

Commercial Contracts and the Pandemic – Conciliate or Litigate?

Remarks by Sir William Blair

17 November 2020

I thank the Centre for Corporate and Commercial Law and the Cambridge Private Law Centre and Professor Louise Gullifer for the kind invitation to speak this afternoon.

When the Covid-19 virus began spreading in February 2020, few could have predicted its global effect.

At the time of speaking, mid-November 2020, conditions in some parts of the world, notably Europe and the United States, have deteriorated sharply.

At the same time, the global picture is not uniform – for various reasons, East Asia has fared much better.

However, this too has been at a price, exemplified by the strict quarantine rules placed on international travel by countries in East Asia.

Nothing shows the effect of the pandemic better than its effect on international travel.

To put the subject into context, I would like to share with you statistics published by the Montreal based International Civil Aviation Organization on 12 November. This puts the economic effect of the pandemic into perspective.

It shows the projected collapse of world passenger traffic during 2020. The estimated decline is between –59% to –60%.

What is particularly revealing about this projection is to compare it with other major events over the past half-century or so.

Each serious crisis – the oil crisis of 1972, the Iran-Iraq war and Gulf crisis, the Asian crisis which by the way was a financial crisis, 9/11, SARS, and the global financial crisis of 2007-2008 – had their effect.

But nothing begins to compare with the effect of the Covid-19 pandemic.

By the end of 2020, international passenger numbers will have gone over the cliff.

This is an illustration. Other fields of economic activity show the same kind of story, an exception being – so far – valuations in the financial markets which as we know, following a disastrous March, have risen steadily ever since mainly reflecting massive injections of liquidity by various key states.

But there is another aspect of the crisis that is troubling. The genesis of the Covid-19 pandemic might, in itself, be the product of human disregard for nature – an aspect of the broader issues around sustainable development.

There was, I think, a feeling earlier this year that a V shaped recovery was a credible outcome within 2020.

Notwithstanding the amazing speed at which vaccines are being developed, no one takes that view as at mid-November.

But because of the nature of this crisis, again, the picture is not uniform. As the WTO has put it, the Covid-19 pandemic has devastated trade in certain types of goods while encouraging trade in others.

We see in our own lives that international trade has in many respects held up – in Britain, for example, panic buying subsided quickly once it became apparent that bare shelves would quickly be refilled.

But the indirect effects of the crisis has hit many emerging markets, with commodity prices falling and tourism drying up.

Zambia has a population of 17 million, and reported as of November 17,000 cases, and 350 deaths, which is a much lower level than most European countries.

Nevertheless, it is reported that last Friday Zambia became Africa's first country to declare a Covid-19 default in its sovereign debt.

Leading commentators such as Lee Buchheit and Sean Hagan have warned of an incipient sovereign debt crisis.

Individual cases aside, because of the unpredictable nature of the crisis, and the longer it goes on, we must expect a continuing impact on trade and commerce, particularly supply chains, and this has the potential to become cumulative.

The question I pose in these remarks is whether to avoid a “plethora of defaults” arising from the crisis (Mario Draghi's phrase), we should be looking at new ways of resolving commercial disputes, or, should we be focusing on how technology can accommodate and ultimately enhance legal proceedings?

The field we are looking at is commercial contracts, but this is not a niche concern, because these in many ways are the lifeblood of international commerce, providing the legal framework which makes it possible.

So what happens to these contracts is important now. This is true both in a positive sense and in a negative sense.

Contractual continuity can help keep trade flowing. Contractual disputes can have the opposite effect.

This is what lies behind the breathing space project hosted by the British Institute of International and Comparative Law.

In this project, we have tried to identify the main types of commercial dispute which the crisis may be expected to throw up, and at the same time suggest a conciliatory approach to resolution which takes into account the public interest in a time of pandemic.

The group that has taken the project forward includes two former Presidents of the UK Supreme Court, Lord Neuberger and Lord Phillips.

It also includes Professor Louise Gullifer, and I take the opportunity to acknowledge the great value of her contribution.

So what are these disputes that the pandemic is throwing up?

In terms of legal characterisation, it is possible to identify three main heads: (1) force majeure, (2) material adverse change and hardship, and (3) discharge of contracts by frustration, supervening illegality, and impossibility.

These terms are not always used in the same sense – it partly depends on which legal system you are in. As you know, English law is widely used in international commerce and finance, but of course it is one of many systems, and there is a difference in approach in the civil and common law.

Commercial contracts often include a force majeure clause relieving a party of liability for non-performance caused by an event which

- is beyond the party’s control;
- could not reasonably have been foreseen when the contract was concluded; and
- could not have been avoided or overcome by the party.

Civil law jurisdictions usually include force majeure provisions in their Civil Codes. Common law jurisdictions usually do not. However in commercial contracts, the distinction is or should be of limited importance since the contractual terms will prevail.

Material adverse change and similar clauses permit a party to exit from a transaction on the occurrence of a fundamental change in the other party’s ability to perform its obligations due to a deterioration in its financial position. Such clauses routinely appear in finance or corporate acquisition documents.

In civil law, codes may contain comparable provisions such as *imprévision* in the French civil code. A feature of these provisions is to enable the court to “adapt” the contractual terms. In China, the Supreme People’s Court has issued guidance as to how these provisions are to be applied in the light of the pandemic.

Common law jurisdictions do not typically invest the court with such power to adapt contractual terms.

Doctrines such as frustration and impossibility apply in both the civil law and in the common law under various different names, but the basic idea is familiar and is the same.

Supervening illegality is a distinct doctrine – it could apply, for example, if a party was required under national law to switch production to medical supplies to cope with the pandemic.

However, the point to stress in relation to all these doctrines, is that so far as international commercial contracts are concerned, the legal analysis will depend upon the terms of the individual contract, and the facts of the case.

It is important to bear this in mind when considering the desirability of conciliation over litigation – it may seem obvious to a business person that their contract has been traduced by Covid-19. But the path to determining legal liability may be far from predictable, and will certainly include issues of causation.

We do not of course suggest that legal proceedings should generally be avoided. This is a matter of judgment for parties and their legal advisers. We do however suggest that in a crisis like the present there is a public interest as well as a private one.

A topical example of where litigation can be constructive is the test case brought by the FCA (which is the UK’s financial conduct regulator) on the scope of business interruption insurance – which can be a vital lifeline for small businesses, but where the potential liability of insurers is massive.

In its judgment handed down in September, the court analysed liability across 21 different types of insurance policy. It decided that coverage can indeed be available for Covid-19 business-interruption losses. However, and it is an important “however”, liability in individual cases depends on applying the principles to the individual facts.

An appeal by some of the parties is being heard under the “leapfrog” procedure by the Supreme Court this week – it is being live streamed, and this Cambridge webinar is taking place during the lunchtime adjournment!

In the first concept note the breathing space project published back in April – it seems a long time ago – we warned of the risk of a deluge of litigation and arbitration placing a strain on the system of international dispute resolution, and reducing the prospect of more constructive solutions and increasing the prospect of uncertainty of outcome.

There are not, so far as I am aware, empirical studies on Covid-19 commercial disputes. Anecdotally, it seems that in the period immediately following the outbreak attention was focused on survival issues.

Since then, there appear to have been a growing number of disputes going to court or arbitration which are either directly or indirectly referable to the crisis – and raising some or all of the issues I summarised earlier.

As an aside, this has resulted in the pandemic affecting the legal community disproportionately.

For commercial lawyers, there is an abundance of work, whereas for others the opposite is true – the pandemic has, for example, seriously impaired the ability of the system to hold jury trials.

A few examples in no particular order illustrate the breadth of such disputes.

In May 2020, an interim order of the Paris Commercial Court found contractual force majeure established in the case of the effect of the virus in producing a “baisse brutale” – steep decline – in the consumption and market prices of nuclear electricity (*Total Direct Energie v EDF*).

This decision was upheld by the Paris Court of Appeals in July.

In New York, litigation is taking place about co-branded airline credit cards issued by a Brazilian bank – it was triggered by American Airlines’ suspension of its flights to Brazil on

29 March so that the mileage points which the bank was obliged to purchase became, it alleges, valueless.

Again issues of contractual force majeure as well as common law frustration arise in the case (which is yet to be decided).

The effect of the pandemic on mergers and acquisitions activity has been widely noted. The *Travelport v WEX* case raises the question whether the buyer under a share purchase agreement can reject the deal on the basis of material adverse effect provisions.

As with the business interruption insurance case, the preliminary question to be decided was the meaning of the relevant contractual provision – a decision in this regard was handed down in the London Commercial Court last month, and the case will now go to trial.

In the financial field, a court in Spain has applied the doctrine of fundamental change of circumstances in a case where the borrower – a steel group – is resisting repayment of a loan.

The court said that it is “well known that the Covid-19 pandemic caused a drastic drop in production and demand” and that “this is an exceptional and unprecedented situation as Covid-19 had paralysed the world economy.” As a result, it was “necessary to adapt contract law institutions to the social reality of the moment”¹.

We believe that our concern as to the risk of a “plethora of disputes” is fully justified, and, of course, there is a distance to go before the pandemic is under control.

So the question is what to do about it. I asked at the beginning of these remarks whether we should be looking at new ways of resolving disputes, or whether the focus should be on how technology can accommodate legal proceedings.

When it comes to litigation, most of us envision the process taking place physically in a courthouse. But from March 2020, in many countries, courthouses were closed. They are only gradually reopening. Among the problems which this has given rise to, is the problem of backlog.

Though the hearing venues for arbitrations are more flexible, and directions hearings have been routinely conducted by phone for a long time, substantive hearings have also to date taken place physically.

The pandemic has given a massive boost to the holding of hearings remotely on various different platforms – so far as major commercial disputes are concerned, this appears to be a global phenomenon.

In brief, from the time when the courts closed physically, hearings in commercial cases began to be conducted remotely. At the outset, the judge participated from outside the courts, but now judicial participation may also take place from inside.

The parties’ lawyers equally participated from outside the courts, sometimes from law firms’ offices, sometimes not.

Protocols were rapidly introduced and approved by the courts.

¹ Roj: AJPI 13/2020 - ECLI: ES: JPI: 2020: 13A (30 April 2020)

Very similar considerations apply to arbitration.

After nearly 8 months, it is possible to draw some conclusions. The remote format is particularly suitable for hearings which do not include witness evidence.

For short or relatively simple hearings in commercial cases, it is quite likely to become the default format, even after the pandemic lifts.

Where witness evidence is part of a hearing, a physical hearing may be optimal, but where it is held remotely, it is important to ensure that the witness is comfortable in this environment, and that their evidence is given without covert assistance.

It does not follow that the remote format is without its drawbacks. Wi-Fi connections, for example, may be less than stable. Different time zones may make remote attendance by some parties difficult. A disparity of technological resources among the parties or the tribunal may hamper the hearing, or even render it unfair.

Also, the principle of open justice requires that the public has access. This in turn requires safeguards against the potential for interference in the proceedings, or abuse for example by recording and distributing copies.

To the question I put, the answer is that both technology and conciliation are important. For those disputes that cannot be conciliated, the opportunity is there for technology to help on two problems in particular which beset the adjudication of major commercial cases, whether in litigation or arbitration, and that is delay and expense.

There is room for optimism on both fronts. As has been said, why fly a bunch of lawyers from New York to Seattle for a half hour hearing when they could join by Zoom, and get an earlier date?

Nevertheless, sometimes you do have to fly those lawyers, and others in the process as well. A physical hearing may be obviously preferable, or for a variety of reasons, a remote hearing may not be practical.

The key point is that the technology must not become an end in itself – the challenge is how far it can enhance decision-making and the adjudicative process, and make it quicker, cheaper, and more accessible.

The second concept note published by the breathing space project concludes with a future-looking section that makes nine recommendations as to how the law should support negotiated solutions reached by the parties to make viable contracts blighted by the pandemic work.

That brings me to the final and most important part of these remarks. Because of its obvious benefits, conciliation has long been promoted as an alternative to litigation, and more recently arbitration (med-arb).

In some systems (such as Switzerland) conciliation is required before beginning legal process in the courts, in others (such as England & Wales) the courts have not so far been prepared to order mediation if all parties do not consent.

The third and latest concept note prepared by three leading commercial lawyers², one of whom has just become a High Court judge, seeks to address these issues in an innovative way.

This document proposes a set of practical guidelines which might be adopted to encourage a more conciliatory approach to contractual disputes, and which seeks to avoid or minimise protracted legal disputes, without prejudicing or altering parties' legal rights.

The guidelines have been prepared having regard to the wider public interest in supporting the economic recovery following the COVID-19 pandemic, and may complement many commercial organisations' existing ESG objectives.

They are designed to create an opportunity for reflection and pause, helping parties to preserve commercial relationships and avoid or limit any potential impact on wider supply chains.

Where legal proceedings have been commenced, the guidelines seek to create an environment where claims are conducted in the most proportionate manner, fostering potential for early settlement.

The Guidelines, which are in the Annex, are brief – they are intended to be read by business people as well as their legal advisers. They provide a check list of points that parties are encouraged to take into account under three headings:

- Interactions between Contractual Parties: behaviours aimed towards supporting contractual relationships
- Dispute Resolution Considerations: behaviours aimed towards resolution and/or avoiding escalation
- Alternative Dispute Resolution (ADR) and Legal Proceedings: behaviours aimed towards efficient legal proceedings and resolution using ADR techniques or other available procedures

Let me now close with this observation.

We need to be looking at new ways of resolving commercial disputes, not just because the pandemic requires everything to be done that can be done to mitigate its effects, but because we have a real opportunity to improve the system that we have. We should take that opportunity and make the most of it.

Sir William Blair

17 November 2020

² Helen Dodds, Adam Johnson QC (now Mr Justice Johnson) and Guy Pendell.

Concept Note 3 - The Guidelines

All parties are encouraged to:

A. Interactions between Contractual Parties: behaviours aimed towards supporting contractual relationships

- 1) act fairly and responsibly in maintaining contractual performance, taking into account the following non-exhaustive factors:
 - a) the possible wider business impact of their actions;
 - b) the financial standing of all parties;
 - c) the disruption associated with continued performance against disruption reasonably likely to be caused by a change, suspension, delay or termination;
 - d) the impact, if any, on other stakeholders, including other contractual counterparties (including sub-contractors), employees, lenders and shareholders
- 2) adopt a mutual without prejudice and confidential 'cards on the table' approach, sharing information relevant to the continued performance under the contract including (but not limited to):
 - a) available resources and potential constraints;
 - b) alternative options, whether or not envisaged under the contract;
 - c) a party's financial position
- 3) engage in discussions to explore solutions for problems arising, including extensions (or reductions) of time for performance and/or payment, non-contractual remedies, increases or reductions in the scope of the contract, and re-negotiation, including with the involvement of a third-party facilitator
- 4) explore ways to balance the impact between all parties, where extensions or reductions of time and/or changes in scope and/or price are sought
- 5) where early resolution of the dispute cannot be achieved, explore whether the dispute can be ring-fenced to allow contractual performance otherwise to be maintained

B. Dispute Resolution Considerations: behaviours aimed towards resolution and/or avoiding escalation

- 6) before resorting to proceedings, and where resources are available, appoint the most appropriate party representatives on all sides to encourage an objective assessment of the dispute and bring different perspectives to its resolution
- 7) agree extensions to contractual or statutory limitation periods where to do otherwise would likely result in proceedings having to be issued

- 8) avoid adopting tactical practices intended to place other parties under unreasonable financial or time pressure
- 9) where a party seeks funding in relation to proceedings, invite any litigation funder to follow these guidelines

C. Alternative Dispute Resolution (ADR) and Legal Proceedings: behaviours aimed towards efficient legal proceedings and resolution using ADR techniques or other available procedures

- 10) use mediation, early neutral evaluation or other ADR techniques pre-action with a view to avoiding legal proceedings altogether or narrowing the issues in dispute (whilst recognising that emergency interim relief may be necessary as a last resort before pre-action ADR has been exhausted)
- 11) where proceedings are unavoidable, work together to adopt litigation/arbitration procedures and timetables aimed at managing the proceedings in an efficient and time-appropriate manner, taking into account:
 - a) the likely cost of proceedings, proportionate to the amount in dispute or relative value of the issues in dispute;
 - b) the available court/tribunal/other procedural resources;
 - c) the relative importance of the issues in dispute in the context of wider factors including the economy (and its recovery)
- 12) use ADR techniques during legal proceedings with a view to resolving the dispute or specific issues in dispute
- 13) consider whether issues arising in the dispute are of wider significance or commonly occurring, such that a court or tribunal may make determinations of wider application through available procedural mechanisms, including a stay pending determination of other cases involving common issues of fact or law, consolidation with other proceedings or the determination of specific issues of precedent value to other parties.

BIICL welcomes your comments to Concept Note 3 (breathingspace@biicl.org).

Charles Clore House
17 Russell Square
London WC1B 5JP
T 020 7862 5151
F 020 7862 5152
E info@biicl.org
www.biicl.org

A company limited by guarantee
Registered in England No. 615025
Registered Charity No. 209425