TRUST BUT VERIFY

Best Practices in Standard and Non-Standard Contracts and Agreements

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What a difference a (calendar) year makes. When business leaders sat down at the end of 2019 to talk about the coming year, it is unlikely that many of them predicted a global pandemic and widespread civil unrest in the United States. The possibility of multiple contract partners breaching their agreements in Q2 was probably considered negligible. But times have changed, and as the saying goes, "Those who cannot remember the past are condemned to repeat it." Smart companies will learn their lessons and amend their contracts. This article offers some considerations and suggestions for doing just that.

CONDITIONAL PERFORMANCE

First, determine what triggers performance. Are additional steps necessary before the parties can perform? Is the ability of a seller to source raw materials from an outside vendor or the ability of the buyer to secure financing for the purchase a prerequisite?

These are real problems in the current environment, and if your contract does not spell out these contingencies and account for third-party delays, your company could be faced with losses or litigation. Pay close attention to what your contracts—including the terms and conditions of any invoices or purchase orders—say about performance triggers and delays. Are extensions possible?

DEALING WITH DELAYS

Many contracts attempt to address unanticipated delays through *force majeure* or "Acts of God" provisions. While the language varies in each agreement, the general concept is that a party may be excused from performance if certain unanticipated events occur that are outside that party's control. If the relevant clause endeavors to list examples of qualifying events rather than using general language, wars and natural disasters will probably make the list, but what about pandemics, civil unrest, or governmental orders? The goal is always to honor the parties' intent, so most courts narrowly interpret *force majeure* provisions. Less is more here; detailed language hampers a court's ability to fashion an equitable result.

Also consider invoking the doctrines of impossibility, impracticality, or frustration of purpose, if possible. These defenses are broader than any specific contract provision and can even provide relief where performance is technically still possible, but not practical or economically feasible.

CHOICE OF LAW

Many states have adopted the U.C.C., which affords some predictability in contracting. Courts differ in determining things like foreseeability, whether performance is truly impossible or just more burdensome and less profitable, and causation (e.g., did the pandemic itself cause the disruption, or were there intervening factors, such as a change in supply or demand or a stay-at-home order).

And what about international contracts? Civil law jurisdictions such as Canada, France, and Germany have codified *force majeure* and similar concepts, while common law jurisdictions such as Australia, India, and the U.K. generally recognize related doctrines like frustration and impracticality. If your contract does not spell out what happens in the event of unanticipated delays, it is important to consider what options are available under the applicable law.

LIMITING EXPOSURE

When issues arise, are you protected? When it comes time to renew or renegotiate your agreements, talk to your trusted advisors and consider the following: Do you have the right insurance coverage in the right amounts? Do you have indemnity

agreements in place so that you do not get caught in between your supplier and your buyer, and whipsawed for delays that aren't your fault? Is your liability limited to compensatory damages and capped at the value of your contract, or are you susceptible to claims for consequential damages?

RIGHT TO TERMINATE

Assume the pandemic or the civil unrest have affected commerce so drastically that one of the parties to an agreement claims *force majeure*. Can the entire contract be cancelled or are additional steps required, such as the submission of a mitigation plan? Must you allow for alternative performance or reasonable extensions? Subsequent action or inaction by the parties can be used to show waiver or modification of the agreement, especially if the behavior is inconsistent with contract terms.

If your contract does not have *force majeure* language, consider alternative ways of leveraging the best result for your particular circumstances. Compare UCC § 2-615, which allows cancellation when performance becomes unforeseeably impracticable, with Restatement (Second) of Contracts § 269, which allows for the temporary suspension of contract obligations, but does not generally excuse performance. U.S. Courts relied on Section 269 in the period following the 9/11 attacks and the 2008 financial crisis, and they could do so again in pandemic-related litigation.

If current events have taught us anything, it is that contracting parties should not only know the process for dealing with delays and disruptions under their current agreements, but they also must think proactively about how to handle the issue in future contracts.

RISK TOLERANCE AND DAMAGES

Proactive thinking requires a careful consideration of all parties' tolerance for risk. What modifications, delays or mitigation efforts can you all tolerate? Can you invoke a liquidated damages clause, a provision for lost profits or business interruption costs, or set new conditions to allow for performance, such as an allowance for increased overhead or expenses?

If you are already in the dispute or resolution stage, what are the respective goals and expense tolerance? Weigh the merits of the specific dispute vs. the importance of the overall contract relationship. Is the upside worth the risk?

COMMUNICATIONS

More than ever, communication is critical. Proactive companies can control the message and the messengers, identify what platforms or devices are used to communicate, and take steps to preserve relevant data. Do you need to consider modifying default deletion rules, implementing an archiving system, or copying personal or mobile devices?

As always, it is important for clients to share information with counsel in a way that protects any privileges. If warranted, take steps to qualify communications as settlement communications. Although privilege rules vary greatly by jurisdiction, involve your legal team in the process early and often; don't just copy them on emails.

WHAT ABOUT GOOD FAITH?

Most states do not require good faith during the negotiation phase, but once an agreement has been reached, a duty of good faith and fair dealing is usually implied between the parties to the agreement. In the broadest sense, every party has a duty not to hinder any other party's performance. Choice of law is again important and should guide the decision-making process.

There is little reason to believe that courts will ignore this important concept because of a global pandemic or widespread protests or demonstrations. To the contrary, good faith cooperation may be more important now than ever before in the parties' relationship and (if you do wind up in a dispute) efforts to work together on extensions and modifications will likely be viewed much more favorably than a tenuous or self-serving attempt to terminate contracts based on Acts of God or claims of impossibility.

ETHICAL CONSIDERATIONS STILL APPLY

Finally, ethical rules apply even during a global pandemic or in times of civil unrest or economic turmoil. Modifications or changes to your contracts and discussions regarding changes should take place within ethical boundaries.

When considering modifications, be aware of jurisdictional variations in ethical rules, including global cultures and norms. Confidentiality rules always apply, and counsel must protect confidential information provided by clients during negotiations or even discussions of extensions or modifications of the contract terms, to address possible breaches.

To protect confidential information, look to the original letter of intent, or consider a mutual confidentiality agreement, limiting the scope of persons with access to confidential information or cloaking it under settlement negotiation rules. Remember that even if settlement negotiations are inadmissible, they may not be protected from discovery.

Remember, too, that ethical duties may apply to a lawyer's relationship with the corporate entity rather than its employees—this is especially true when directors, officers or employees violate the law or engage in behavior that could potentially harm the organization. Counsel and business leaders should work together to ensure that the corporation's interest is protected even during times of economic stress.

Even in tense times, lawyers are not permitted to knowingly advance a contract claim or defense that is unwarranted or has no basis in the law, unless that position is warranted by a good faith argument for extension, modification, or reversal of existing law. Lawyers also have a duty of honesty to courts and tribunals, as well as to adversaries and third parties. In working through contract delays and disruptions, a lawyer may not make false statements or directly mislead another party.

CONCLUSION

We are living in a strange new world. There are myriad ways for companies and the lawyers who represent them to legally and ethically negotiate or modify contracts to help prevent anticipated problems (or even address unanticipated ones) by being proactive. In fact, now may be the perfect time to not only examine your existing contracts, but also to reach out to key business partners to discuss ways to assist and cooperate on accommodations and extensions, so that we can all get through this together.

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