situation stabilises, it is difficult to predict how long the COVID-19 pandemic will last and whether new waves will come as cases rebound across the globe. However, what we must learn from the COVID-19 experience is to be forward-looking when managing contractual obligations in general. Instead of terminating contracts, one possible option would be coming to an agreement to suspend mutual obligations

under the contracts until the situation eases or when government restrictions are lifted. This will ensure the continuity of business once things return to normalcy, instead of having to negotiate fresh contracts with other parties, which may be even more time consuming. Doing so will also help to build goodwill, and will go a long way in preserving contractual relationships that parties may have spent years establishing. If you do decide to suspend and/or vary such contracts, it is advisable to set out the agreed terms in writing, and ensure that a proper record of all discussions is kept.

The COVID-19 situation is continuously evolving, and countries are rolling out new measures reactively on almost a daily basis so as to curb the spread of the virus. In such situations, it is advisable to review existing contracts with other parties, so as to ascertain whether the contractual obligations can still be fulfilled, and if not, what steps should be taken to mitigate the losses. While everyone is now eager to find their way out of performing a contract, this must not be done hastily, and should ideally be done in consultation with your legal advisors. Any misstep may cause the party to invoke the termination clause wrongfully, possibly resulting in more losses instead. More importantly, every contract is different. Parties cannot and should not adopt a one-size-fits-all approach when looking at contractual rights and obligations. In times like this, parties should keep calm, and review their contractual rights and obligations instead.

Click here to read more insights on how we can weather the coronavirus outbreak with you.

Authors

Keoy Soo Khim

PARTNER | HONG KONG

Litigation and Arbitration

+852 3711 1688

sookhim.keoy@withersworldwide.com

Angela Law

SPECIAL COUNSEL | HONG KONG

Litigation and Arbitration

+852 3711 1736

angela.law@withersworldwide.com

Kelly Tan

ASSOCIATE | HONG KONG

Litigation and Arbitration

+852 3711 1735

kelly.tan@withersworldwide.com