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Frustration of Contract and Force Majeure Clauses in a Pandemic

Every sector of the economy in the UK and abroad is facing unprecedented challenges arising out of the current Coronavirus (Covid-19) pandemic. This update looks at commercial and supply chain contract issues.

In normal circumstances once a contract is entered, the fact that it becomes difficult, or unprofitable to perform, will not mean that the affected party can walk away from their obligations. A failure to perform a contractual obligation would usually lead to a claim for damages. This can potentially include claiming for higher costs of engaging a different person to perform the obligations.

However, these are clearly not normal circumstances. The current Covid-19 pandemic could lead to contracts either being "frustrated" or to parties relying on "force majeure" clauses, if the contract contains them. In many instances, discussion and agreement between the parties may well be a more pragmatic and sensible approach than rigidly applying either the doctrine of frustration, or relying on force majeure clauses, without looking at other options first.

Force Majeure

Force majeure clauses are often different in scope and effect in different contracts. The term "force majeure" itself has no precise meaning in English and Welsh law. Not every contract has such terms included, and the extent, meaning and operation of the clauses can differ markedly between different contracts. However, in broad terms, a force majeure clause will often protect a party which is unable to comply with its obligations from the usual consequences of noncompliance. It may, or may not, also affect the obligations of other parties to the contract or give one or all parties additional rights under the contract.

Whether you, or your contracting party, is entitled to rely on a force majeure clause will require careful review of the meaning of what amounts to a "force majeure event" and the trigger conditions. Simply because the current pandemic is occurring, does not necessarily mean that a party can rely on this clause to excuse performance or terminate the contract. For example, if this pandemic has not, in fact, prevented your contractor carrying out their tasks, they could not (or should not!) seek to rely on such terms to escape a contract in reality because it is simply a bad bargain, or because they wish to seek lower obligations or higher terms of payment.

However, in all circumstances the wording of the contract itself will be crucial. There is a marked difference between "impossible" to perform and "hindered or delayed" in performance. Different clauses provide for different meanings of what is a force majeure event, and it may not be immediately clear whether the term can be relied on even in these unusual times.

If you, or a contracting party, wish to rely on any force majeure clauses you should ensure that the relevant terms (including on how and where to give any required notices) are complied with.

Frustration

The English and Welsh courts have historically been reluctant to find that contracts are "frustrated". The law allows this doctrine to be relied on when it is physically or commercially impossible to fulfil the contract, or where events have changed the nature of obligation to perform into a radically different obligation. The fact it is difficult or more expensive to carry out obligations is not sufficient to engage this doctrine. The High Court recently held that the European Medicines Agency's 25-year lease of premises in Canary Wharf was not frustrated by the UK's departure from the EU.

Where a force majeure clause provides for the situation which has arisen, it will not be possible to rely on that situation as frustrating the contract, rather the parties must proceed under that clause. It is also not possible to rely on a situation which was known to the parties at the time of entering into the contract as frustrating the contract – the situation must be one which was outside the contemplation of the parties when the contract was formed.

There is no such thing as a "temporary" frustration of a contract. Once the contract has been frustrated it is discharged forthwith. Therefore, if a party incurred obligations before the time of frustration, it remains bound to perform them, but neither party may claim damages or other remedies for the other's non-performance of future obligations.

The effects of a contract being frustrated are not the same for every contract as these depend on whether the Law Reform (Frustrated Contracts) Act 1943 applies, or whether it is a contract to which the "common law" (non statute law) applies. For most commercial contracts this Act will apply, but not for all.

Under the Act, unless matters can be resolved by agreement, it will be for a court to determine exactly what sums paid before the frustrating event may be recovered, and what value for works already carried out should be retained or paid for (a "just sum").

In the event of difficulties in the performance of contracts, we would expect that most parties will act responsibly with one another to find solutions to the present unprecedented events. In most instances, expensive litigation over delays and difficulties in present conditions providing the potential for damages in the distant future are unlikely to be the first choice for commercial parties, particularly where there is the expectation of future co-working. It may be appropriate to delay the commencement of a contract by way of a standstill agreement, or negotiate variations to the parties' obligations, rather than seeking to proceed under the strict contractual terms or to terminate contracts in reliance of force majeure provisions or the doctrine of frustration.

If you require assistance understanding your particular contracts, requirements and rights Hempsons would be happy to assist.