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Coronavirus: contracts, force majeure and frustration (long read)

As coronavirus continues to spread, this article looks at the potential impact on commercial and business interests, particularly obligations under contracts with customers.

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Please note: the information contained in this legal update is correct as of the 1st May 2020

As coronavirus continues to spread, many of our clients are expressing concerns that they may not be able to perform their obligations under their contracts with customers. On the face of it, non-performance will be a contract breach subject to two key exceptions, being an express force majeure provision within their contracts or, in the absence of this, a reliance on the common law doctrine of frustration.

Force Majeure

Force majeure clauses generally provide that, upon the occurrence of a specified act, event or circumstance which is outside of a party's reasonable control, that party will be excused from performing part or all of its specific obligations under the contract and will not be liable for failing to perform those obligations.

Typically, force majeure clauses will provide that specific obligations will be suspended where the obligation is "prevented" (rendered impossible) or "hindered or delayed" (become substantially more onerous but still possible by other means).

Depending on how the force majeure clause is drafted, either the obligations under the contract will be suspended until the relevant event has ended or, usually after an extended period of the event continuing, the whole contract could be terminated.

The effect of a force majeure clause on a party's contractual obligations, and the circumstances that will give rise to an ability to suspend obligations, depends entirely on how the force majeure clause is drafted. Whether an event is included as a force majeure event depends on the words used, not the parties' intentions.

- The events resulting in suspension of obligations are limited to those expressly stated in the contract, either via the definition of 'Force Majeure Event' or in the body of the force majeure clause itself.
- A common inclusion in long form force majeure provisions is specific reference to "epidemic or pandemic". The former is generally understood to be a widespread local outbreak of infectious disease; the latter is generally understood to be a disease prevalent over a whole country or the world. Coronavirus would seem to fall within these definitions. In addition, given the WHO's announcement that coronavirus constitutes a Pandemic, force majeure clauses which specify 'pandemic' within them, will now be more likely to be engaged.
- Another potential option is the phrase "governmental actions", or the long-form "any law or action taken by a government or public authority". This would certainly seem to include the current lockdown imposed by the government, restricting large gatherings, travel and many other everyday activities.
- It is well established that economic or market circumstances cannot be a relevant event for the purpose of a force majeure clause. Therefore, the early signs of coronavirus shaking many economies globally are not relevant for current purposes.

If the contract sufficiently refers to an outbreak of the coronavirus as a force majeure event, it would then be necessary for the party relying on the clause to demonstrate that:

- Coronavirus has caused prevention, hindrance or delay of its obligations; this will be specific to each case;
- Coronavirus is the sole cause of prevention, hindrance or delay: if there is another reason that the obligation cannot be performed (i.e. for a conference, the venue has not been prepared in time for unrelated reasons), the force majeure clause may not be relied upon; and
- The impact of coronavirus upon the party's ability to perform its obligation was beyond the party's control and that the party took all reasonable steps to prevent this impact of coronavirus. This, combined with the fact that coronavirus has received widespread attention, means that parties may be expected to have taken extensive precautions against it on the basis that they could potentially mitigate the impact of the virus (for example, if work cannot be completed because staff are on sick leave after catching coronavirus, it could be argued that the employer's failure to provide sufficient sanitation products at work meant that the employer had not taken all reasonable steps). Given the severity of the virus, however, it is difficult to anticipate arguments that individual companies could be expected to resist the impact of coronavirus and its consequences.

Where a contract provides that the outbreak of coronavirus is a force majeure event care must be taken to comply with any notice or procedural requirements specified in the contract, as failure to do so may result in a loss of the ability to suspend obligations in the contract.

In the event that obligations under a contract are suspended or the contract is terminated, each party will typically bear their own costs caused by the suspension or termination (unless otherwise specified in the contract). If one of the parties had paid for a service under the contract that was now rendered impossible, hindered or delayed, what happens next will depend on the circumstances:

- If the force majeure event is merely temporary and the contract is capable of resumption at a later date, it is likely no money will be returned as the contract has not been terminated and the obligations of both parties will resume once the force majeure event has ceased;
- If the force majeure clause expressly provides for termination of the contract in the event of the force majeure event, or if the parties are otherwise able to terminate the contract by mutual agreement, the relevant clause may set out what happens to any money already paid;
- If the force majeure event will continue indefinitely and render performance of obligations impossible, then the paying party may well be entitled to restitution (although case law does not provide any clear guidance on this) or the contract may be considered 'frustrated', in which case monies paid will be returned via restitution (being repayment of any gain made) under the Law Reform (Frustrated Contracts) Act 1943 (discussed in more detail below).

It should be noted that certain legislation provide consumers with the right to a full refund where an event or service is postponed or cancelled due to a force majeure event. The Package Travel and Linked Travel Arrangements Regulations 2018, for example, provide consumers with a right for a full refund where performance of the package holiday is prevented "because of unavoidable and extraordinary circumstances".

The Competition and Markets Authority (CMA) issued a statement on 30 April 2020 in which it interpreted consumer legislation as generally allowing consumers to obtain a refund where a consumer contract is incapable of performance due to coronavirus. The CMA also stated that, in its view, attempts by businesses to retain any money paid by the consumer (such as through a 'non-refundable deposit') will not be upheld (subject to certain exceptions, such as where the business has incurred costs under the contract). Whilst the CMA's statement is not legally binding, its role in regulating the performance of businesses during this difficult time definitely lends the CMA's views considerable weight.

Finally, much of the public may not know what 'force majeure' means. Consumers may therefore be unaware of the extent of what they are agreeing to when entering into a contract containing a force majeure clause if the impact of that clause is not made clear. As a result, it is possible that a force majeure clause could be deemed 'unfair' (and therefore non-binding) under the Consumer Rights Act 2015 on the basis that it was not written in plain and intelligible English. It is advisable that care is taken in consumer contracts to define force majeure clauses and their impact in plain language so there is no deniability on behalf of the consumer.

Frustration

In the event that there is no force majeure clause in the contract or the force majeure clause does not extend to the specific coronavirus circumstances in play at the relevant time, parties may need to rely on the doctrine of frustration. This is an undesirable route as it is so rarely permitted by courts and should only be pursued as a last resort.

There are three main requirements for frustration:

- The intervening event must cause the obligation owed under the contract to become impossible or radically different from the obligation contemplated at the time of entering the contract;
- The occurrence of this event that caused the radical change cannot be due to either party; and
- The contract must not deal (or deal properly) with what will happen on the occurrence of the alleged frustrating event (i.e. the contract lacks a force majeure clause or does not otherwise allocate risk in the event of coronavirus).

The 'radical change in obligation' requires that both parties make an assumption at the time of entering into the contract that later proves incorrect. The relevant examples of types of frustration for coronavirus include:

- Illegality, i.e. the government lockdown prevents performance of the contract through, for example, the ban of large gatherings, in which case conferences over a certain capacity may be frustrated;
- Contracts for personal services where one party becomes unable to perform due to death, illness or incapacity: the court will look at how long the party is unable to perform for, how long the contract was for, the terms of the contract and whether the illness genuinely makes the contract impossible to perform (if someone else can act on the ill party's behalf to perform the contract, it will not be deemed impossible, per Blankley [2015].

If the relevant event is foreseeable but the parties do not include a provision providing what should happen in the event that it arises, frustration will not be available as a defence to breach. Therefore, it is highly unlikely that any contracts entered into from the moment that coronavirus began to obtain significant media momentum will be capable of being frustrated.

In almost all cases it could be argued that steps could have been taken to prevent improbable/undesirable circumstances from being classified as 'impossible' (i.e. Company A cannot claim its contract with Company B is frustrated due to its regular supplier, Company C, becoming insolvent and incapable of providing the necessary goods: Company A could simply acquire the necessary goods from an alternate supplier, even if Company A would now make a loss on this deal). Due to this difficulty of reaching the high bar of 'impossible', frustration should not be relied upon except in circumstances where there is no other method of avoiding a contract breach.

If frustration does arise, the contract will be brought to an end automatically. All parties are released from their obligations (except those that should have been performed before the frustrating event, which they can remain liable for). In relation to sums already paid under a frustrated contract, the Law Reform (Frustrated Contracts) Act 1943 provides that:

- If Party A has paid money to Party B under a contract before the frustrating event arises, Party A is entitled to receive that money back subject to an allowance for the expenses that Party B incurred for the purpose of performing their side of the deal; and
- If Party A owed money under an obligation that fell due before the contract was discharged via frustration, Party A does not have to pay the money, although Party B may recover a sum in respect of expenses that they have incurred (capped at the amount that Party A had owed).

What to look out for:

- Check for an express force majeure clause.
- Carefully review:
    - whether the outbreak constitutes a force majeure event;
    - if the causation requirements are met;
    - whether the impact of the outbreak on the contract obligations concerned was beyond the affected party's control;
    - whether the affected party took all reasonable steps to prevent the impact; and
    - what mitigation duties will apply.
- Consider the impact on any advance payments / retentions already made, particularly in the light of the CMA's 30 April 2020 statement on refunds for consumers.

Get in touch with Paula Dumbill, Jonathan Tardif or Connor Griffith to find out more.

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