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How to Negotiate Temporary Agreements or Contracts in Times of Crisis?

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The rapid spread of COVID-19 and the introduction of strict government measures are limiting or changing many businesses' operations. These measures impose unusual restrictions that make it more difficult to meet certain contractual obligations.

In such a situation, many companies will want to assess the possibility of modifying certain undertakings and terms of their contracts in order to get through the pandemic and resume their business activities post-crisis.

To that end, we have gathered a few thoughts on how to look into negotiating a temporary agreement, some legal principles that can be applied to begin discussions and negotiations, and some other elements to consider in a negotiation approach, which we share with you below.

How to do it and where to begin: some ideas

It is relevant to review all your contracts and sort them to determine which are essential for your business operations and which have the most significant financial impact. Think about the other contracting party as well, who may also be affected by the pandemic.

Has the other party defaulted of performing its correlative obligations to you, or is your inability to meet your obligations causing it prejudice in any way? Most of the obligations included in a contract cannot be changed unilaterally. However, contracting parties must still perform their respective obligations in good faith. The occurrence of an exceptional situation such as COVID-19 is likely to force each of the parties to act more flexibly in order to comply with their duty of good faith.
It is possible to validate whether some of these contracts, by their very nature, are still relevant or whether they will remain relevant once the curve flattens and economic activity recovers. For less relevant contracts, you can check whether they include provisions allowing for unilateral termination, by the mutual agreement of the parties or by a particular mechanism.

Otherwise, you could then consider initiating a discussion with the other contracting party to negotiate certain terms of the agreement in order to mitigate negative impacts, if any, during the pandemic.
For each contract that must be maintained, you can list all the obligations that you are unlikely to be able to meet, in whole or in part, as well as those that your contracting party might not be able to meet, in order to open the door to an out-of-court negotiation of certain provisions for the coming months. In your analysis, you should pay particular attention to the following clauses:

- **Default:** What constitutes a default under the terms of the contract? What are the consequences of defaulting? Does a default under this contract constitute a default under another contract? Does the contract provide for a time period to cure a default? On what conditions?
- **Time limit:** Does the contract set specific time limits for the performance of certain obligations? Which ones? Does the contract provide for the possibility of postponing the time limit for its performance? Should a notice be sent to this effect? Does it expire soon?
- **Exclusivity:** Is the contract exclusive? Can this exclusivity be overridden? Under what circumstances and on what conditions?
- **Force majeure:** Does the contract include a superior force clause (most commonly called a "force majeure")

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forgiving a party's inability to perform its obligations? What happens to each party's obligations, especially financial obligations, in a context of superior force? Although the *Civil Code of Québec* defines such a notion, the contract can always provide its own definition. A case of superior force usually requires the presence of an unforeseeable, irresistible event external to the party invoking it.
Continuous information: Does the contract provide for the obligation to keep the other contracting party informed when certain events occur? If so, which ones? Is COVID-19 or any other pandemic included?
Negotiation: Does the contract provides for the parties the possibility to renegotiate certain terms ? Which ones? When? On what conditions?
Payment: Does the contract set out time limits for payments to the other contracting party or for making any other kind of payment, depending on the nature of the contract? Does it provide for additional time limits to proceed to the payments? What is the impact of delaying or not making a payment?
Financial performance: Does the contract establish financial performance criteria (e.g. compliance with certain financial ratios)? How often? What are the consequences of not meeting these financial criteria?
Penalties: Does the contract contain penalties for late payment of certain amounts or for failure to meet certain contractual obligations? When is this penalty due? What amount can it reach?
Liability: Is the liability of the contracting parties unlimited under the terms of the contract or does the contract instead provide for limits on the amount that may be claimed?(maximum/minimum amount)? Is there a predetermined time limit to make a claim? Does the contract provide for a notice to be sent to this effect?
Dispute resolution: Does the contract provide for a dispute resolution process? Mediation or arbitration? Under which conditions can these mechanisms be applied?

List all the impacts that result from a breach of obligations (e.g., penalties, notice of default, interest), and make a list of viable proposals that you can submit to the other contracting party as an alternative.

What legal principles can you use to negotiate a temporary agreement with your contracting party or a postponement of your obligations?

Certain provisions or legal principles may make it possible to terminate a contract or may serve as arguments for a temporary agreement or a postponement of your obligations. Here are a few examples. (This list is non-exhaustive, of course.)

Force majeure

Some parties to a contract will want to invoke the concept of superior force to terminate or temporarily suspend the effects of the contract. Although this concept is interesting, it applies only to very specific situations and its application is not generalized.

As previously mentioned, the *Civil Code of Québec*[1] provides that superior force is an unforeseeable and irresistible event that must not arise from the actions of the contracting parties. Depending on the nature of the obligations covered, a contracting party may be released from its obligations or have its successive obligations suspended during the superior force period.

The contract may also provide for other parameters and circumscribe the terms of what may constitute a case of superior force between the parties.

The right to invoke superior force requires a case-by-case assessment of each contract and of the relationship between the parties. In any event, a party that is unable to perform its obligations, in whole or in part, must take all steps at its disposal to minimize its damage.

You will find more information on the concept of superior force and its application in the bulletin *The Impact of COVID-19 on Contracts.*

Right to terminate

Certain contractual provisions may allow for resiliation (termination) by either party, on specific terms or for specific reasons. Some contracts will provide for a termination mechanism at either party's discretion or further to their mutual consent.

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In the absence of such clauses in the contract, it remains essential to characterize the nature of the contract, since legislative provisions could allow its resiliation. That is also the case of a contract of enterprise or a contract for services, which the client may unilaterally resiliate as permitted by sections 2125 and following of the *Civil Code of Québec*, subject to certain limits, of course. Before deciding to unilaterally resiliate a contract, it is important to consult your legal advisor in order to properly determine the nature of the contract, validate its terms and conditions with respect to resiliation and determine the possible impacts of such resiliation (e.g., penalties, prejudice to the other party, etc.).

Obligation of good faith in contractual performance

The obligation of good faith imposes certain contractual duties, including those of loyalty and cooperation. The duty of loyalty entails certain prohibitions such as not increasing the burden on a contracting party, not compromising the contractual relationship, and not engaging in excessive and unreasonable[2] behaviour. The duty of cooperation, on the other hand, is more positive in nature and aims for assistance and collaboration between the contracting parties to encourage contract performance.

Thus, beyond the contractual relationship between the parties, the obligation of good faith allows for a genuine collaborative relationship, a partnership, even, between the parties.

A party being a victim of its contracting party's actions, which are not in accordance with its obligation of good faith under the terms of the contract or which are implicitly derived from those terms, may be in a favourable position to claim damages.

Thus, if a party experiences difficulties in performing its obligations because of an event beyond its control, it is entitled to expect the other contracting party to show good faith in the performance of the contract and to act reasonably.

Abuse of rights

A party's exercise of its contractual rights may, in certain situations, constitute an abuse of rights. For example, a party that is in default of its payment obligations under the contract, due to the closure of its business as required by government authorities, may trigger the application of a contract default clause by the other party. Such other partycould proceed with the immediate resiliation of the contract upon simply providing notice.

While the terms of the contract may be clear, the other party's haste in resiliating the contract may constitute an abuse of rights. Indeed, the nature of the relationship between the parties, the duration of the business relationship and the facts that led to the default have an impact on the way a party may exercise its rights under the contract. The exercise of rights provided for in the contract in such a way as to create devastating or catastrophic effects for one of the contracting parties could constitute an abuse of rights in the performance of the contract.

Mediation

The contract may provide for dispute resolution processes such as mediation or arbitration. To the extent that a dispute arises between the contracting parties and that the contract provides for recourse to alternative dispute resolution mechanisms, it will be possible or even mandatory to submit the dispute to a process such as mediation before a third party, which will attempt to help the parties find an acceptable common ground. In the event of non-performance by a contractual party, this may be a very good option, insofar as the contract contains a provision providing for recourse to

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such mechanisms, of course.

How can a temporary agreement be negotiated, and are there elements that can be put forward as part of the discussions?

Given the exceptional current situation, it may also be appropriate for the contractual parties to communicate and verify the impacts of the pandemic on the contractual performance. In this way, the parties may jointly conclude that there are particular difficulties in performing certain obligations under the contract.

In such a case, propose solutions or present scenarios that aim to minimize the negative impacts for your respective businesses. Rely on the mutual aid factor to meet certain obligations and/or suspend others (performance, manufacture, delivery, time limits, forbearance, etc.).
It is possible to suggest performing certain obligations in consideration for the performance of your contracting partner's correlative obligations.
Where feasible, consider partial payments, deferred payments, staggered payments over time or a reimbursement based on a percentage of revenues or sales once operations resume after the pandemic.
If it is possible, offer additional guarantees to the other contracting party (e.g. collateral security, personal suretyship, third party guarantee).
Validate whether your insurance covers the cessation of your operations, business interruption, delays in the performance of your obligations, or financial losses arising from some of your contracts, to enable you to propose viable alternatives.
Determine which suppliers or partners are willing to conclude a temporary arrangement and those who refuse or are less open to it. You can then to try to optimize your agreements with the more conciliatory partners, allowing you to continue performing certain obligations with your more reluctant contracting parties.
Innovate! Think about alternatives that might not have been possible, or that you might not have considered before the pandemic, that allow you to optimize your business practices or relationships. In short, think outside the box.

A few thoughts before undertaking a negotiation

Do not restrict your thinking to the period of restriction on non-essential activities which is, at the time of writing, until May 4, 2020. Think instead about the weeks and months that will be required to re-establish your business relationships and resume normal business operations, while performing your ongoing obligations and any deferrals negotiated during the pandemic;
The inability to adapt, or the maintenance of a hard line, will bring some businesses to the brink and force them to consider various insolvency processes. You must be in a position to show your contracting parties why a position that is too firm or inflexible will not, in the long term, be satisfactory or serve the parties' interests, in addition to being detrimental to those parties who are likely to require flexibility in the performance of their contractual obligations.
You need to be able to identify the considerations specific to your business and business model, and determine the elements that may influence your decisions, such as the nature of the relationship with the other contracting party, particularly if it is a long-standing customer or supplier, whether it is a relationship that will continue into the future or if it is a one-time contract that is non-recurring, and what impacts and reputational risk your actions may entail.
Beyond legal principles, the long-term business relationship must be prioritized and protected. This argument should not be underestimated. The objective of most Quebec businesses is to find satisfactory common ground for the parties involved, while trying to minimize the impacts on both sides. The watchword the parties should keep in mind is "flexibility."

During these times when solidarity is in order, it seems to us that it would be wise for each party to make the effort to reach a duly negotiated temporary agreement.

We are sharing these options to provide you with ideas on how to approach the negotiation of ongoing contracts, knowing that each contract, relationship and situation are unique. For more information, our corporate law team remains at your disposal to accompany you during the pandemic. #WeWillGetThroughThis

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1. Section 1470 para. 2 C.C.Q.
2. Didier Luelles, *La bonne foi dans l'exécution des contrats et la problématique des sanctions*, Canadian Bar Review, Vol. 83, 2004, pp. 189-190.

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