

# Practical 5 steps approach how to avoid or manage contractual claims

Accept/Reject/Negotiate and always quantify



The COVID-19 outbreak is causing uncertainty around the world. Organizations are facing or have faced already significant challenges in their supply chain network. In the current world of global economy and international trade a delay or non-performance of one supplier may cause a chain reaction effect on the whole supply chain network, triggering a wave of claims, delay notices, Force Majeure notices, contract suspensions or even terminations. As companies navigate through the crisis it is important to consider mechanisms and processes to recover losses incurred and to protect themselves from potential claims.



## Quantify the losses sooner rather than later

Organizations are currently suffering losses in connection with the COVID-19 pandemic. Losses could be pursued under various mechanisms including contractual claims, insurance claims, losses claimed from governments in response to decrees and/or other measures or under bilateral investment treaties. The exact mechanism to be used is something that needs to be assessed with legal advisers. Irrespective of the mechanism, the process to quantify the losses is similar – and this is something that should be done **sooner than later**.

# Force Majeure or Extraordinary Events clauses

Many contracts contain specific clauses designed to protect the parties from the impacts of extraordinary events, which are beyond their control. In the international contractual law these clauses are called Force Majeure (FM). However, the topic of unforeseeable events may not be included in an explicit Force Majeure clause but may be addressed in the various clauses across the contract, such as Extraordinary Events, Acts of Government, Inability to Perform etc. The clauses are often designed to allow for a range of remedies from an extension of time to the relief from contractual performance, contract suspension or contract termination.

The analysis of Force Majeure or equivalent clauses needs to be performed on a contract level to understand its impact and potential enforcement.

Though regardless of the fact how the clauses are phrased in the contract and under which law they were signed, there is a general obligation of the injured party to **prove the losses incurred**. Specifically, this includes the **occurrence** and the **amount of losses** as well as the **causal link** between the loss and the loss event or the

breach of contract (e.g. what losses were caused as a result of the government measures in the case of a claim against the government, or the **direct connection to the COVID-19 pandemic**, illustrating that the contractual nonperformance was due to the outbreak).

The injured party would also need to prove that it had taken **reasonable steps** to mitigate the losses incurred and disclose whether these losses have already been fully or partially compensated in other ways.

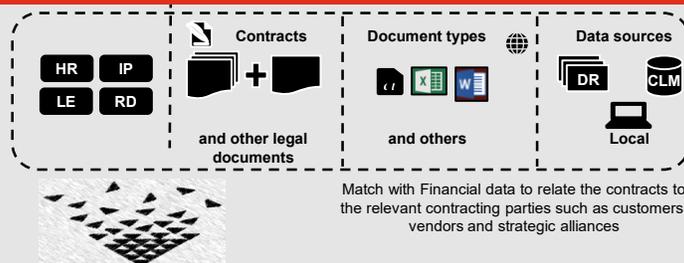
It is important to **act now** and **start collecting evidence** in relation to potential losses as later it may be difficult to go back and recreate and capture all of the information retrospectively.

In addition, later on it is possible that important documents and information that may have supported the claim or its defense may be missed.

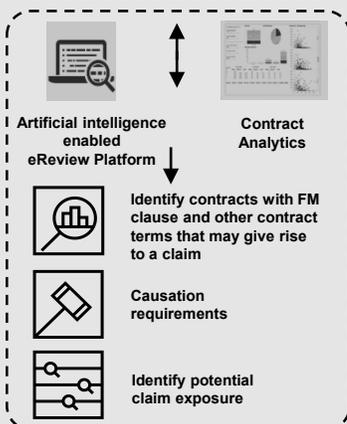
In this regard it is worth considering organizing a central claims management team and a centralized process.

## Illustrative claims management process

### Discover and collect



### 1. Perform contractual diagnostics



### 2. Record relevant cost



### 3. Document relation to COVID-19



### 4. Establish claim management process

- Issue an internal guidance how to process with the claims reviews. This can be a decision tree with Accept/Reject/Negotiate process
- Identify the documents, required to justify the costs and causation
- Start collecting evidence

### 5. Prepare/respond to claims

Make a request for compensation in a timely manner, within the time limit specified under the applicable contract, policy or regulation.



Managed workflow with ongoing monitoring and reporting



# Below are 5 practical steps which will help you to be prepared and well organized for the potential future claims and financial losses

## Step 1: Perform contractual diagnostics

- Review the specific contract terms that may give rise to a claim or potential issue (FM clause, Extraordinary events, etc.)
- Review the contracts to identify potential problems. These can be for e.g. cross-border contracts, contracts under foreign law, contracts with Force Majeure clauses etc.
- Understand the requirements to make a potential claim or time limit when such claims or requests for compensation can be made.
- Review procedural requirements for both parties to make a claim.

As pointed out above, the relevant clauses that cover extraordinary events may vary between individual contracts. In addition, there may be a vast number of contracts that need to be analyzed. Rather than performing a manual review, it is worth considering the use of **forensic IT-Tools** to support the contractual analysis. Such tools are based on artificial intelligence and efficiently support the process of identifying the relevant contract clauses and make them available for further legal assessment.

## Step 2: Record relevant cost

- From the contractual diagnostics (mentioned earlier) identify the costs that you can potentially claim from your supplier, or that you can be confronted with by your customer.
- These costs may include actual costs incurred, lost profit, obligation to reimburse a counterparty etc.

## Step 3: Document relation to COVID-19

- Review the status of the contract before COVID-19 and assess the potential impact of the pandemic.
- Verify if all of the delays and disruptions or other negative impacts can be attributed to COVID-19 or if the contract was in delay (distress) before that.
- Review causation requirements, if these are stated in the contract. Compile the evidence, that is required to support the connection to COVID-19.

## Step 4: Establish claim management process

- Set up an internal process so that the information required to prove the loss is stored in one place and you do not have to search for it once needed. It is better to have more data and documents than less, but all of it should be relevant.
- Develop and share approach, governance process and principle with the focus on ensuring a consistent approach with the same suppliers.
- Issue an internal guidance how to process with the claims reviews. This can be a decision tree with Accept/Reject/Negotiate options.

## Step 5: Prepare/respond to claims

- Make a request for compensation in a timely manner, within the time limit specified under the applicable contract, policy or regulation.
- Identify the documents, required to justify the costs and causation.
- Start collecting evidence.
- Document appropriately steps taken to mitigate the effects of the potential crisis and their evolution as the crisis develops, such as: seeking to reduce wages and other fixed costs, finding alternative suppliers, negotiating deferrals, transfer of employees to another job etc.





# Checklist of potentially relevant documents (only illustrative)

## Financial

- Accounting documentation including managerial accounting, financial statements (consolidated as well as for individual divisions), general ledger;
- Business plans, budgets, comparison with the actual figures;
- Financial restructuring and communication with banks;
- Periodic or ad-hoc financial and budgetary reports for management;
- Minutes from management and shareholder meetings;
- Long-term and short-term profit and cash flow plans;
- Information on wages, including supporting documents to identify the impact of the state of emergency;
- Investment plans and programs;
- Break-even point analysis;
- Planned and actual R&D expenditure;
- Key performance indicators (inventory turnover, rate of return on investment, working capital, analysis on ageing of receivables);
- Review of costs drivers and change in cost allocation policies;
- Sales and revenue analysis, profitability studies of individual products;
- Internal audit reports;
- Tax returns.

## Marketing

- Long-term and short-term marketing objectives;
- Estimation of the market size and market share per product;
- Sales trends and forecasts, sales budget and sales plans;
- Advertising and promotion plans and budgets;
- Order intake and backlog;
- Order history;
- Records of complaints, returns and lost customer orders;
- Development of new products, analysis of competitiveness of existing products.

## Production related

- Production capacity, production plans and schedules;
- Inventory records and obsolescence;
- Work efficiency information;
- Scrap and rework costs;
- Records of orders of production inputs and their fulfilment by suppliers;
- Cost of changing suppliers;
- Maintenance problems and associated costs;
- Quality control reports;
- Purchase budgets;
- Make-or-buy study results;
- Staff turnover, availability/shortage/absenteeism, time sheets, overtime costs;
- Industrial relations reports.

## Others

- Invoices, receipts, delivery notes;
- Bank account statements;
- Contracts (including insurance policies), termination of contracts/ cancellation of orders, payment notices, instructions, etc.;
- Discounts granted, e.g. for perishable goods;
- Documentation of fines, penalty payments, late payment interest in causal connection with crisis development - including evidence of their payment;
- Internal communication - e.g. emails, newsletters;
- Confirmation from the doctor, decision of the hygiene station;
- Photo-documentation;
- Overview of material seized by the State without adequate compensation.

Please call us if you wish to discuss further



**Irina Novikova**  
Partner

+49 69 9585-6070  
[irina.novikova@pwc.com](mailto:irina.novikova@pwc.com)



**Sally Trivino**  
Partner

+49 211 981-7063  
[trivino.sally@pwc.com](mailto:trivino.sally@pwc.com)



**Michael Hammes**  
Director

+49 69 9585-5942  
[michael.hammes@pwc.com](mailto:michael.hammes@pwc.com)