

# CHANDLER MHM

## Newsletter

### **COVID-19 SEVEN ISSUES TO LOOK AT WHEN CONDUCTING A MATERIAL CONTRACT REVIEW**

The COVID-19 pandemic, and the governmental response to prevent the spread of the virus, has been a shock to the system for most businesses around the world. The direct effects of the pandemic will be felt unevenly, though the indirect consequences will certainly be widespread. Even for operators in "safe" sectors, it is almost certain that many of its suppliers, service providers, or other business partners will be affected by the pandemic.

Given the unprecedented effects the outbreak is likely to have in the coming weeks, months and years, General Counsels and senior management should be conducting a review of their material contracts to ensure that they are fully aware of their companies' position thereunder. The purpose of the contract review is to better understand and assess the company's current legal risks and rights in the event counterparties default on their obligations.

This raises an important question: what should the contract review look like? Put differently, what contractual clauses are significant in the present context? The answers to these questions will depend on the sector in which your company operates. Banks and other commercial lenders will need to develop a checklist based on their loan documentation, whereas property developers and managers will need to consider their sale and purchase agreements and lease agreements. The below topics are a general starting point which should be adapted to fit the circumstances of your particular business operations.

#### 1) Timeline for performance

The COVID-19 pandemic is likely to cause numerous delays in performance. The issue to assess is whether your contract contains an explicit timeline for performance, or whether the contract is silent on this point. If the contract does contain specific timelines, it is important to check whether they are measured in "days" or "Business Days", and if they are measured in the latter, what the definition of "Business Days" is under the contract. Often, the definition of "Business Days" will be linked to the announcement of public holidays and/or days on which banks are open for regular business in a particular jurisdiction. As of the date of this writing, commercial banks in Thailand remain open to transact regular business Monday through Friday, but query whether their potential closure would impact the definition of "Business Days" under your agreements.

Another point to confirm is whether the contract contains a delay liquidated damages regime, and if it does, when payment of these liquidated damages will be triggered. This will also require an assessment of whether delayed performance can be excused by an external event, whether or not that event amounts to force majeure.

If the agreement does not contain any explicit timelines, the default rules prescribed by law may apply in their absence. The governing law of the agreement will be important in understanding what these default rules are.

#### 2) Payment terms

Most commercial agreements will provide for explicit timelines for invoicing and payment of invoices. In practice, where two businesses have been engaged for extended periods of time

#### Key Contacts



Jessada Sawatdipong  
TEL + 66-2-009-5000 Ext. 3102  
[jessada.s@mhm-global.com](mailto:jessada.s@mhm-global.com)



David Beckstead  
TEL + 66-2-009-5000 Ext. 3112  
[david.b@mhm-global.com](mailto:david.b@mhm-global.com)

#### CHANDLER MHM

Chandler MHM Limited  
36th Floor, Sathorn Square  
Office Tower  
98 North Sathorn Road  
Silom, Bangrak, Bangkok 10500  
Thailand  
[www.chandlermhm.com](http://www.chandlermhm.com)

on an ongoing basis, they may not strictly adhere to these rules. Generally, the prospect of future business is enough of an incentive for a supplier or service provider to ignore late payments, even where the delay results in a technical breach of the contract.

It is important to outline the timelines prescribed by your contracts in order to know: 1) how long you can lawfully delay any payments which are due; and 2) how long your counterparties can lawfully withhold payments to you. This is not to imply that all businesses are expected to delay payments as long as possible; however, it is important to properly understand what delays are permissible and what delays are a breach of contract.

Many contracts will contain an explicit figure of default interest which can be charged in the event of delayed payment. If no such provision exists, the default interest payment may be set pursuant to applicable law. Further, it is important to note whether the default interest need to be claimed, or if it begins accruing automatically and without demand once the debtor is in default.

### 3) Force Majeure

Many sophisticated commercial agreements will contain specific provisions dealing with force majeure. In the absence of an explicit force majeure clause, it is important to understand what the default rules will be (for more on force majeure in Thailand, see our previous newsletter [link](#)).

A contractual definition of force majeure will typically fall into one of two categories: 1) a closed-list definition, or 2) an open-ended definition. A closed-list definition will explicitly outline what circumstances constitute an event of force majeure. These will typically involve wars, natural disasters, Acts of God, etc. For a closed-list definition, it will be important to note whether "pandemics", "epidemics", or similar circumstances are included within the definition. Perhaps more importantly, assess whether "governmental action" of the "acts of a governmental authority" are also included within the definition. For many contracts, the COVID-19 pandemic itself may not be the proximate cause for either party's inability to perform their contractual obligations; rather, the governmental response to the pandemic may be the actual impediment. A careful reading of the definition is important to understand how it might apply to any eventuality.

By contrast, an open-ended definition will typically involve a set of criteria which must be met in order for an event to qualify as force majeure. Typically, this will include: 1) unforeseeability, 2) the inability of the affected party to have avoided the consequences, 3) the event not being caused by the affected party, and 4) a resulting in a delay in performance. Please note, however, that not every definition of "force majeure" is identical, so the precise elements need to be assessed for each contract. On the point of "unforeseeability", the timing of execution of the contract may be significant. It is unlikely that a party to a contract executed in 2018 could have reasonably foreseen the COVID-19 pandemic; however, a contract executed in February 2020 may require a different assessment.

Most force majeure clauses will excuse a party's non-performance of its obligations under the agreement. The reciprocal rights and obligations of the non-affected party should also be noted. Generally speaking, if the force majeure event continues for a set period of time, one or either party will have the right to terminate the agreement.

### 4) Termination

Many contracts will explicitly lay out grounds upon which either party may terminate. Amongst these grounds would typically be a "material breach" of the agreement, non-payment after a set period of time, bankruptcy or insolvency, etc. The termination clause may contain a cure period, allowing for the defaulting period to remedy its breach by performing its obligations.

With respect to bankruptcy and insolvency as a ground for termination, a careful reading of the precise actions or circumstances which may give rise to termination rights is necessary. In some agreements, the right of the counterparty to terminate may be triggered if a company makes arrangements with its creditors, or a certain class of creditors, on the repayment of its debts. In the wake of COVID-19, many businesses may be tempted to reach out to their contractual

counterparties to rearrange payment schedules; whilst this may appear sensible, it is important to first assess whether any other agreements would be prejudiced by this action.

5) No Amendment Clauses

Contractual boilerplate clauses, though rarely considered closely, exist for a reason. A “No Amendment” clause will state that the contract may only be amended by a written instrument, duly executed by all parties to the agreement. In the difficult circumstances many businesses are currently confronting, assurances may be given verbally or by way of email indicating that a specific right, remedy, demand for payment, etc., will not be strictly exercised. While this may provide comfort in maintaining the business relationship, attention must be paid as to whether these assurances would be legally binding if challenged.

6) Governing Law and Jurisdiction

If the contract does not provide clarity as to the parties’ respective rights and obligations in confronting the challenges presented by COVID-19, the default rules prescribed by the governing law of the agreement will generally apply. If the parties have selected the governing law, this will be binding, subject to any local conflict of laws rules. If there is no explicit governing law in the agreement, an assessment of the appropriate governing law under the relevant conflict of laws rules will be necessary. This will typically involve an assessment of the domicile/nationality of the parties, the place where the primary obligation in the agreement is to be performed, etc.

A separate question is what dispute resolution forum has been selected by the parties. If the contract calls for arbitration, then any claim would need to first be brought through arbitral proceedings. Courts in most states will decline jurisdiction where the parties have agreed in advance to arbitrate their disputes. The dispute resolution forum is important in assessing the ease of a creditor initiating legal proceedings.

7) Other noteworthy clauses

No two agreements are identical, meaning it is important to understand any unusual or atypical terms and conditions which need to be considered. This may require a bit of “thinking outside the box” and will also require a deep understanding of the company’s operations. In short, this heading is a reminder that the contract review exercise should not be completed to check boxes of relevant clauses; rather, it should be seen as a platform for conducting an honest assessment of existing legal risks.

Final Thoughts

During this turbulent time, it is easy to be overwhelmed by new problems and complexities being encountered for the first time. That said, in order to provide a sober analysis of your business’ exposures, carrying out a methodical and objective assessment of material contracts is a good starting point.

The above items should not be treated as an exhaustive list. A more detailed contract review, or a more narrowly tailored one, may be preferable given your company’s circumstances. We would be pleased to discuss potential solutions with you to assist in this exercise.

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This publication is intended to highlight an overview of key issues for ease of understanding, and not for the provision of legal advice. If you have any questions about this publication, please contact your regular contact persons at Mori Hamada & Matsumoto or Chandler MHM Limited. If you should have any inquiries about the publications, or would like more information about Chandler MHM Limited, please contact [bd@mhm-global.com](mailto:bd@mhm-global.com).