Tucker Ellis LLP

CLIENT ALERT

PROTECTING ASSETS AND PRESERVING CLAIMS DURING THE COVID-19 CRISIS

MARCH 20, 2020

WHAT YOU NEED TO KNOW

- The global shutdown of business activities due to COVID-19 will lead to unfulfilled contract obligations in virtually every industry. Because this is a situation without precedent, there is no way to know how much of this conduct will be excused, nor how much will be held to constitute a breach of contract or business tort.
- Injunctive relief for breach of contract in commercial matters is likely unavailable.
- Aggrieved parties should carefully examine the language of their contracts and ensure they provide non-performing parties with any required notices of contractual breach. They should then move quickly to preserve all relevant documents, data, and testimonial recollections.
- Rather than obsess over liability, smart businesses should focus their energy and efforts on quickly and accurately assessing and calculating their damages. Parties with comprehensive, accurate damages models will be in a better position to negotiate resolution and pursue prompt court action, if necessary.
- This crisis will inevitably lead to opportunistic behavior, so, beyond contract claims, companies should remain vigilant about identifying and prosecuting tortious conduct.
- While some courts are restricting operations, they generally remain open for filings as of now; however, unless courts expressly order that deadlines (including proof of claim bar dates in bankruptcy cases) are extended, parties should continue to assume that such deadlines remain in place and should therefore act vigilantly. Parties should move quickly to file claims to better position themselves with potential bankruptcy filings, avoid timeliness problems, and ensure "front of line" treatment when normal court operations resume.

DOES YOUR BUSINESS HAVE ANY RECOURSE?

With economies around the world going into extraordinary states of shutdown, virtually every business is being forced to confront two issues: (1) Are we still required to perform our contractual obligations; and (2) What recourse do we have if others fail to perform their contractual obligations? The first question is largely dealt with in our Client Alert dated March 17, 2020, *Coronavirus Impact and Contract Performance: Understanding Options*, which discusses the applicability of force majeure clauses and other excuses for non-performance. This Client Alert will address the second question – specifically, what businesses should be doing right now to position themselves for recovery of any assets lost due to contractual breaches.

When a vendor, supplier, customer, partner, or other entity with whom your business contracts either stops performing its obligations or communicates an intent to stop performing due to the COVID-19 situation, you may question whether that party has a legal right to stop performing. The answer to that question will likely turn on the following factors:

- **Does the governing contract have a force majeure clause, and if so, what does it say?**
    - If your contract includes a force majeure clause, does it specifically identify pandemics, acts of God, or governmental actions? Does it have "catchall" language like "any similar event beyond the reasonable control of the party"? If so, it is much more likely that the non-performing party will be able to successfully argue that its non-performance is excused as a force majeure.

- **What is the federal and local law of the land at the time of the non-performance?**
    - At the time of the writing of this Client Alert, some jurisdictions are essentially under a "shelter in place" order, while in others, the state and local governments have not imposed any restrictions whatsoever. In addition, many states, as well as the Department of Homeland Security, are promulgating rules and guidance designed to permit certain critical infrastructure to remain open, even as everything else is ordered to shut down. If a business seeks to excuse non-performance based on a force majeure clause or impracticability defense, the governmental landscape at the time of the non-performance may be a relevant factor in determining whether such a defense is viable.
- **How sympathetic will courts be to COVID-19 breaches?**
    - Under the doctrine of *stare decisis*, established legal decisions are to be recognized and followed in subsequent cases where the question of law is again in controversy. In other words, courts are expected to follow prior legal precedent. Thus, an unprecedented situation like COVID-19 creates uncertainty as to how courts will treat breaches of contract. The most likely outcome is that courts will try to differentiate between those that stop performing due to legitimate impracticability obstacles and those that stop performing because performance is no longer economically advantageous.

When your business is harmed by non-performance, it is tempting to fixate on whether that non-performance constitutes a breach of contract; however, that determination requires a case-by-case assessment that often takes months, if not years, to litigate. Accordingly, during the COVID-19 crisis, time, energy, and resources are better spent preserving rights to recovery and ensuring that if and when the matter is litigated, your business is in the best possible position to maximize recovery while minimizing expenses.

A WORD ABOUT IMMEDIATE INJUNCTIVE RELIEF

Inevitably, aggrieved parties first look to injunctive relief to force non-performing parties to fulfill their contractual obligations. Short-term injunctive relief may come in the form of a temporary restraining order or a preliminary injunction; however, even under normal economic circumstances, such relief is hard to obtain for two reasons. First, a party seeking injunctive relief must be able to show irreparable harm. In lay terms, this means that if money damages, regardless of amount, would be enough to make the non-breaching party whole, injunctive relief will not be available. Second, while courts may grant injunctive relief to prevent a party from committing an act, they will rarely grant such relief to force a party to affirmatively perform an act. That outcome generally can be obtained only through the more circuitous path of obtaining an award of specific performance.

Practically speaking, in the midst of the COVID-19 crisis, unless you or your company are in the business of saving lives or ensuring the viability of critical supply chains or infrastructure, injunctive relief is probably a nonstarter. Courts are currently operating with skeleton crews, with most resources focused on criminal matters. Getting a judge to hear your petition for relief will be a difficult task. Getting that judge to force another party to put people in harm's way to fulfill a contract is likely impossible.

With injunctive relief unavailable, parties should turn their focus to longer-term recovery. In order to best position your business, consider following the steps.

STEP 1: FOLLOW THE CONTRACT TO PRESERVE RIGHTS

If the time for payment, delivery, or other performance has arrived, and your vendor, supplier, customer, or other contracting partner has not satisfied its obligations, you may decide to declare a breach of contract. Likewise – even if performance is not yet due – if the other party makes clear to you that it will not satisfy its future obligations, anticipatory repudiation has occurred, and you may immediately declare a breach of contract. Importantly, in many business contracts, the non-breaching party has a limited amount of time in which to notify the other party that a breach has occurred. Often, the contract will specify the manner in which the breach must be communicated, e.g., in writing, and the recipient to whom the notice of breach must be delivered. In some cases, failure to declare a breach within the contractually allotted time period and in the manner specified in the contract may result in waiver of the non-breaching party's right to pursue damages. It is therefore of the utmost importance that you read the contract carefully and strictly comply with notice requirements.

Keep in mind that even if the governing contract does not appear to have a section discussing post-breach procedures, it may incorporate terms and conditions that do. These terms and conditions may appear in small boilerplate text, they may have been included in another document, or, in some instances, they may be incorporated by reference to their location on a website. Regardless of the manner in which the terms and conditions are incorporated, read them carefully and ensure that your business complies fully with breach procedures.

STEP 2: PRESERVE AND RECORD EVERYTHING

Regardless of jurisdiction, a party has at least three years after a breach occurs to bring a claim for breach of a written contract. Thus, for many aggrieved parties that do not want to pursue claims during the COVID-19 shutdown, there will be a temptation to simply declare a breach and resolve to attend to the matter at a later time. This is a mistake.

After satisfying applicable notice provisions, you should immediately take steps to preserve all relevant documents, information, and data related to the breach. Necessary steps may include:

- Identifying all employees with documents or information relevant to the matter. We will call this the "Custodian Group."
- Sending a litigation hold to the Custodian Group, asking them to gather and preserve all documents and information relevant to the matter, both in paper and electronic form.
- Sending the litigation hold to the person in charge of your business's computer systems to ensure that all routine deletion of Custodian Group emails and other potentially relevant documents are suspended.
- Interviewing members of the Custodian Group to obtain their accounts of the facts giving rise to the breach.

Even if you ultimately decide to wait to pursue an action for breach, taking these immediate steps will better position your business to prevail on its claims, and will undoubtedly reduce the cost of recovery.

STEP 3: FOCUS ON DAMAGES

While aggrieved parties commonly obsess over proving that the non-performing party is in breach, the equally important issue of damages is often overlooked. This mistake can lead to a pyrrhic victory.

Contract damages must be proven with reasonable certainty. Invariably, the best time to make an initial damages assessment is at the time of the breach, when the facts are fresh in the minds of the Custodian Group. Accordingly, aggrieved parties should immediately compile the information necessary to calculate damages and put together rough computations or projections if possible. If damages are ongoing, someone at the company should be put in charge of keeping a running damages tabulation, along with compiling any underlying evidentiary support.

The types of damages that may be recoverable will depend on the nature and language of the contract. Regardless, you should keep an account of the following categories of harm:

- **Direct damages**, i.e., those that can be expected to flow naturally from the breach. Examples include lost revenues and the cost to procure substitute goods or services.
- **Incidental damages**, i.e., those incurred to avoid other losses caused by the breach. Examples include additional costs for transportation or storage.
- **Consequential damages**, i.e., those that occur because of special circumstances that are not ordinarily predictable by the parties. For example, if a supplier breaches your contract, which causes you to breach a contract with another customer, this is a consequential damage to you. Other categories of consequential damages may include lost profits, loss of goodwill, and loss of business reputation.

In this rapidly deteriorating economic climate, few businesses will have either the time or the resources to embark on lengthy legal journeys in pursuit of contract recovery. The savvy ones will reduce costs and infuse cash by inducing early settlements of their claims. A well-developed model of damages is the most powerful tool to achieve such an outcome.

STEP 4: MITIGATE YOUR HARM

The law of contracts requires a party to mitigate the harm it sustains as a result of another party's breach of contract. If an aggrieved party fails to act reasonably to mitigate its harm, the law will reduce the amount of recovery to which it is entitled in an amount equal to that which could have been saved. Practically speaking, this means that in the wake of a breach, you should actively look for ways to reduce the amount of harm to your business. If substitute goods or services are available to a buyer, even if at a higher cost, purchasing them may be the commercially reasonable path. Likewise, if a buyer breaches a contract, the seller should look for alternative customers to whom goods can be sold or services offered.

DON'T FORGET ABOUT BUSINESS TORTS

The sad reality of any economic crisis is that it breeds greed, desperation, and opportunism. As many businesses are furiously scrambling to stay afloat, their capacities for monitoring wrongful conduct are diminished. As a result, the COVID-19 situation is likely to breed a rash of tortious conduct, including fraud and misrepresentation, interference with contracts, breaches of fiduciary duties, and misappropriation of intellectual property. Despite ongoing operational challenges, parties should remain vigilant at identifying and prosecuting such conduct. Unlike the non-performance of contracts, courts are likely to take a hard stance against those who seek to take advantage of this crisis.

WHEN IS THE RIGHT TIME TO PURSUE MY CLAIM?

While, as noted above, statutes of limitation typically allow for claims to be brought years after the events giving rise to them occur, there are disadvantages to waiting. In addition to fading memories, timeliness defenses such as waiver and laches can become an issue. Moreover, the unfortunate reality of the COVID-19 situation is that the future viability of innumerable businesses is now in question. With that in mind, it may be advantageous for potential creditors to file claims quickly in order to improve the likelihood of recovery. If current cash flow issues make litigation costs unpalatable, businesses should seek to engage counsel under alternative fee agreements that defer costs or tie them to eventual asset recovery.

ADDITIONAL INFORMATION

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