BLAKE MORGAN

# GUIDE TO FORCE MAJEURE AND OTHER COVID-19 CONTRACT ISSUES

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## Introduction

We are receiving multiple queries regarding 'force majeure' and other potential ways of reducing contract exposure given the effects of COVID-19.

We hope this summary of relevant English and Welsh contract law will help but please do not hesitate to contact us with your specific query.

Force majeure clauses are included within contracts to limit liability where an event, outside your contemplation and control, means that you are unable to perform your obligations under the contract. Force majeure clauses specify the type of events that could delay or terminate the contract.

COVID-19 may or may not fall within the description of a force majeure event. If it does it will enable parties to rely on these particular clauses when they can no longer perform their obligations under the contract. But what if your contract does not include a force majeure clause, or you had a verbal contract? See below for further details on other options that may be available.

## Force majeure clauses in contracts

The purpose of a force majeure clause is to define events that would excuse the parties from their obligations under a contract.

A force majeure event would usually have to make it impossible or illegal for the parties to perform their obligations, although some force majeure clauses can be wider in scope.

The scope of a force majeure clause will depend on the specific wording within a contract (that may or may not have clear wording covering epidemics and pandemics). In the context of the coronavirus pandemic, parties may look to rely on the force majeure clause within their contracts in circumstances such as supply chain breakdown or the self-isolation of service providers in line with government orders or requests.

## Prove it

It is the responsibility of the party seeking to rely on the force majeure clause to prove that:

1) the event falls within the scope of the force majeure clause; and
2) their inability to perform their obligations was caused by that event.

That party must also prove that they have taken reasonable steps to prevent or mitigate the effects of the force majeure event, e.g. by looking for alternative suppliers if the supply chain is broken. This is because, by nature, force majeure events must have been unforeseeable and outside the reasonable control of the parties.

The force majeure clause may set out a process to be followed when the clause is triggered. For example, it may impose an obligation to notify the other parties of the event or an obligation on all parties to meet to discuss the best way to mitigate the effects of the event. The process will vary depending upon what was decided by the parties when drafting the contract.

The effect of the force majeure clause should be outlined within the clause itself. Typically parties would agree that their obligations under the contract are suspended for a certain period, or until the force majeure event has come to an end. It is also possible for a force majeure clause to state that a force majeure event would give the parties the right to terminate. A standard effect is that once the force majeure event occurs, the non-performing party's liability is removed until that event comes to an end.

## Other relevant contractual provisions

Whilst considering force majeure clauses, it is also worthwhile reviewing your contract to check for the provisions regarding events of default in general, whether for breach of performance obligations, breach of other covenants, insolvency events as well as termination procedures.

There may also be provision in your contract for Relief Events and a Dispute Escalation Procedure. These provisions will need to be carefully considered in light of the issues you face before deciding on the best course of action.

## The common law doctrine of frustration in English and Welsh law

If an agreement does not contain a force majeure clause or the impact of the COVID-19 outbreak is outside its scope, the parties should consider whether the agreement can be said to have been terminated by operation of law on any other basis.

Further, remember that contracts can be established at law without a written agreement, provided that there is:

1) an offer;
2) an acceptance of that offer;
3) consideration; and
4) intention for the contract to be legally binding.

It may be possible that COVID-19 triggers the common law doctrine of frustration. If it does, the relevant agreement will be automatically terminated and neither party has to perform any future obligations to the other.

Frustration applies when something occurs following the formation of a contract which makes it physically or commercially impossible to fulfil the contract, or if it transforms a party's obligation to perform into a radically or fundamentally different obligation from that undertaken at the time the contract was entered into and it was not in the contemplation of the parties.

Therefore, whether COVID-19 (or events resulting from COVID-19) would be deemed to frustrate a contract requires a careful analysis of the facts surrounding the relevant contract and recent events.

In order to rely on frustration, the event:

1) must not be an event anticipated or provided for in the contract;
2) must not be caused by the party seeking to rely on it; and
3) must be an outside event or extraneous change of situation.

In the current climate, disputes may arise over whether the disruptions make performance impossible or a radically different obligation. One of the considerations to be borne in mind is whether the events can be overcome with time or not. Frustration is unlikely to apply where performance is merely delayed or because obligations become more expensive or onerous to perform.

## Relying on frustration could be problematic

A party seeking to rely on frustration to cease performing contractual obligations is normally required to demonstrate something akin to impossibility of performance in circumstances entirely beyond its control. Frustration therefore tends to have limited application but it could be a potential avenue for relief in certain circumstances, e.g. where emergency measures have made the supply permanently unavailable or the necessary skilled labour to perform a contract have become unavailable due to travel restrictions or illness.

The Law Reform (Frustrated Contracts) Act 1943 ("LRA") applies to the majority of commercial contracts that are governed by English and Welsh Law unless excluded by the terms of the specific contract. Under the LRA you could be entitled to retrieve money paid or expenses incurred before the frustrating event, as well as discharge any future payments that you owe under the contract.

If the LRA does not apply to your contract, you will need to rely on the common law rules on frustration. Frustration does not mean that the contract is 'undone' to place the parties back to their original positions, but rather that the contract ends on the current position: in other words "loss lies where it falls".

Claiming frustration is often difficult and complex and, therefore, where an agreement contains an express force majeure clause, which is broadly drafted or describes the present situation, this would be the preferred route.

## Other possibilities for termination in English and Welsh law

English and Welsh common law provides other avenues for an aggrieved party to terminate a contract which can be relied on if the terms in the contract are not sufficient.

If a contract contains no express provision on termination, a term allowing termination on reasonable notice may sometimes be implied, for example where it is obvious and necessary to give business efficacy to the contract. What constitutes reasonable notice in the circumstances is a question of fact to be determined at the time of the termination.

English and Welsh law may also imply other terms into a contract from statutes such as the Sale of Goods Act 1979, the Supply of Goods and Services Act 1982 or the Consumer Rights Act 2015, or by usage or custom, a previous course of dealings or by fact. These implied terms could be useful if you are seeking to justify termination for a breach of contract and there isn't a relevant provision in the contract.

If another party has committed a repudiatory breach of contract, it would entitle the wronged party to bring the contract to an end if it so chooses and claim damages.

A repudiatory breach:

1) goes to the root of the contract;
2) frustrates the commercial purpose of the venture;
3) deprives the innocent/aggrieved party of the whole or substantially the whole of the benefit which it was the intention of the parties as expressed in the contract that it should obtain; and
4) indicates an intention to abandon performance. Note that repudiatory breach is usually a higher test than material breach.

An anticipatory breach of contract occurs before a party is bound to perform its obligations under the contract. If a party declares an intention not to perform the contract or some essential aspects of it, or an intention to perform it in a way that is substantially different to the way envisaged by the contract, the innocent party will be entitled to terminate the contract at that point.

Not every threatened breach will be an anticipatory breach. If a party intends to perform some, but not all, of its obligations, it will depend on whether the anticipated non-performance will amount to a breach of a condition or a sufficiently serious breach of an intermediate term. If the breach is an anticipatory one amounting to repudiation, termination can be immediate even though the actual date for performance has not yet arrived. Alternatively, the innocent party can wait until the date for performance has passed and the defaulting party is in breach.

## Recovering losses and insurance

A party who has suffered financial loss as a result of COVID-19 should also look at ways of recovering its losses, either from an insurer or another contracting party. It is important to ensure that you keep documentary evidence of losses incurred due to delays or failures in order to support potential claims.

Check whether you have any business interruption or credit insurance in place which might protect your business in the event that operations are severely disrupted or you suffer significant bad debts.

Where goods are being supplied, you should also look at whether the contract has a Retention of Title clause.

Even if a party does not have insurance to directly recover its losses, it might have legal expenses insurance which can be engaged to pursue a claim against another party who is at fault.

Finally check your contracts for any guarantee, surety or bond which may allow you to claim sums owed from a third party.

## Practical points on termination of contracts

Whether termination of a contract can be established depends on the terms of your agreement and the effect upon the specific obligations (of both you and other parties). If you terminate a contract in circumstances where you are not entitled to do so that in itself is a breach of contract entitling the other party to terminate and claim damages.

The options available under the agreement should therefore be considered carefully and legal advice sought before action is taken and the reason for terminating documented properly in order to minimise potential liability for wrongful termination of the contract.

Termination notices need to be carefully drafted otherwise they could be considered invalid so it is important to seek advice before the notice is sent.

The party with a right to terminate, whether at common law or under a contractual term, has a choice to end the contract or keep it alive. Once the choice is communicated, whether expressly or by conduct, to either terminate the contract or continue with it, that decision cannot be undone without the agreement of all parties.

If a contract is terminated, it does not cease to exist. Therefore any accrued rights and obligations must still be adhered to, it is just the future rights and obligations of the parties which fall away.

A party cannot recover damages for losses which could have reasonably been avoided so consider how you might be able to prevent or reduce loss.

Notwithstanding a party's ability to terminate a contract, it is always important to assess the relationship between the parties before doing so. If there is an important ongoing relationship an alternative approach may be appropriate, e.g., renegotiating the contract with a view to varying its terms or following a prescribed dispute escalation procedure and/or mediation to try and achieve a mutually acceptable solution.

If you require any legal advice on commercial contracts affected by COVID-19, please contact us.

This guide has been co-written by:-

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