

The Impact of Force Majeure and Frustration on Contracts

The significant impact of Covid-19 is felt by businesses around the globe. Owners are desperately reviewing contracts, in the hope of finding clauses which might assist them to:

- cancel or amend a contract; or conversely
- force the other party to abide by the terms of a contract.

A force majeure (FM) clause can prove invaluable to overcome, or halt, financial damage. However, do not despair if this clause does not exist in your contract or, if it fails to cover your situation. We also look at the English common law doctrine of frustration, which you might be able to rely on if your contract is governed under English law.

Both remedies rely on a detrimental event which, in turn, prevents performance and which must be (i) beyond the parties' control; (ii) outside of their knowledge at the time of contracting; and, (ii) without either party being at fault. However, a FM clause may allow, not just for termination but also, to vary or suspend the contract until events change, whereas frustration will simply terminate the contract.

What is a force majeure clause?

An FM clause applies to events that occur outside of the parties' control and, looks to protect the parties from continuing obligations and liabilities under the contract. In simple terms it is:

- a contractual term;
- triggered by events outside of the parties' reasonable control;
- preventing performance or radically altering the obligations between the parties; and thus,
- enabling a contract to be cancelled, varied or suspended.

Due to the significant impact of these clauses, they are rarely used, and generally relate to events that resonate throughout the world; such as World War II, Brexit, and now, the Covid 19 Pandemic.

As a powerful remedy of last resort, these clauses must be properly drafted. Most FM clauses list the triggering events within them. A clause does not need to be labelled "force majeure" to be effective. It must merely include details of options available to the parties during interrupting events.

What effect does the force majeure clause have?

If properly triggered, an FM clause may enable parties to cancel, suspend or vary their obligations under the contract. You may however want to reject attempts to trigger a FM event, and push on with the contract. The wording of each clause is heavily relied upon for and it is essential to examine the wording carefully.

FM clauses will typically list trigger events and frequently include sweep-up language to ensure it is not interpreted as an exhaustive list, for example the use of phrases such as "or any other causes beyond our control". However, for an event to be captured by such sweep-up wording, it must still be of similar type to the events listed within the clause.

A FM event cannot just create great difficulties in performance or, make things more costly than envisaged when entering into the contract, it must be so serious as to render the contract unworkable.

It is important to note that the FM event should be the sole event relied on, having a 'direct impact' on the default. For example, a party is already defaulting on its obligations, the FM event cannot be used as a convenient way to extract it from the contract. The effect of the FM clause will often be to prevent; hinder; or, delay performance, with the burden of proof obviously being higher on prevention, than the other options. There is also a duty to mitigate your losses where possible. Of importance, you must ensure you comply with any conditions of the FM clause e.g. notice provisions. You do not want to lose your rights simply because you served late notice!

The remedies will be set out within the contract, commonly found in the FM clause and in termination clauses, and will often involve the repayment of monies or, the cancellation of monies being paid in the future.

Force majeure and COVID-19

Previous attempts of clients to utilise and amend old contracts, which can often lead to conflicting clauses within the new contracts, are now being felt. It is highly recommended for businesses to obtain relevant legal advice when entering into new agreements.

The burden of proof lies with the party seeking to rely on the FM clause. They must demonstrate that the current pandemic is captured within the scope of the clause. Key words to look out for in the COVID-19 context would be references to “pandemic”, “infectious diseases” and “quarantines”. It will often be down to the courts as to how each clause is interpreted.

Government advice is also important when considering whether such events have been triggered, for example where the country has closed its door to specific imports or prevented public gatherings.

You cannot just cite Covid-19 to trigger your FM clause. You have to:

- show the direct link prevent the contractual obligations from being performed; and
- take all reasonable steps to mitigate the consequences of the FM event.

Frustration

Not all of you will have FM clauses within your contracts. Under English law, we have something called the ‘doctrine of common law’, which evolves out of decisions of the courts and tribunals and so can have the benefit of moving with the times and with world events. Frustration is governed by the Law Reform (Frustrated Contracts) Act 1943.

Frustration developed to apply fairness where contractual remedies were not available. Like FM, it focuses on events outside of the parties’ control. In simple terms it is:

- an unexpected event;
- triggered by events outside of the parties’ reasonable control;
- preventing performance or radically altering the obligations between the parties; and thus,
- discharging the parties from their liabilities and terminating the contract.

A word of warning: you must be certain your contract is frustrated before you attempt to claim the contract is void. If you get this wrong, you can be held in breach of contract and thus liable for damages. As frustration is a draconian measure and will terminate the contractual obligations of the parties, there must be no other option available to the parties.

By way of example, think back to the closure of Suez Canal crisis in the 1950s. The canal was closed, thus preventing vessels transporting goods via that route. Despite this, the English courts largely held this did not frustrate those contracts, as an alternative route could be utilised. This emphasises what we say above, there must be more than significant difficulties or vast economic changes for contracts to become void. This is a high bar which both FM and frustration have in common.

Another concept to consider is the knowledge of the parties when entering into the contract. If we think of civil unrest/riots within a country, if a contract was entered into during the unrest or, with the knowledge this was pending, the courts will consider this knowledge to be part of a calculated risk, known to the parties at the time, and not an unexpected or unforeseen event as required for frustration (and FM) to apply. However, should the unrest significantly increase beyond what was reasonably expected, this may alter the courts position.

In the case of *Davis Contractors Ltd v Fareham UDC* [1956] AC 696, Lord Radcliffe expressed the common law doctrine of frustration as:

“Frustration occurs whenever the law recognizes that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. *Non haec in foedera veni. It was not this that I promised to do.*”

Where frustration applies, the agreement will come to an end, in whole or in part, depending upon the circumstances. The parties will thus avoid their obligations and liabilities. It is likely that monies already paid will be returned and, monies to be paid will be cancelled. However, there will also be a set off element to consider i.e. what reasonable expenses that have already been incurred, should be deducted to make the final balance fair to both parties.

Other matters to consider

Before claiming FM or frustration, consider if you could renegotiate. Sometimes opportunities may present themselves and, a little leeway on both sides can lead to a stronger working relationship for the future.

What impact will your actions have on your business's reputation? For example, attempts by wealthy football clubs to reduce salaries or make redundant low-level staff, have led to an outcry around the world, where the footballers and executives continue to receive salaries these workers can only dream of.

Finally, where one party is contracting as a consumer then, under English law, they have protection under the Statute law and, concepts of fairness and the bargaining powers of the parties may apply.

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