DISPUTE RESOLUTION

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Risk Mitigation and Efficient Dispute Resolution during COVID-19 and beyond in Africa

CDH

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Risk Mitigation and Efficient Dispute Resolution during COVID-19 and beyond in Africa

In this note we set-out the salient points discussed by our panel of experts during the Webinar held on 16 April 2020 dealing with Risk Mitigation and Efficient Dispute Resolution during COVID-19 and beyond in Africa.

Our panel during the webinar consisted of:

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The context of the discussion during the webinar was with reference to the projected impact of COVID-19 and the worldwide lockdown on African trade and investment. The World Bank projects that as a result of the pandemic economic growth in Sub-Saharan Africa will for the first time in 25 years go into a recession, with UNCTAD estimating that global foreign direct investment to Africa could decline by as much as 30% to 40%.

For businesses operating during these unprecedent times it is not business-as-usual. What can businesses do to balance the understanding of their operating risk, mitigate such risk and effectively deal/navigate potential disputes that may flow from either its inability to perform or a counterparty's inability to perform.

In this time of uncertainty, more than ever, parties should consider amicable resolution of any disputes that may arise. Parties may also consider varying, where appropriate and agreed, the dispute resolution mechanism contained in their contracts. For example, where a contract provides for litigation, parties may agree to mediation or arbitration. A variation may be a convenient way to ensure efficiency, and save on time and costs.

What follows is a general summary of each speaker's discussion points.

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Understand Your Operating Risk: From Government Regulatory Measures to the day-to-day Contracts

Follow a step-approach in assessing and mitigating your risk.

1. In these uncertain times where there are continual changes, it is important to understand your ever-changing operating environment (i.e. restrictions whether actual and perceived).

    1.1 Take a birds-eye view of your entire operating environment (each country you operate in, what can and cannot be done, alternative supply/production sources, restrictions on import/exports, delays at ports of entry for goods etc).

    1.2 Do high-level country specific assessments of government measures (Lockdown Laws/Regulations/Directives) inhibiting domestic and international trade (i.e. trade goods say alcohol, tobacco etc). Understand, amongst others, the nature and extent of the restriction on the imports of goods or export of goods destined for other jurisdictions, its impact on revenue.

    1.3 In respect of goods or services that have been embargoed or trade restricted in certain jurisdictions:

        1.3.1 **Do comparative analysis** - understand what other countries are doing, objectively considering whether the embargo/restrictions in the context are rationale (i.e. there is a less restrictive means to achieve the same objective by government).

        1.3.2 **Consider approaching government for relaxation of restrictions** – the South Africa government has generally been receptive to proposal on relax some restrictions (notably cigarettes and alcohol has had no success).

        1.3.3 If embargo/restriction is objectively deemed irrational, do a preliminary assessment of potential loss or damage suffered as a result of such measures for the period they remain in place. Consider potential legal options both from a domestic law and international law perspective (treaty protection etc). In Ndanga's discussion she unpacks considerations that would be relevant from a treaty protection perspective.

    1.4 In doing the risk assessment consider objectively what "delays, hinders and/or prevents" you from buying material/goods or selling your goods or rendering your services in your entire value chain.

The aforesaid is not an exhaustive list – but covers the fundamental considerations.

2. Move from the birds' eye view of your entire operating environment, to drilling down into does critical contracts/clients that ensure your company remains a going concern. Checklist of pertinent issues to consider:

    2.1 Governing Law/Applicable Law (particularly relevant for cross-border/international contracts):

        2.1.1 regulates the validity and enforceability of the contract.

        2.1.2 dictates the interpretation afforded to contractual provisions (i.e. performance obligations and exclusion provisions) by courts or arbitral tribunals.

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Understand Your Operating Risk: From Government Regulatory Measures to the day-to-day Contracts...*continued*

2.1.3 legal doctrines that potentially aids you in a time of need (i.e. impossibility of performance)

2.1.4 If your counterpart is sovereign/government or state-owned entity, consider whether there are specific legislative provisions applicable to commercial terms with government (i.e. public policy/ so-called unconscionable terms). This may be largely dictated by the governing law clause.

2.2 Performance obligations (i.e. understand your performance obligations, understand your counterparty's performance obligations).

2.3 Exclusion clauses, does your contract have them:

2.3.1 ***Force Majeure* Clause** – this clause regulates the specific consequences of supervening events beyond the parties' control on the performance obligations of one or both of the parties to the contract. (Whether Covid19 and/or such lockdown laws of a host government falls within a *force majeure* clause turns on the proper construction of the wording of such clause.) Important points to note:

2.3.1.1 Carefully consider the events covered. [Your operating risk assessment will come in handy here.]

2.3.1.2 Comply with the notice requirement (in substance and form). [Remember it is for the party relying upon a *force majeure* clause to prove the facts bringing it within the clause.]

2.3.1.3 There must be a causal link between event and performance obligations under the contract (i.e. actually prevented or hindered from performance). You may need to demonstrate physical or legal impossibility, as opposed to merely that your performance obligations have become more onerous or unprofitable. Thus, the economic toll of Covid19 will not be suffice.

2.3.1.4 Understand that the event may result in the termination of the contract; excuse from non-performance (whether in whole or in part), entitle a party to an extension of time of the contract, and/or to suspend performance.

2.3.1.5 Understand that your past conduct (i.e. past non-performance under the contract) could exclude a valid reliance on a *force majeure* clause. The so-called "But For" test. So "but for" the Covid19 and lockdown (deemed as a valid *force majeure* event which excuses liability), the party invoking the *force majeure* would anyway not have performed under the contract.

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Understand Your Operating Risk: From Government Regulatory Measures to the day-to-day Contracts...*continued*

2.3.2 **Hardship Clause** – distinguish this from a *force majeure* clause. It is about financial hardship of a party to a contract and principle entails that one party requires a re-negotiation of the commercial terms to ensure so-called "commercial fairness" between the parties. Follow link to an article of Jackwell thereon titled Invoking-hardship-in-difficult-economic-times.

2.3.3 **Material Adverse Change**.

[Madeline discussed some of these provisions in more detail – with reference to Tanzanian law - her discussion thereon is on pages 6 to 7 of this document]

2.4 Understand what constitutes a material breach under your contract.

2.5 Comply with the requirements under your contract to declare a dispute. If you dispute the declaration of a *force majeure* by your counterparty – consider:

2.5.1 do you issue a breach notice; or

2.5.2 merely declare a dispute under the contract.

2.6 Assess the nature of the dispute (quantum and complexity) and your agreed dispute resolution process.

2.7 Depending on the construction of the dispute resolution clause, consider the most efficient, effective, and cost-effective means of resolving any potential dispute. Important to note:

2.7.1 The absence of a mediation or arbitration clause does not preclude parties from agreeing to mediation or arbitration after the dispute has arisen.

2.7.2 In the era of social distancing the use of technology for mediation or arbitration could ensure that disputes are resolved on a more efficient and cost-effective basis. Read the discussions of Madeline and Ndanga thereon.

2.7.3 A seat of arbitration in London, Paris or Singapore does not mean your venue for the arbitration cannot be in any African jurisdiction or virtual for that matter.

2.8 In considering the merits of proceeding with a claim for damages or loss also consider the prospects of successful enforcement of such claim against the counterparty (i.e. know your counterparty – assets etc, including jurisdiction for enforcement).

3. Businesses in Africa are faced with a lot of uncertainty – however even in the darkest of times there must be vision and strategy to get to the other side. Nothing your company does today is done in a vacuum, develop those strategy in dealing with actual and perceived risk to your business remaining a going concern. This will at the very least assist you to manage such risk whether on a regulatory level or a contractual level and then how to deal with such risk if it mutates into a dispute.

Risk Mitigation and Efficient Dispute Resolution during COVID-19 and beyond in Africa

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Introductions

As to the statistics from the World Bank and other sources show, undoubtedly the COVID 19 pandemic has tested and will continue to test the limits of societies and economies across the globe, and African countries are no exception.

I will be exploring on the commercial contract legal risks mitigation from the Tanzanian perspective and whether the pandemic can amount to *force majeure*, or hardship or material adverse effect bearing in mind that the softer approach (no lockdown, minimal import/ export restrictions) maintained by the government. I also discuss the available efficient dispute resolution mechanism that may be contained in our contracts and the need to embrace technology during the pandemic.

Commercial contractual legal risk management

Commercial contractual legal risk management involves the calculated actions to reduce the severity, frequency, and unpredictability of damages, losses, and claims. It is therefore important for businesses at this juncture to understand their legal exposures and raise the necessary provisional measures required to mitigate loss and hence encouraged to;

- **Conduct Risk analysis** (Legal Risk Management -LRM) or assessment on existing contracts objectifying the legal issues at stake by identifying and managing legal risks proactively. LRM helps to rationalize and objectify (i.e. use and develop objective criteria for negotiation and dispute resolution) their risk assessments and strategies. I would recommend compiling a matrix of these conditions and developing approaches to negotiations with counterparties, depending on their content.
- **Closely Manage Supplier Risk:** by assessing supplier contracts and obligations management including exploring the need for cost management measures in consultation with your suppliers - this includes halving or cutting off budgets. In other circumstances, if service levels are pegged against penalties it may be prudent to consider to minimize the exposure to such risk and issue Termination Notices if such obligations will be harmful to the commercial business. It is rare not to have a termination for no cause clause in commercial supply contracts.
- **Ensure to Secure evidence**. It is necessary to record, that it is impossible to perform obligations in connection with the epidemic. This step may include filing applications to chambers of commerce, government agencies, obtaining information from counterparties, etc. If non-performance is expected to occur or delay make a detailed record of the event and the cause of the event, timing, impact, potential length in delays and parties involved.

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Mitigation Provisions

By reviewing and assessing your contractual obligations with suppliers or customers you will be able to access mitigation provisions contained in your respective contracts, such as *force majeure*, hardship, material adverse effect clauses and the doctrine of frustration. Ideally, such clauses should be reviewed in line with the applicable or governing law of the contract.

(i) *Force Majeure* Clause (FM)

There is a clear freedom between the parties to agree on the terms of the contract and the incorporation of *force majeure* clauses, in common law jurisdictions such as Tanzania.

Broadly speaking, FM event might be considered a compensation event and/or a relief event. However, due to its relevance and international consolidation as a category of risk, it is common and good practice to grant this risk its own status in the contract. It is a contractual provision allocating the risk of loss if performance becomes impossible or impracticable, especially as a result of an event that the parties could not have anticipated or controlled.'

FM clause is usually put in all contracts in order to prevent termination of the same due to unforeseeable circumstances that render performance of contractual obligations as impossible and/or difficult to perform and may: (i) establish what circumstances the parties recognize as *force majeure* (for example, epidemics entailing the introduction of quarantine measures); (ii) determine the necessary evidence of *force majeure*; and (iii) clarify the consequences of *force majeure* (suspension of the contract, its termination, etc.).

While *force majeure* has neither been defined nor specifically dealt with, in Tanzanian statutes, some reference can be found in Section 32 of the Law of Contract Act, CAP 345 (the "Contract Act") envisages that if a contract is contingent on the happening of an event which event becomes impossible, then the contract becomes void.

For the coverage of this pandemic in the *Force Majeure* clause, it should encompass within its ambit, 'prevention of fulfilment of obligations due to governmental restrictions', 'any unforeseen circumstance that prevents the fulfilment of obligations' or specifically mentioning a 'pandemic/epidemic' as an event that would come within the ambit of *Force Majeure*.

The threshold of the FM clause is very high. There are generally three essential elements to *force majeure*: (i) It can occur with or without human intervention; (ii) It cannot have reasonably been foreseen by the parties and (iii) It was completely beyond the parties' control and they could not have prevented its consequences. In relying on the FM clause, the burden of proof is on the claiming party that performance of contractual obligations be rendered impossible which means that even if the performance is made more burdensome, more expensive, or even unprofitable, that is not enough to classify an event as *force majeure*. For instance, if a seller of goods can perform its contractual obligations by using a different sub-supplier (though more expensive), the seller will be required to do so.

(ii) Doctrine of Frustration:

But some FM clauses are ill drafted and are limited to a few circumstances only, in which case invoking the FM clause would not do much good unless both the parties to the contract mutually decide to suspend the operation of the contract for a specific period of time. In the absence of such mutual understanding the party which is not able to fulfil the terms of the contract can invoke the common law 'doctrine of frustration" usually relied upon for termination of the contract unlike the concept of FM which is for suspension of the obligations.

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Mitigation Provisions...*continued*

This doctrine has been embodied in the Tanzania Contract Act, ('Act') by way of Section 56 which provides that where the entire performance of a contract becomes substantially impossible without any fault on either side, the contract is prima facie dissolved by the doctrine of frustration. However, it is to be noticed that, section 56 is exhaustive in itself and it is not permissible for the courts to go beyond its provisions. According to Tanzanian law, when an event of changes of circumstances occurs, which is so fundamental as to be regarded by law as striking at the root of the contract, the court will generally examine the contract, the circumstances under which it was made, the intention of the parties, evidence adduced of whether the changed circumstances destroyed altogether the basis of the contractual arrangement and its underlying object. Nonetheless, such interpretation will depend on the length of the lockdown and on each individual case. It is not known at this point how the Tanzanian courts will consider the economic circumstances of present lockdowns worldwide that are affecting in-country business operations.

(iii) Hardship Clause:

Clause comes from article 6.2.1 of the UNIDROIT principles of international commercial contracts – contractual duties should normally be performed – principle known as "pacta sunt servanda" – and it is provided that "where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions on hardship". The "following provisions" are provided for under Article 6.2.2. The hardship clause operates in different circumstances and has different effects from FM clauses and hence should be kept separate. For fair allocation of risk in circumstances of FM and hardship, both clauses can of course be incorporated into the same contract. Refer to the ICC Hardship Clause 2003.

(iv) Material Adverse Change (MAE)

M&A transactions that are in the pre-signing or the pre-closing stages will, undoubtedly, be subject to the COVID-19 endurance test. During these uncertain times, one key question that dealmakers should start thinking about is: whether the COVID-19 pandemic can trigger a material adverse effect (MAE) / material adverse change (MAC). A "Material Adverse Effect" means any matter, event or circumstance that has [or which would reasonably be expected to have] a material adverse effect on the business, assets or profits of the Company.

MAE requires a case-by-case determination, and will, *inter alia*, depend on the language of a contract along with the law governing such contract. Contracting parties will need to demonstrate that the MAE that has occurred is so fundamental that is strikes at the root of the contract to warrant a discharge on the grounds of frustration per Section 56. A widely-worded MAE provision might not be of help to an acquirer. As a general rule, courts are reluctant to violate the sanctity of contracts, if so, the acquirer will need to rely on the test laid by Section 56 of the Contract Act.

Risk Mitigation and Efficient Dispute Resolution during COVID-19 and beyond in Africa

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Efficient Dispute Resolution Management (EDRM)

Dispute Avoidance is key during difficult times.

- **Obligation to take Bonafide steps to resolve disputes:** Notably, Section 96 of the Arbitration Act 2020 of Tanzania provides for provisions which seek to encourage parties to ensure to follow all pre-action protocols must be exhausted by the parties in good faith in trying to resolve matters out of the court.
- **Negotiations with counterparties.** If an obligation is required to be fulfilled, the same can be suspended by mutual consent of the parties. I recommend that you inform counterparties in detail of difficulties you have encountered, including in the form of notifications for which *force majeure* clauses provide. Based on the results of negotiations, it is important to agree on supplemental changes/variations to the contract: a suspension of deadlines for performing obligations, deferred payments, changes in the methods of performance, etc. It is important to focus on reaching compromise agreements with counterparties.
- **Expert Opinions:** to improve communication between disputing parties and provide a "reality check" for everyone involved parties may opt for an expert opinion on an issue. During this process, a neutral expert assesses the merits of the case and works with each party involved to come to a clear understanding of the central issues in the dispute.

Mediation, Arbitration & Embracing Technology

Mediation as remedy for difficult times: Mediation is a highly informalized method of resolving disputes in business, which, in addition, is several times cheaper than court proceedings or arbitration proceedings. A mediator plays a facilitative role in assisting the parties to forge a negotiated settlement of their dispute. The Civil Procedure Code (Amendments to the 2nd Schedule) 2018 extend support of the mediation process and enforcement of mediated settlement agreements (MSA) in Court, but, it should be noted that to date Tanzania is yet to sign up to the Singapore Convention on Mediation which allows countries to enforce international mediated settlements across borders.

Mediation can also be carried out using various means of distance communication (by video- or teleconference, or even in writing on-line). Mediation in participation with a mediator can be carried out without their direct contact, i.e. - at present - without a threat to their health – adopting to remote mediations will be useful during the pandemic- using ODR platforms or virtual hearing facilities such as ZOOM and Skype. Of course, the difficulty here is convincing Tanzanian parties to take part in mediation due to the f

Arbitration: The new Arbitration Act 2020 came into force in February this year. The Act has specific provisions allowing for arbitral parties and tribunals to embrace the use of technology under section 3 definition of "records" to include those in electronic form; section 87 (electronic signatures) and work hand in hand with the Electronic Transactions Act of 2018. Therefore, virtual arbitration hearings are valid under the law and encouraged.

In the wake of the pandemic, the conservatives who were slow to jump onto the technology wagon have been left with no option and as such several arbitral institutions have issued guidelines and protocols to aid the use of technology such as the ICC guidance on virtual hearings /Korean Arbitration Board Video Conferencing 2018/ CIARB guidelines on virtual arbitrations. In my view we are able to learn from great examples such as the WIPO dispute resolution for domain name disputes. Furthermore, we expect that legal practice will change for the better, i.e. the use of AI-enabled contract management platforms are out there to utilize because using AI for *Force Majeure* clauses can do in seconds what would take a team of lawyers weeks, and it can provide more and better results than a standard contract analysis tool.

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Dispute Resolution During the Covid-19 Pandemic and Beyond: Government Measures, Foreign Investors, and Technology

I. Government Measures and Their Impact on Foreign Investors

- Governments in Africa, like those across the world, are taking extraordinary measures in the fight against Covid-19. These include restrictions on movement, public health measures, social and economic measures, and lockdowns.
- The range of measures are having, and will continue to have, a profound impact on commercial activity in Africa. Investors should familiarise themselves with the measures and prepare for the impact they will have on their businesses.
- To prepare themselves, investors should be aware of their rights and obligations, and have answers to questions like the following,

• What is the substance of the measures? Which sectors do they impact? Are they generally applicable, or do they only apply to specific sectors? How do they affect my business, including my ability to meet obligations?

• What types of disputes might arise from these measures? Where will they be settled?

• What legal remedies do I have available to me? Do I have treaty protection? What does the text of any applicable treaty say? Does the treaty have exceptions? Am I familiar with state defences under customary international law (e.g. *force majeure*)?

• Am I familiar with the *force majeure*/hardship and dispute resolution clauses in my contract? Does the contract provide for termination or suspension? Will my remedy be specific performance or damages?

• Am I aware of the risk to my business during this crisis? Am I mitigating risk? What impact will not mitigating risk have on my access to legal remedies?

- The impact of government measures on investors and their investments is complex and uncertain, and investors should not wait for a crisis in their business such as bankruptcy or depleted cash flow, before they seek legal advice.

II. Technology and Dispute Resolution During the Covid-19 Pandemic and Beyond

1. Technology and Dispute Resolution During the Pandemic

- Parties should recall that technology is an enabler not a panacea. Making use of technology for electronic filings and virtual hearings can ensure that proceedings continue during the crisis. In the longer term, technology can expand access to dispute resolution, especially in Africa where the geographical vastness of many countries limits access to courts and tribunals in remote areas.
- Technology delivers many advantages, and holding virtual hearings and using electronic filing may improve efficiency and lower the time and costs of proceedings. But, parties should remain cognisant of the challenges of using technology such as, ensuring equality of the parties, risk of abuse of technology by opponents, risk to confidentiality and integrity of proceedings due to poor cybersecurity, and limitations contained in applicable laws and arbitration rules.

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Dispute Resolution During the Covid-19 Pandemic and Beyond: Government Measures, Foreign Investors, and Technology...*continued*

- Parties may also wish to consider the more practical aspects of holding virtual hearings including, differences in the time zones where parties, counsel and tribunals are based, compatibility of software and hardware used in the different log-in venues, sequestering witness, low bandwidth, sequestering witness, power outages, and so forth.

2. **Arbitral institutions, domestic and international courts**

- Arbitral institutions and courts are at the vanguard of facilitating dispute resolution during this time of crisis.
- Most arbitral institutions have turned their operations fully virtual, and have issued guidelines to help parties, counsel, and tribunals hold virtual hearings. Included in the guidelines is guidance on how to deal with the challenges inherent in these hearings, and tips on how to use other procedural tools to keep the arbitral process moving forward. Some examples of institutional guidelines are:

• ICC Guidance Note on Possible Measures Aimed at Mitigating the Effects of the Covid-19 Pandemic, https://iccwbo.org/publication/icc-guidance-note-on-possible-measures-aimed-at-mitigating-the-effects-of-the-covid-19-pandemic/

• KCAB (Korean Commercial Arbitration Board) Protocol on Videoconferencing in International Arbitration, http://www.kcabinternational.or.kr/user/Board/comm_notice_view.do?BBS_NO=548&BD_NO=169&CURRENT_MENU_CODE=MENU0025&TOP_MENU_CODE=MENU0024

• CIArb - Chartered Institute of Arbitrators Guideline on Remote Dispute Resolution Procedures, https://www.ciarb.org/media/8967/remote-hearings-guidance-note.pdf

• ICSID – A Brief Guide to Online Hearings at ICSID, https://icsid.worldbank.org/en/Pages/News.aspx?CID=362

- Many courts have also adopted virtual hearings at varying degrees – some have fully embraced them, while others are hearing only urgent applications, with all other matters suspended. Professor Richard Susskind, of Oxford University, long-standing proponent of modernising court systems, has set up a website to share experiences of, and best-practice on, remote hearings from around the world. You can find the website at this link: https://remotecourts.org/

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Dispute Resolution During the Covid-19 Pandemic and Beyond: Government Measures, Foreign Investors, and Technology...*continued*

III. Think. Act. Adapt. Cooperate.

- **Think deeply and strategically.** How will the Covid-19 pandemic affect your business? After you have assessed your risk, what should you do to mitigate risk, including risk of disputes? What is your internal strategy for dealing with Covid-19 and its impacts? Have you designated someone to lead on your internal response?
- **Act quickly.** Focus on what you know and what you can do immediately (review the text of your contract, consider virtual hearings for existing disputes, mitigate risk) instead of being paralysed by uncertainty. Seek legal advice early.
- **Adapt fast.** It is unlikely that we will ever go back to the way 'things used to be'. Get a head start by adapting your business to a new approach to dispute resolution that involves more virtual activity (meetings, hearings, etc.). Consider whether you will need to adapt to a new way of doing business.
- **Co-operate widely.** The key to getting beyond the Covid-19 crisis is co-operation across borders and disciplines. Reach out beyond your 'usual' network. For e.g., think about how your business can participate in tackling climate change (can your business become carbon neutral?), lead on reducing inequality, and support the transition to more sustainable business, investments, and economies.

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COVID-19: Commercial Risk Mitigation and Efficient Dispute Resolution in Africa

Introduction

- In this part, the takeaways from the part of this webinar considering commercial disputes from an accounting and finance perspective are set out, focussing on *force majeure*, hardship provisions, and considerations for damages claims that may arise in these challenging times.

Force majeure clauses

- Companies need to be careful not to simply invoke *force majeure* without careful consideration of whether the *force majeure* event and the impact on their business has meant it has been impossible to perform their obligations under the contract. Otherwise companies could be found to be in breach of contract.
- To help manage this risk, it will be important for the parties to have taken reasonable steps to try and reduce and mitigate the effect of the *force majeure* event.
- Parties should keep a documentary record to evidence such effects, including why performance has been impossible, the costs that have incurred as a result of the event, and the steps taken to mitigate the effects of the event.
- Colleagues at FTI Consulting South Africa share further insights on this topic here: https://www.fticonsulting.com/insights/articles/covid-19-business-beware-do-not-invoke-force-majeure

Hardship provisions

- Hardship provisions may be seen in long term supply agreements, for example, involving the supply of raw materials.
- They may give a party who is suffering financial hardship various options in relation to non-performance.
- Issues to consider will be informed by contract terms.
- From a legal perspective, as explained above, issues may include evidencing that the events leading to hardship were outside the parties' control and not foreseeable when the contract was entered to.
- From an economic and accounting perspective, the first step for evidencing hardship would be to examine the accounting records and financial performance. However, other potential issues to consider include:
  - **Period of assessing losses** – whether the period is of sufficient length to evidence that hardship has been or will be suffered.
  - **Cost measurement** - whether costs should be measured under accrual-accounting (i.e. the measure used in a company's profit and loss account) or under the cash basis.
  - **Cost allocation** - if the company has more than one business line, questions may arise over how to allocate common costs (such as head office costs) to the relevant business line.

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Hardship provisions...*continued*

- **Efficiency** - one party may argue that the alleged hardship has been caused by inefficiencies and not from unforeseeable events out of the control of the parties.
- **Mitigation** – similar to considerations of invoking a *force majeure*, it will be important to consider what steps have been taken to mitigate losses resulting from the hardship event.

- Again it will be important to keep thorough documentary evidence and records, to help prove the cause and extent of hardship.

Potential breach of contract

- If a company is not able to rely on a *force majeure* clause or similar provision, it may risk being in breach of contract for non-performance and face a damages claim.
- In a damages claim, a claimant may seek compensation for the profits it would have earned had the contract in dispute been performed by the other party.
- The damages (or lost profits) are usually quantified by reference to the difference between the financial position the claimant would have been in if the contract had been performed (the But-For Position) and the position the claimant is actually in.

The But-For Position and the assessment date of damages

- The But-For Position is a key element of a damages calculation. It should be plausible, consistent with the facts and evidence available at the time, and intuitive to accept.
- It can be significantly affected by the date at which damages are assessed, which is typically either the date breach or date of hearing/trial.
- Assessing damages at the date of breach should restore the claimant to the financial position it would have been in 'but for' the breach, using information only available at that time. If the breach occurred before the outbreak of COVID-19, for example, the But-For Position should be based on projections of financial performance excluding any effects of COVID-19 on the business.
- However, if the assessment is at the date of hearing, information that becomes available between the date of breach and the date of hearing needs to be taken into account
- Given many businesses have suffered from the effects of COVID-19 and the associated government measures, the timing of the assessment may have a material effect on the damages claimed.
- The assessment date is ultimately a matter of law. Under English law, it is said that the general rule is to assess damages for breach of contract at the date of breach. However, there have been a significant number of exceptions to this general rule. The date chosen can be a complex issue dependant on the facts and specifics of the case, but in particular on whether the Court or Tribunal considers that events (e.g. the COVID-19 crisis) occurring after the date of breach should be taken into account in the But-For Position and damages assessment.

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Potential breach of contract...*continued*

- An example of a case where information available at the date of trial was taken into account in the damages assessment was The Golden Victory[1]. In this case, a seven-year ship charter agreement was repudiated before a *force majeure* event, the outbreak of war, occurred. The House of Lords decided that damages for breach of contract could only be claimed from the date of repudiation to the outbreak of war, rather than over the full remaining term of the agreement. The reason was that the claimant would not have benefited from the contract once war commenced, and should not be placed in a better position than if the contract was actually performed. However, this decision was not unanimous: two of the five Lords adjudicating considered that damages should be assessed at the date of breach, and hindsight information should be excluded. This suggests that the selection of the damages date could be a highly contentious issue in cases where a company who may have relied upon COVID-19 or its effects as a *force majeure* event, breached a contract before the outbreak.

The But-For Position – discounted cash flow analysis

- In a lost profits claim, typically the But-For Position of the claimant is assessed using a discounted cash flow (DCF) analysis. This is where the expected cash flows that would have been earned by the claimant had the contract been performed are projected, and discounted back to a present value lump sum as at the assessment date using a reasonable discount rate.
- Cash flows. It is important for a valuer to make realistic projections. If the assessment date of damages is after the COVID-19 outbreak, due to the effects on businesses and future uncertainty, making these projections will likely be a complex exercise. In establishing the But-For Position a valuer may assume that the obligations under the contract in dispute would have been performed. However, the wider effects of COVID-19 on the business still need to be taken into account. For example, if a manufacturer of glass bottles in South Africa is claiming against one of its suppliers for failing to supply materials, the But-For Position of the manufacturer should take into account the effect the reduced sales caused by the alcohol ban would have had on its business.

[1] *Golden Strait Corporation v. Nippon Yusen Kubishka Kaisha, [2007] UKHL 12.*

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Potential breach of contract...*continued*

- Discount rate. There are usually several inputs into a discount rate that need to be assessed. These inputs are not discussed in this article, but one general pitfall to be aware of is the double counting of risk. The expected cash flow projections should typically reflect relevant specific risks affecting the business, and such risks should not also be reflected in the discount rate. For example, for the glass bottle manufacturer, if the projected cash flows reflect the effect of the alcohol ban on sales, this effect (or risk) does not also need to be taken into account in the discount rate. For example, for the glass bottle manufacturer, if the projected cash flows reflect the effect of the alcohol ban on sales, this effect (or risk) does not also need to be taken into account in the discount rate. Otherwise, a valuer will double count the risk and understate the value of lost profits.

Mitigation – the claimant's obligation

- As explained earlier, it is important for parties looking to invoke a *force majeure* clause to ensure they have taken appropriate commercial steps to mitigate the effect of the *force majeure* event. However, it may also be important for the claimant in a breach of contract dispute to mitigate any loss it has incurred.

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