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COVID-19 FORCE MAJEURE AND FRUSTRATION – PRACTICAL TIPS

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Introduction

The containment measures imposed by the Government have had a significant adverse impact on many businesses in the UK. Supply chains are impacted; there are material labour constraints; planned events which cannot be adapted to the virtual world are having to be cancelled.

Continuity plans will be under constant review. Such review will include checking how risk is allocated in existing contracts including any notice provisions; and considering appropriate steps to mitigate delays and prolongationcosts. Any future contracts will need a sharp eye on the detail of how future risks are addressed.

This article is a summary only of the legal issues on the allocation of risk in a contract. The practicalities however, should not be ignored. Everyone is in the same boat. The other party to the contract is likely to be going through the same, similar or worse experience. Negotiation and use of the change control mechanism in the contract may be of longer term benefit to both parties, recognising the challenge of negotiating all the way down the supply chain.

This article follows on from the article by Nicola Diggle and Heather Welham which sets out the core principles under English and Welsh law which need to be considered when contracts are being reviewed during the COVID-19 crisis.

So what does the contract say?

Governing law clause

First, check what the governing law is of the contract. English and Welsh law does not have a general concept of force majeure, but other jurisdictions may. This note assumes that English and Welsh law is the chosen jurisdiction in the contract. As there is no statutory or common law definition of force majeure, the parties have total freedom to define what amounts to a force majeure event, and what the effect is of such event. So it is to the words of the contract to which we turn.

The force majeure clause introduction

Always start by checking whether there is a force majeure clause. The clause does not have to be labelled “force majeure”. What you are looking for are clauses which anticipate that there may be some sort of supervening event beyond the control of the parties, be it factual (such as a fire at the supplier's factory) or legal (such as restrictions imposed in reaction to a pandemic prohibiting mass participation events), which may affect the performance of a contract.

Force majeure clauses vary between listing every possible event (and running the risk that the one event not listed is the one that occurs) and a few words to specify that any event beyond a party's reasonable control will suffice. The clause may also specify that the force majeure event must "prevent" performance and thereby be of limited effect, or "hinder" or "impair" or "delay" performance, thereby being of broader effect.

Many phrases in force majeure clauses are boilerplate and have been well-litigated, but the interpretation depends on the exact wording of the contract. For example: The words “*Act of God*” are said to mean *”such a direct and violent and sudden and irresistible act of Nature as the defendant could not, by any amount of ability, foresee would happen, or, if he could foresee that it would happen, he could not by any amount of care and skill resist, so as to prevent its effect”* (*Nugent v Smith (1876) 1 CPD 423; Cockburn CJ at paragraph 426*)

Many force majeure clauses still do not mention diseases, epidemics or pandemics. Historically, Acts of God have been linked to natural disasters such as floods and earthquakes. A pandemic may be within the meaning of the phrase. But what if the real reason for your inability to perform is because of the government regulation brought in to deal with the COVID-19 outbreak? If a party is required to maintain a business continuity plan and/or if there is a carve out in the contract in relation to any change in the law after the contract has started, then this may make a big hole in any arguments around force majeure.

Force majeure clauses are construed restrictively. For example In *Metropolitan Water Board v Dick Kerr & Co [1918] AC 119*, the clause purported to cover delays “howsoever caused”. Despite this very wide

language, the House of Lords held that the clause nonetheless did not cover substantial delays caused by the First World War: properly construed, the force majeure was only intended to cover minor delays.

Interpretation of the force majeure clause

1. Look at the express language of the clause. The party relying on the clause bears the burden of proof and the courts will not rewrite clauses for the parties with the benefit of hindsight.

2. The non-performance must be due to circumstances both beyond the control of the party and for which the party had not assumed responsibility.

   For example, in the case of *Seadrill Ghana V Tullow Ghana [2018] EWHC 1640* Tullow hired a drilling rig from Seadrill. The relevant clause defined "force majeure" as including "*Drilling moratorium imposed by the Government*". The court held that the real reason for the moratorium was that Tullow's infrastructure had broken down. This was not a force majeure even though the Government had also stopped drilling because of a dispute about title to some land. Similarly, in the case of *Tandrin Aviation Holdings v Aero Toystore [2010] EWHC 40*, Aero refused to accept delivery of a jet and paid nothing to Tandrin. Aero relied on the fact that there was a downward spiral in the world's financial markets. However, the force majeure clause said nothing about the general economic situation, although did refer to "*any other cause beyond the Seller's control*". Of course Aero was the buyer and not the seller, and the clause said nothing about anything beyond the buyer's control. Aero was liable for breach of contract and damages.

3. There must have been no reasonable steps which could have been taken to avoid or mitigate the intervening event or its consequences.

   In the case *of Channel Island Ferries V Sealink [1988] 1 Lloyds Reports 323* the Court of Appeal held that the words "*beyond a party's reasonable control*" imposed a duty on the party to take reasonable steps to avoid the operation of the clause or to mitigate its words and effects. In other words a party cannot stand back and let matters take their course. In this pandemic, compliance with government guidance is likely to be relevant in determining whether a party has taken reasonable steps to mitigate its effects. This may be complicated where some sectors are permitted to work and others not. Also, if the Government were later to allow some sectors to restart and a party refused (or was unable because the workforce refused to attend at the place of work) then this may bar that party from relying on the force majeure clause.

4. Although it will in each case depend upon the particular wording of the force majeure clause, many clauses exclude foreseeable and/or foreseen events.

   In the COVID-19 context, the current pandemic is not likely to be foreseeable. But would a COVID-19 caused global recession be foreseeable now? And what about contracts entered into after the cry went up from Wuhan about an unusual virus?

The notice provisions

Force majeure clauses normally require the party seeking to rely on them to serve a formal notice. The contractual provisions, which could be set out in a different part of the contract, must be adhered to. Invoking force majeure may need to be done in a particular way, or within a particular time period, or the event or consequences may need to be certified by an independent state or other body. The leading case is *Bremer Handels MBH v Vanden Avenne PVBA [1978] 2 Lloyd's Rep 109*. Notices clauses have become complex in recent years. It is even harder where the notice requires reasonable details, because case law suggests that quite a lot of detail may be required for a valid notice.

There may also be a continuing obligation to report on the effect of force majeure at regular intervals. Failing to do so may mean that the benefits of the clause are lost.

The consequences of the force majeure clause

The consequences of a force majeure clause will depend on the express terms of the clause. Normally parties agree to suspend performance, or excuse liability for non-performance for a particular period of time rather than provide for an automatic discharge of the contract.

For a party whose contractual duty is to make a payment under the contract, the party will have to show that the force majeure event relied on has caused an inability to make the payment. This may be difficult – the affected party may have to show that the force majeure event has, for example, prevented, hindered or delayed performance. But the force majeure event does not, of itself, prevent payment.

What about costs? The clause may deal with costs or it may be silent. If it is silent then the common law principle is that costs fall where they lie. Parties should look at their insurance policies to see if any of these losses, including costs, can be recovered from their insurers.

Other clauses and wording to look out for

There may be other, interrelated clauses that need to be looked at, for example minimum spend and volume provisions, and relief event clauses. If relief is to be claimed, again there are likely to be complex notification provisions and tight time limits.

And look carefully at the force majeure clause itself. Sometimes it includes matters which one would not automatically consider to be force majeure, because arguably they are the responsibility of one of the parties. For example the clause may include failure of supply or of subcontractors, or financial hardship. It may also include government action or regulation – and yet there may be another clause which requires the provider to comply with any new regulations or changes in the law.

Frustration – a brief overview

What if there is no force majeure clause, or if it does not help you? What does the common law provide? One alternative is to rely on the doctrine of frustration, although it is rarely invoked successfully and the test for frustration is high. The performance of the contract must either be impossible, or the frustrating event has made the performance of the contract result in something radically different to that envisaged in the contract so that the original obligations are incapable of being performed. This is a high bar. The obvious example of a contract which may meet this test is a contract for a specific event involving mass participation for a date during the period of required social distancing.

In addition, the existence and scope of a force majeure clause is very likely to affect any argument about frustration. This is because, in order to rely on frustration, the event must not have been anticipated or provided for in the contract. In the case of a force majeure clause, the parties may have made express provision for the consequences of the particular circumstance which occurred. In the most recent frustration case, *Canary Wharf (BP4) T1 Limited v European Medicines Agency [2019] EWHC 335*, the court held that defendant had failed to show that Brexit had frustrated the lease (EMA arguing that, because of Brexit, it no longer required premises in the UK). Further, as the contract provided for unforeseen events by dealing with risk allocation, the doctrine of frustration was ousted – the parties had addressed their minds to EMA having to vacate the premises by allowing a sub-let, albeit at a price.

At common law, if a contract has been frustrated it is automatically discharged and the parties are excused from their future obligations. The contract is brought to an end immediately. It is not rescinded (which undoes a contract as if it had never existed and restores the parties to their pre-contract position). Therefore, if a party incurred obligations before the time of frustration, it remains bound to perform them and because no one party is at fault, neither party may claim damages for the other's non-performance. A court does not have the power at common law to allow the contract to continue and to adjust its terms to the new circumstances.

Law Reform (Frustrated Contracts) Act 1943 "LRA"

The ability of a party to recover money paid under a contract before the occurrence of the frustrating event depends on the applicability of the LRA. Generally speaking, this statute applies to many commercial contracts, with the exception of contracts which have excluded its effect, certain shipping contracts, insurance contracts and contracts for specific goods which have perished. The LRA also only applies to contracts which are governed by English and Welsh law and only to those contracts which have become “impossible of performance or been otherwise frustrated” (section 1(1), LRA).

The LRA provides that:

- Money paid before the frustrating event can be recovered and that money due before the frustrating event, but not in the fact paid, ceases to be payable (section 1(2), LRA).

- A party who has incurred expenses is permitted, if the court thinks fit, to retain an amount up to the value of the expenses out of any money they have been paid by the other party before frustration; or where money was due and payable at the time of frustration, recover a sum not exceeding that amount for expenses (section 1(2), LRA).

- The court may require a party who has gained a valuable benefit under the contract before the frustrating event occurred, to pay a "just" sum for it. This is the case whether or not anything was paid or payable before the frustrating event (section 1(3), LRA)

These provisions do not provide express rights for parties to recover or retain sums. The purpose of the LRA is to provide the courts with some flexibility in assessing the circumstances of the case and prevent unjust enrichment of one party over the other. The affected party must show that it took all reasonable steps to mitigate the frustrating event on its performance of the contract.

Illegality

What if the performance of the contract is now illegal? With the introduction of the government emergency legislation many activities that were perfectly legal before are now temporarily illegal. Does the existence of a force majeure clause still preclude the doctrine of frustration from operating? We have to look back in history for authority, unsurprisingly to events which took place during a time of war. In the case of *Ertel Biber & Co v Rio Tinto Co [1918] AC 260 HL* an English company had contracted to sell and ship to German companies large quantities of ore when war was declared with Germany. The contract contained a clause that, should a state of war emerge between the parties' countries, neither party was bound to perform their obligations until a reasonable period after the conclusion of the war. Lord Dunedin, giving the lead judgment in the House of Lords, held that, had it not been for this condition the contract would certainly have been avoided, and even with such a clause the parties were not bound by their obligations. In other words, the condition relating to the suspension of the contract did not automatically preclude the doctrine of frustration from operating. Based on this case, it is open to argument that where performance of a contract becomes illegal, a contractual term that seeks to exclude frustration is void and contrary to public policy.

Cancellation clauses

Returning to the theme of a mass participation event which is cancelled during the pandemic, then what about refunds on tickets sold? The first port of call is the wording of the contract. If cancellation rights are triggered by force majeure and one party is a trader and the other a consumer, then those rights must be read in light of the Consumer Rights Act 2015. If the cancellation clause only gives the event organiser the right to cancel, and the ticket holder limited rights to a refund, then this may be an unfair term. If the relationship is business to business, where both parties are acting in the course of trade and not as consumers, then there may be greater tolerance as to whether or not the cancellation provision in the contract could be considered an unfair term. However, as it is an exclusion clause it must meet the test of reasonableness in order to be relied upon.

If there is no force majeure clause in the contract then the next step is to consider if the test of frustration is met (see above).

Concluding thoughts

The force majeure clause may allow a party to end the contract (which is unusual) or, more commonly, provide a defence to a claim for delay in performance. The way in which the delay arises may be critical in determining its contractual consequences. For example, in a JCT construction contract, in circumstances of a site shut down, if that resulted from government intervention or force majeure under the terms of the contract, the contractor could claim an extension of time but not loss and expense. If it arose from the employer's instructions then a claim for both time and money could be made.

If force majeure, or frustration in the absence of a force majeure clause, do not suspend or end the contract, then thoughts will turn to other options. For example:

- has there been a material adverse change (where the contract includes such a clause);
- has there has been an insolvency event or breach of an earnings covenant triggering termination or other consequences;
- has there has been a material or repudiatory breach entitling termination, and if so how to frame the notice of termination.

Again, there are practical considerations – it may be inadvisable if you are the customer to consider termination before you have another supply lined up, which may be easier said than done.

Finally, if you get served with a force majeure notice, you need swiftly to consider whether you should serve similar notices on your head and sub contracts if you are in a chain. If those contracts are not back to back then this can get complicated, In short, as well as considering the enforceability of the notice that has been served on you, you need to think about the knock-on effects.

As we said at the beginning, negotiation is far better than threats, but do not forget to serve any contractual notices at the same time as negotiating. Hopefully the pandemic is short lived, but the ripples are likely to be felt in millions of contracts around the world for some time to come.

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