COVID-19 and its Impact on English Law Contracts

March 18, 2020

The international spread of the COVID-19 virus has drawn an unprecedented global response. The World Health Organization declared COVID-19 to be a pandemic on 11 March 2020. Several countries, including China, Italy and the United States, have imposed measures to try to contain the virus, including restrictions on local and international travel and cancellations of public events. The impact on business is significant, as workers cannot go to work, manufacturing and transportation is disrupted, and shops and businesses close. It remains unclear how long the restrictions will remain in place.

For affected businesses, important questions arise as to how their contractual obligations are impacted. In this client update, we address the impact of COVID-19 on contracts subject to English law from the perspective of Force Majeure, frustration, and Material Adverse Change. On the Debevoise Coronavirus Resource Center webpage (https://www.debevoise.com/topics/covid19checklist), you will also find guidance on the position under other governing laws, including New York law and French law.

We note at the outset that whether the principles of Force Majeure or frustration will apply in any particular case is always highly sensitive to both the background facts and the actual terms of the relevant contract. While this update provides general observations on each area of the law, for parties considering the application of these principles to their own contracts there is no substitute for having their situation reviewed by experienced lawyers. This is particularly so when a party that wrongly claims Force Majeure or frustration can expose itself to claims for breach of contract and significant liability. Should you wish to discuss any of these matters further with Debevoise, contact details are provided at the end of this bulletin.

GENERAL POSITION

Generally, contractual obligations under English law are absolute. A party that fails to comply with its obligations for any reason will be in breach of contract, and will

generally be liable to its counterparty in damages for any losses caused by the breach.[1]

However, if a party is left unable to fulfil its obligations because of an intervening factor, two exceptions may apply: (i) if a Force Majeure clause in the contract can be invoked; or (ii) where the common law concept of frustration applies.

FORCE MAJEURE CLAUSES

'Force Majeure' is not a term of art under English law, but is the phrase used to describe contract clauses that set out what should happen if a party becomes unable to perform its obligations because of events beyond its control.

Force Majeure under English law therefore depends on whether the affected contract contains a Force Majeure clause and on how that clause is drafted. There are, however, a number of issues that commonly arise.

Is the obstruction to performance covered by the Force Majeure clause?

A party wishing to rely upon a Force Majeure clause will need to ensure that it meets all of the requirements of such clause. Two elements in particular need to be considered: (i) whether the nature of the event falls within the definition of a "Force Majeure event" in the relevant contract; and (ii) the extent of the obstruction it causes to contractual performance.

Effective Force Majeure clauses will define what constitutes an event of Force Majeure. This may take the form of a generic definition of an event which prevents a party from performing. It may include one or more lists of the types of events that will be considered Force Majeure, and such lists may be exhaustive or may be provided as illustrations of categories of events.

A party wishing to claim Force Majeure will need to confirm that the definition in its contract will cover the measure or event that has obstructed its performance. It will not usually be sufficient to rely upon general disruption, but in most cases a particular event or restriction which directly impacts the party's ability to perform will need to be identified. For example, this may be a particular outbreak of COVID-19 that directly impacts its staff, or a particular government restriction that causes its operations to be obstructed or stopped. Similarly, the requirement that a Force Majeure event be beyond the control of the parties typically means that a restriction imposed by the party on itself will not suffice, but this may differ depending on the precise wording of the clause or if the party had no reasonable alternative to putting the restriction in place because of external concerns.

---

1 *Paradine v Jane* (1647) Aleyn 26.

Some clauses may also require that the particular event or measure could not reasonably have been foreseen and avoided by the parties. This may require parties to consider whether it would have been reasonable in the context of the particular contract for the affected party to have made plans for a potential virus pandemic, and whether such plans would have avoided the obstruction concerned. Some commentators have suggested comparisons to previous virus outbreaks such as SARS, H5N1 and MERS, although caution would be needed with such comparisons as the scale and spread of those viruses differed around the world.

The second question is whether the extent of the obstruction is sufficient to constitute Force Majeure. Again, this depends on the precise wording of the particular clause.

Many clauses require that performance is "prevented" or made "impossible" by the event. In such case, the party will typically need to show that it has become physically or legally impossible to perform its contractual obligations: it may not be enough in such cases that performance has become more onerous, that the party's costs have increased such that the contract is no longer profitable, or that the party is experiencing financial difficulties and so cannot meet its payment obligations on time.[2] Similarly, a particular clause may require the parties to consider whether the contract can still be performed by alternative means—for example, if alternative workers or alternative goods could be sourced from elsewhere—before Force Majeure can be invoked.[3]

Alternatively, the clause may only require that a party be "hindered", "impeded" or "impaired". In that case, it may be easier to invoke Force Majeure, including in circumstances where performance is still possible but has become significantly more onerous. The degree of "hinderance" required in these cases will be determined by the precise terms of the contract, but generally speaking even Force Majeure clauses of this type will not be engaged by obstructions that are only minor. In particular, questions commonly arise as to whether a purely economic impact, such as cash flow difficulties, an increase in costs, or a reduction in profitability for the affected party, is sufficient obstruction to fall within a Force Majeure clause.

What process needs to be followed?

If the Force Majeure clause can be invoked, the parties will need to consider what process is required by the contract to do so. Often, contracts will state that the affected party must give notice in writing, using a particular address and form of communication. Contracts may also require that such notice is given within a particular time after the event which obstructs performance. Where the Force

---

2 *See*, *for example*, *P. J. van der Zijden Wildhandel NV v Tucker & Cross Ltd* [1975] 2 Lloyd's Rep. 240; *Seadrill Ghana Operations Ltd v Tullow Ghana Ltd* [2018] EWHC 1640 (Comm), [2018] 2 Lloyd's Rep. 628 at [70]–[80].

3 *See*, *for example*, *Dunavant Enterprises Inc v Olympia Spinning & Weaving Mills Ltd* [2011] EWHC 2028 (Comm), [2011] 2 Lloyd's Rep. 619 at [29], [32].

Majeure event is continuing, the clause may require the affected party to give regular updates to the other parties, and may set deadlines for such updates.

What is the effect?

The effect of Force Majeure on the parties' obligations will depend upon the terms of the clause. Some provisions relieve the affected party from performance of the relevant obligation in its entirety. Provisions in other contracts, particularly those of long duration, may only suspend performance for a period of time, or extend contractual deadlines for the duration of the Force Majeure event.

Parties should pay particular attention to whether the Force Majeure event affects all of the parties' obligations, or whether some obligations will still need to be performed.

It is also common for each party to meet its own costs associated with any Force Majeure event, but particular contracts may stipulate that this burden should fall on only some of the parties.

Can the contract be terminated?

A Force Majeure clause can also give rise to a right to terminate. Such termination may be automatic, or it may be at the option of one or more parties. Parties should pay close attention to the terms of any such right. Common issues include:

- whether the right arises immediately or only after the Force Majeure event has continued for a particular period, and in the latter case whether it is clear what the start date should be for calculating that period;

- whether a particular form of notice is required;

- whether there is a time limit for the right to be exercised, and what happens if the right is not exercised within this time, yet the Force Majeure event continues for a long period afterwards; and

- in multi-party contracts, whether termination brings an end to the whole contract or has effect only as between certain parties.

Termination of a contract is often a step with significant commercial consequences, and disputes over whether termination rights have been appropriately and lawfully exercised are common. To the extent that there is any uncertainty in the terms of a contract regarding when and how a termination right can be exercised, parties may prefer to engage with each other promptly, rather than waiting until close to any contractual deadlines. Such discussions could be "open", or the parties may prefer to hold them on a "without prejudice" basis.

What happens when the Force Majeure event comes to an end?

The Force Majeure clause may also set out when a Force Majeure event will be considered to have ended, and what the consequences of that will be for the contract. Parties should be aware of the events or circumstances that will trigger a resumption of their obligations, and make sure that they have made appropriate provision to perform again from that date onwards.

Do Force Majeure provisions line up?

For complex projects or transactions involving multiple parties and multiple contracts, parties should also consider carefully whether the Force Majeure provisions in each of the contracts are aligned: i.e., whether a Force Majeure event under one contract will also be regarded as Force Majeure under the remaining contracts in the suite. If there are any uncertainties, again it may be preferable for the parties to try to resolve these issues promptly.

It seems likely that many situations resulting from COVID-19 and the attempts to combat it may constitute "Force Majeure" under many contracts. However, the terms of relevant Force Majeure clauses will need to be checked carefully, and prescribed processes may need to be followed, if affected parties wish to benefit from the relief from performance that they provide.

FRUSTRATION

If a contract does not contain a Force Majeure clause, the common law principle of frustration may apply. Conversely, frustration cannot be triggered by any event that is covered by a force majeure clause.[4]

Frustration can apply under English law where an event:

- occurs after the contract is concluded;
- was not foreseen by the parties;
- is not caused by, nor is within the control of, any of the parties;
- renders further performance of the contract by one or more parties impossible or illegal, or means that performance becomes radically different from what the parties had contemplated at the time of entering into their contract.

Where it applies, the effect of frustration is automatically to terminate the contract. All of the parties are automatically released from their remaining contractual

[4] *Jackson v Union Marine Insurance Co. Ltd* [1874] LR 10 CP 125.

obligations, but the contract is not rescinded and so the parties are not automatically entitled to recover anything that they have already provided or transferred prior to termination. For most contracts, a party that is disadvantaged by this automatic termination may be able to bring a statutory claim to recover a fair value for any benefits they provided prior to the frustrating event, but there are some contracts that are not covered by this statute, and the recovery available may in some cases differ from the amount that the party expected to receive if the contract had continued.

The potentially harsh consequences of frustration mean that English law can be reluctant to find that a contract has been frustrated, and a party seeking to rely upon the doctrine will need to show clearly that obligations have become impossible or radically different to perform. Complex questions can arise as to whether the facts that obligations have become more onerous to perform, that a party's costs have substantially increased, or that a party is in financial difficulty and cannot meet its own payment obligations are sufficient to frustrate a contract. However, in the context of the COVID-19 outbreak and the widespread restrictions and cancellations that it has caused, there may be cases in which frustration will apply.

MATERIAL ADVERSE CHANGE/MATERIAL ADVERSE EFFECT

In addition to Force Majeure clauses, modern commercial contracts frequently include provisions for a Material Adverse Change or Material Adverse Effect ("MAC"), often referred to as "MAC Clauses". Such clauses may in particular be found in English law finance agreements, where the occurrence of a MAC will typically entitle a lender to accelerate repayment obligations.

As with Force Majeure clauses, whether a MAC clause will be triggered by the COVID-19 pandemic or measures taken against it depends upon the wording of the particular clause. English courts have previously indicated that a MAC clause often will not be triggered by events that are merely temporary,[5] but whether the COVID-19 pandemic will have impacts of sufficiently long duration to engage such clauses remains to be seen. The consequences of a wrongful attempt to exercise a MAC clause may involve significant liability for the exercising party itself, and may also affect the party's reputation. Parties wishing to exercise a MAC Clause should therefore consider their contract carefully, and they may wish to obtain external advice.

* * *

[5] [2013] EWHC 1039 (Comm).

To discuss any of the issues in this update further, please feel free to contact us through your regular Debevoise contact or using the contact details provided below and on the Debevoise Coronavirus Resource Centre.

LONDON

Christopher Boyne
cboyne@debevoise.com

Tony Dymond
tdymond@debevoise.com

Lord (Peter) Goldsmith QC
phgoldsm@debevoise.com

Gavin Chesney
gchesney@debevoise.com