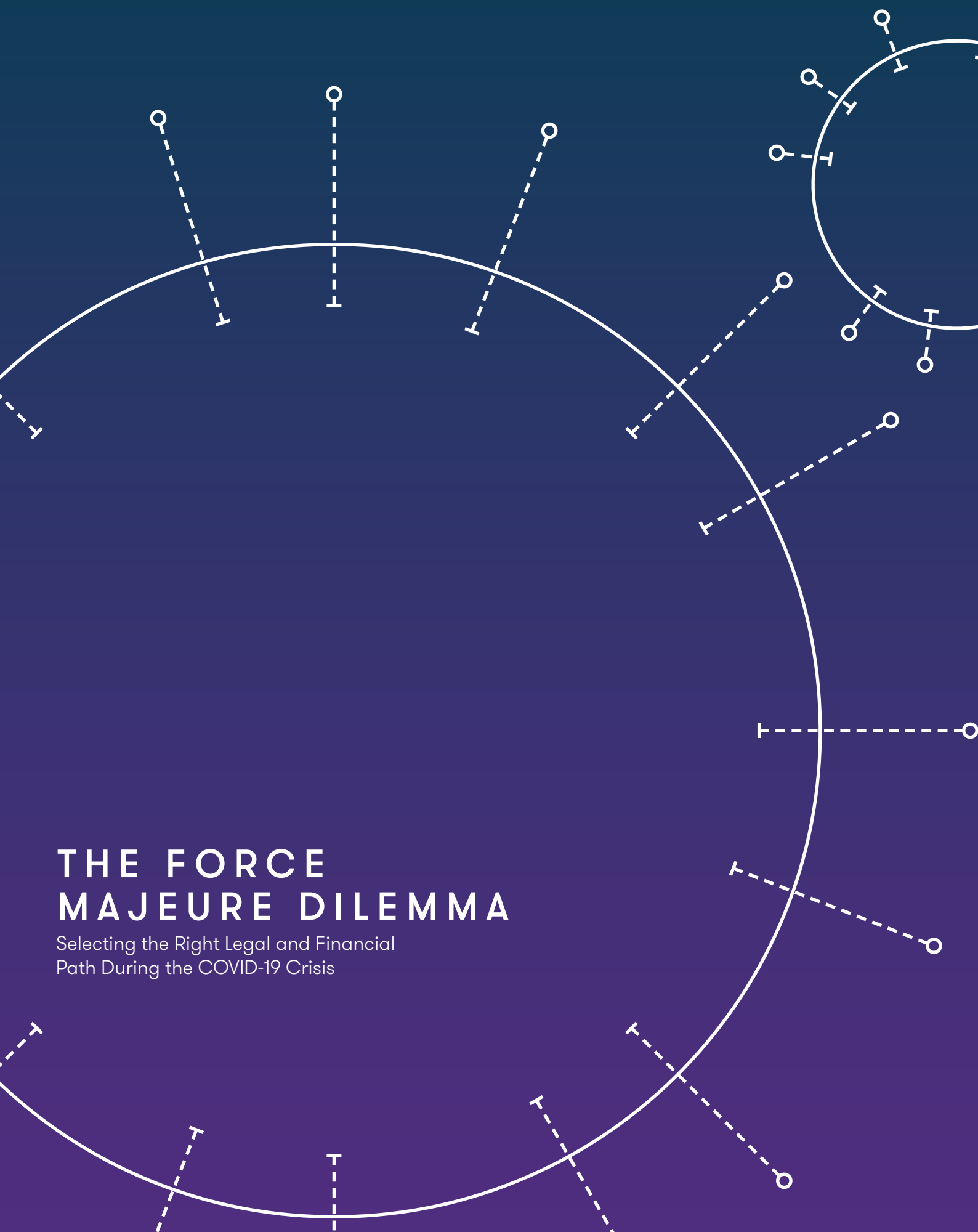
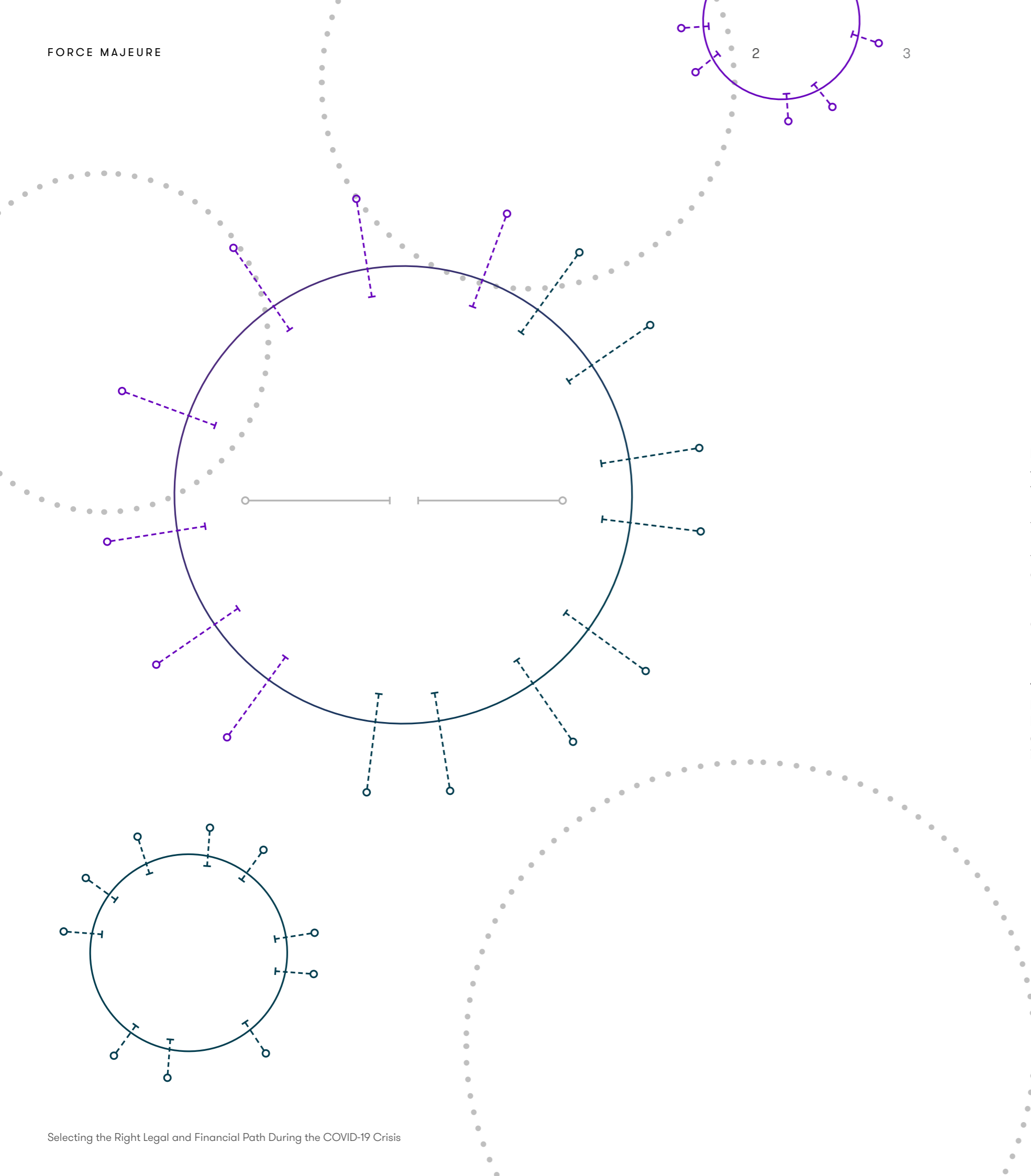


THE FORCE MAJEURE DILEMMA

Selecting the Right Legal and Financial
Path During the COVID-19 Crisis





INTRO

The cost of the coronavirus outbreak has been widely reported and the tragic consequences continue. It is not only health and safety concerns that can have a negative impact on people's lives: the outbreak has nearly paralyzed the global markets, causing a panic that can potentially lead to haphazard business decisions and fallacious legal battles.

The cancellation of contracts has become a real risk and most businesses seem to believe that enforcing their force majeure clause is the easiest way out.

Unfortunately, such hurried decisions can potentially cause further chaos, and lead to worse economic conditions and delays in market stabilization.

To that effect, our experts from **Grant Thornton UAE** and **Charles Russell Speechlys** have jointly prepared legal and financial analysis to provide the UAE businesses with a set of guidelines to help navigate the current climate by encouraging communication between all parties, making the right legal and financial decisions, and choosing the right path to improve their liquidity within the legal bounds.

THE LEGAL ROUTE

- Force Majeure:

As of now, 94% of the Fortune 1000 are already seeing COVID-19 disruptions. That said, other businesses will experience significant commercial turmoil if they have not already done so. The sudden lack of liquidity has pushed businesses to want to financially and legally protect themselves. For that reason, businesses are looking at the power of the force majeure clause in their commercial contracts:

A force majeure clause is a contract provision that relieves the affected party from performing their contractual obligations when circumstances beyond their control arise that make performance impossible.

THE FORCE MAJEURE CLAUSE PROVISIONS:

Force majeure clauses commonly include **Acts of God**, such as floods, fires, earthquakes, as well as other events such as wars and government orders. Even though this virus is relatively a new phenomenon and is not expected to have been mentioned in any previously drawn contracts, it would still be uncommon for force majeure clauses to have incorporated pandemic outbreaks, and raises a question as to whether the same could be argued in courts of law.

At times, crises might only affect a portion of contractual obligations, without impacting the remainder and force majeure may apply partially leaving the remaining obligations in effect. On that basis, the contract would not be canceled altogether, the affected party would still be liable for performance of the obligations that are not affected by the force majeure.

Additionally, there may be other measures to be taken prior to tapping into the force majeure clause: a notice is to be given to the other party prior to taking any actions to nullify the agreement. Also, the affected party must provide evidence that there are no alternative means for performing their obligations, and that they have taken all reasonable steps to mitigate the effects of the force majeure event. Increased costs or hindrances alone will not be sufficient to prevail on a claim of force majeure.

As such, where such measures are included in a force majeure clause or elsewhere in the contract, these must be followed otherwise a party invoking force majeure may find that they are in breach of contract.

FORCE MAJEURE IN THE UAE

The UAE Courts generally proceed on a narrow interpretation of force majeure, taking 3 criteria into consideration:

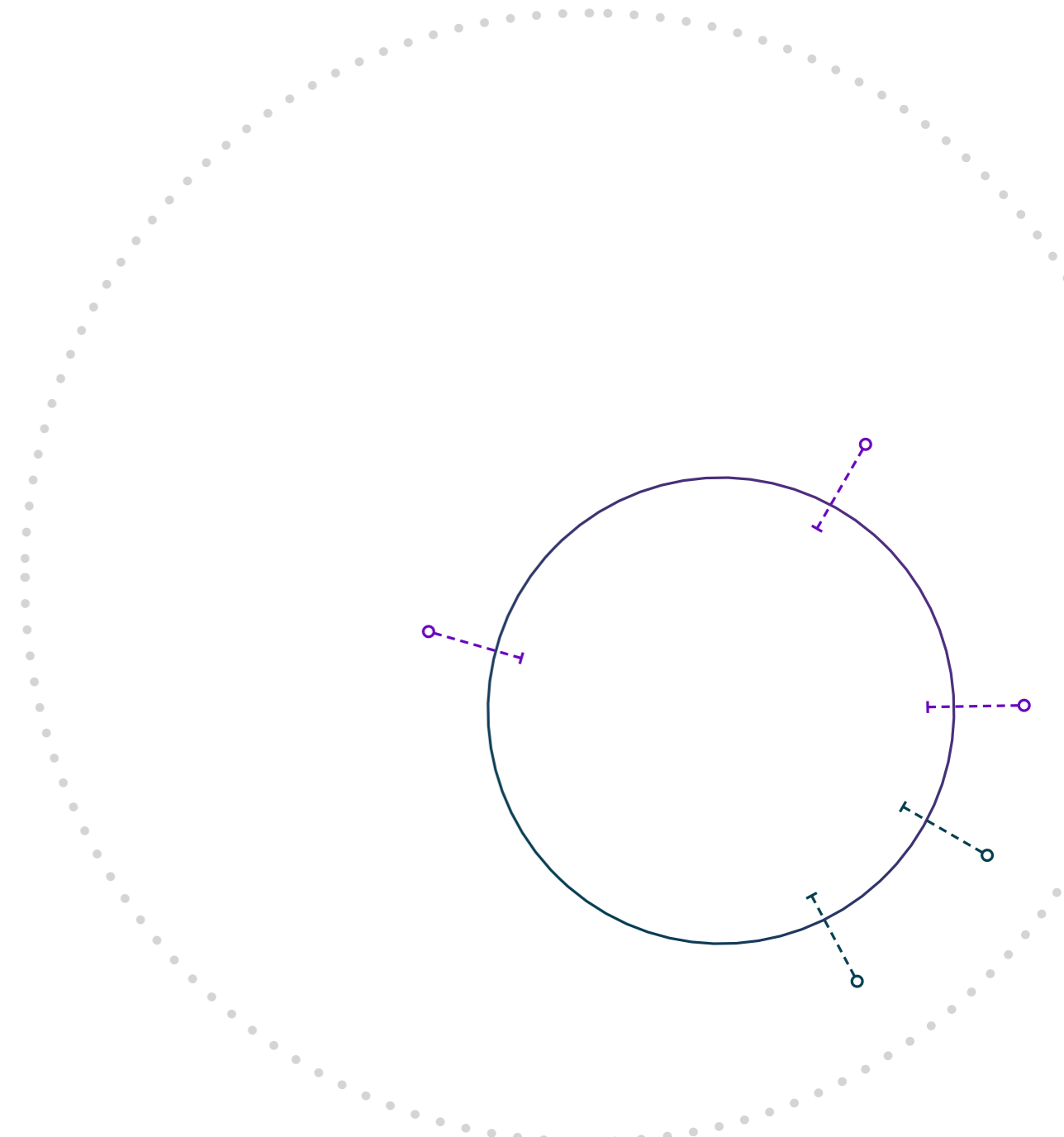
- that the event was unforeseeable;
- that the event was beyond a party's control;
- that the performance of the party's obligations was impossible.

Therefore, the applicability and enforceability of a force majeure clause would be considered on a case-by-case basis.

FORCE MAJEURE & COVID -19

Despite this, if a company believes it has a strong force majeure case and aims to invoke the clause, they are still advised to review their contracts and including any specific force majeure provisions, monitor the situation, stay alert of the local and international regulatory updates, and be smart with their timing. The current situation is fluid which means that facts and circumstances can change quickly, and they often do. That said, even if the legal option appears to be viable today, it may not achieve the expected results tomorrow

So, what are the alternatives?



ALTERNATIVE NON-LEGAL SOLUTIONS

While there may be enough grounds for taking the legal route, commercial considerations may take precedence and are the better choice.

If the shared objective is the resumption of performance as soon as possible, then collaboration, underpinned by a sound understanding of the contractual position, is the way forward. Settlements and new mutual agreements can be drawn as addendums to the original contract and create the win-win status businesses seek at times of crisis.

Tapping into insurance agreements and reviewing the existing insurance coverage T's and C's would be the next best step forward. Business interruption coverage is the most

logical place to start – this clause may have a similar read to the force majeure's; however, insurance contracts are easier to argue given their protective nature as opposed to business contracts that are written with a commercial intent only.

In general, companies need to remain mindful of the fact that the outbreak has impacted businesses worldwide, and even though the response strategies can vary, it would be best to remain collaborative and focus on reclaiming balance and stability to the economy as well as individual businesses.

THE INTERNAL OUTLOOK

Events are unfolding with astounding speed, significantly reducing the businesses' control over external variables. Hence, the best strategy for businesses to lead through the current times would be to shift their focus to internal capabilities and solutions.

The primary internal step would be to set the necessary protocols in place to help with protecting the health and safety of employees, clients, and other stakeholders. Businesses are

also required to facilitate an open and consistent flow of information between key stakeholders. This is to maintain stakeholder confidence and to inform their customers about the stream of services that will be impacted.

BUSINESS OPERATIONS & FINANCES

After safeguarding the wellbeing of all stakeholders and establishing the required internal and external communication channels, businesses need to understand their commercial and financial risk exposure, and then move on to establishing systems and ad hoc solutions to limit any commercial damage from the spread of the virus.

In order to overcome operational or financial challenges, businesses are advised to take a swift approach to solidifying their cash and liquidity positions by taking a realistic view of the current circumstances. They need to understand how financial stability may be impacted from further stock

market declines, potential delays and cancellations from suppliers and customers, and extended restrictions in access to funding.

Revising cash flow, working capital management, inventory forecasts and budgeting for the worst-case scenario are good places to start. By the same token, businesses need to review their organization-wide sales & operations planning as well as their integrated business plans to help ensure that tactical and strategic business arrangements are synchronized, and that their key revenue sources are protected.

COSTS

If a contract cancellation becomes a reality, affected businesses would be well advised to consider the costs incurred to date, or that may be incurred in partial performance in the future.

Many costs may be cancelled completely or renegotiated to more favourable rates. In the event that a claim is required, a clear and well-documented statement of cost will help support any claims directly.

To that effect, businesses can use the below as a guide to consider various costs distinctly and prepare.

DIRECT COSTS

These include all specifically attributable costs of performance of a contract, such as specific sub-contractor costs or the staff hired for a certain purpose.

This also includes material costs that are affected by output or production and can be identified and calculated. These can be directly calculated or estimated, and should also be linked back to documentary evidence, such as invoices.

INDIRECT COSTS

Indirect costs are further broken down to fixed and variable: Fixed costs, such as rent, do not vary with changes in output and are easily calculated.

On the other hand, variable costs, such as utilities, office overheads, legal and professional fees are simply overheads of the business and the key factor will be whether on the cancellation of a contact, these costs could be or might be attributable to the contract.

INTERNAL COST ALLOCATIONS

These are likely to not be solely related to one contract and are, therefore, likely to be estimates.

Consider the time costs of a specific team member hired to work on multiple projects: timesheets may clarify the extent of time spent on one contract over another, or other estimates will be required.

LOST PROFIT

Whether lost profits are claimable, and if so, to what extent, is a complicated issue that should only be required in dispute, where collaborative communication has broken down.

In such cases, a clear overview of costs to-date, as outlined above, will be an important first step.

COMPLIANCE & REPORTING

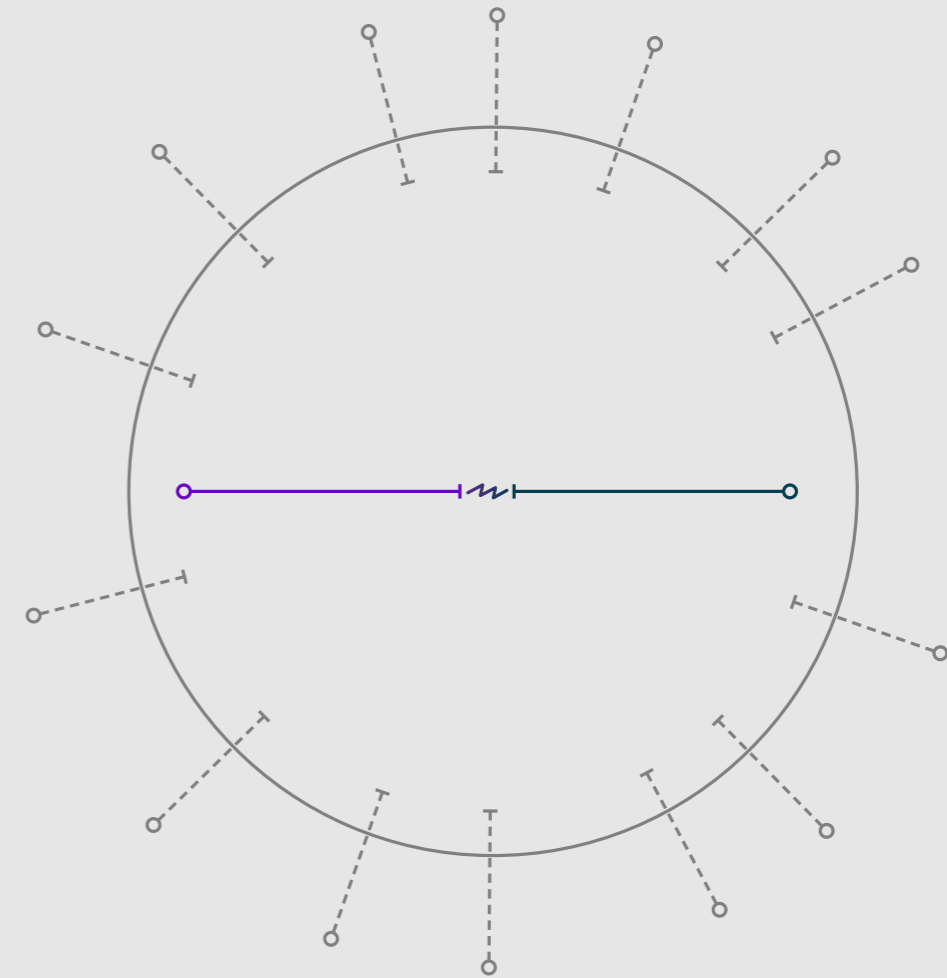
To minimize accounting exposures, companies should consider their disclosure obligations regarding business risks related to the impacts of COVID-19 within the context of their relevant financial regulatory requirements.

Companies should also evaluate whether or not events occurring after the reporting period, but before the financial statements for that period have been issued, require disclosure or possibly recognition.

Companies with significant global operations should consider two additional possibilities: whether there are any negative consequences

on internal control over financial reporting due to the local impacts of COVID-19, and whether their ability to obtain and provide financial statements has been adversely impacted or not.

That said, if companies anticipate reporting or filing delays due to the outbreak or travel restrictions, they should contact their relevant local regulatory bodies as any failure to follow regulations will have consequences.



CONCLUSION

Communication and collaboration are key. Taking smart measures and immediate actions will almost certainly assist organizations to survive this catastrophic period and plan for recovery. It also provides an opportunity to reflect on their ability to navigate a crisis and, going forward, consider actions to increase agility and become more resilient in the future.

Nevertheless, businesses are not alone in navigating through the current storm.

The Central Bank of the UAE has recently announced sizable economic stimulus packages to help a variety of stakeholders overcome liquidity and solvency issues. Other local entities are chiming in with various initiatives, such as Abu Dhabi's Ghadan21, along with other governments worldwide who are also mediating to help bring the global economy back on course.

REACH OUT

To help you navigate through these difficult times, please contact:



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Areas of Expertise

Forensic Accounting, Historical Cost analysis, and Dispute Support.



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Areas of Expertise

Financial disputes and investigations, review of historical and forecast financial information, financial due diligence



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Areas of Expertise

Private and in-house legal practices, protection and enforcement of intellectual property, portfolio management, brand custodianship, joint ventures, commercial agreements, and related disputes and litigation.

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GRANT THORNTON UAE

Grant Thornton is a network of independent Assurance, Tax and Advisory firms, made up of 53,000 people in over 135 countries.

For the past 50 years, Grant Thornton UAE has been helping various clients, including privately owned, publicly listed, as well as the public sector on a local and international scale. We help clients focus on what matters by investing the time to understand their challenges to provide insight and solutions that help them grow in an ever-changing environment.

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