

Covid-19 : Commercial contracts and cancellations

Guidance for businesses regarding the effects of Coronavirus on business contracts

Given the substantial disruption being faced by the majority of businesses, we offer the answers to some frequently asked questions regarding the contractual position that many businesses may find themselves in during the current lockdown.

Many businesses are wondering if they can be relieved from their contractual obligations if they are unable to perform them due to the effects of the coronavirus. Common mechanisms to seek relief from the performance of contractual obligations in such a situation are through reliance on a force majeure clause or the common law doctrine of frustration.

Force Majeure

Q Does your contract have a force majeure clause?

A force majeure clause generally excuses one or all parties from performance of the contract in some way following a particular event which makes fulfilling their obligations impossible.

A force majeure event is an event, act or some other circumstance which occurs that is beyond the reasonable control of the parties to the contract. Examples may include natural disasters, industrial action and a pandemic.

Q Is the coronavirus pandemic covered by the force majeure clause in your contract?

Parties should check whether their force majeure clause specifically covers pandemics such as the coronavirus or, if it does not, whether the effects of the coronavirus are the type of events that would fall under the force majeure wording.

A party seeking to rely on a force majeure clause must prove that the event falls within the scope of the clause and that their non-performance is a result of this event.

Furthermore, parties should look closely at their force majeure clause as generally a force majeure clause requires the defaulting party to show that they have exhausted all reasonable endeavours to prevent the force majeure event from affecting performance of their obligations.

Q So, what are the effects of implementing your rights under your force majeure clause on your contract?

This will depend on how the clause has been drafted. Common effects are suspension, non-liability and termination.

Suspension

If the force majeure clause provides for suspension, this results in the contractual obligations being suspended while the force majeure event continues. When the event comes to an end, the contract will continue.

Non-liability

A force majeure clause will generally allow the non-performing party to bear no liability for not fulfilling their obligations until the event comes to an end.

Termination

A force majeure clause may be drafted in a way to allow one or all parties to serve notice terminating the contract, either immediately or after a certain period.

Therefore, a force majeure clause could firstly suspend obligations for a certain period and if this period passes, and the effects of the coronavirus are still resulting in a party being unable to perform their obligations, a party may be able to terminate the contract.

Q What should your next steps be?

We suggest businesses take a close look at their force majeure clauses and engage in discussions with the other parties to the contract as soon as possible if they believe their contract may be impacted by the effects of the coronavirus, particularly if the force majeure clause allows for termination of the contract after a certain period.

Q What happens if your contract does not have a force majeure clause or if the clause does not cover pandemics or the effects of the coronavirus?

You may be able to rely on the doctrine of frustration.

Frustration

Q What's the difference between force majeure and frustration?

Similar to force majeure, the common law doctrine of frustration provides that a party or parties to a contract may be relieved from their obligations to perform if an event occurs which makes it impossible to perform the contract. However, unlike force majeure, where a contract is frustrated, the contract is automatically terminated.

Q When can the doctrine of frustration be applied?

The test to enable a party to rely on frustration is high and generally, a party must prove that the frustrating event goes to the root of the contract and is beyond what was contemplated by the parties when they entered into the contract.

For example, the contract may require a party to deliver certain goods however, due to the lockdown imposed by the UK government on 23rd March, such delivery is no longer possible and therefore frustration may apply.

It is extremely difficult to prove that a contract has been frustrated.

Q Are there any consequences if a party relies on the doctrine of frustration?

If a party relies on the doctrine of frustration and terminates the contract, there could be detrimental consequences to the party in question if it is found that frustration does not apply, and the contract has therefore been wrongly terminated. Consequences could include being sued for damages and the relationship between the parties breaking down irretrievably.

Q What happens to the parties' obligations if the contract is found to have been frustrated by the coronavirus?

The parties to the contract are discharged from any future obligations they may have under the contract. It is important to note that any obligations under the contract which occurred before the frustrating event remain and the parties are still liable to perform these obligations.

Finally, parties may have contractual remedies other than force majeure and frustration. We recommend parties check the contract in full or ask their legal advisor to do so.

Q What steps can we take to mitigate the effects of the coronavirus on our contracts?

We recommend businesses review their contracts to identify whether or not they contain force majeure clauses and if these clauses specifically cover a pandemic or alternatively, whether the effects of the coronavirus on the contract in question are covered by the general force majeure wording.

After this, we recommend clients familiarise themselves with how the force majeure clause operates and whether it imposes any particular time limits.

If no such force majeure clause exists, parties may be able to rely on frustration to terminate the contract. We would recommend in this instance you contact us to discuss frustrating your contract.

For further guidance and support, you can contact:

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