20 March 2020

We are all now feeling the damaging impact of the rapid spread of the coronavirus (Covid-19) pandemic. This includes businesses who are seeing unprecedented effects across their operations, including through their supply chains.

Disruption in global supply chains may mean that businesses are unable to supply their customers, which poses a real threat to corporates.

Businesses will then be looking to their contracts to understand what happens if: (a) they cannot perform and/or (b) their counterparties cannot perform (or say they cannot).

In particular, can you or your supplier rely on a force majeure clause or the common law doctrine of "frustration"?

**Force majeure! Step by step**

1. Get the contract. What the contract says is really important. Force majeure clauses do vary. The application of the specific words to the precise facts is crucial - every case is different.
2. What law applies? The impact of a force majeure event will depend on the governing law. This note is for contracts subject to English law only. Each country's laws on force majeure do vary. We have also put together alerts on force majeure in [Canada](#), [China](#), and the [UAE](#).
3. Identify what is causing the supply issue. COVID-19 does not itself usually stop a contract being fulfilled. It is the consequences of COVID-19 which causes problems. For example, is the issue that a factory has been closed due to a government instruction, or is it because of workforce issues due to lockdown/remote working? Identifying what is actually causing problems is important for the legal analysis.

4. What can be done to work round the problem? If a factory in Milan is shut, does the supplier have other factories it can use (or acting reasonably, rent?)? Is it impossible to perform or just more difficult/expensive?

5. Does the contract have a force majeure clause? With no force majeure clause it will be more difficult to claim relief. This means that the person who cannot fulfil the contract could be in breach of contract. If the contract has no force majeure clause then frustration may apply. We have set out a section on frustration below.

6. If there is a force majeure clause then read it! The section below on force majeure sets out what you need to know. To claim relief under a typical force majeure clause you will normally need to work through the following:
   - An event has happened outside the control of the party. This is the specific issue that is hindering performance - see step 3. COVID-19 is not enough. What is the specific consequence of COVID-19 that is causing the problem?
   - What is the impact - how is it hindering performance? Is it merely inconvenient (not a force majeure) or does it make performance impossible or "radically different" form what the contract envisages (more likely to be a force majeure) or is it a shade in between.
   - Could the force majeure event be reasonably anticipated? For many contracts entered into before January 2020 then COVID-19 issues could not have been anticipated. But it would be more difficult to claim that COVID-19 issues could not have been anticipated for a contract entered into mid-March 2020. This is important as if COVID-19 issues could reasonably have been anticipated, then relief for force majeure is probably not available.
   - What can be done to overcome the force majeure event? You will need to use reasonable endeavours to overcome the force majeure impacting your performance.
   - Tell the other party. Many contracts expressly require the party impacted to tell the other party within a specified timetable. Even if no express requirement it will be challenging to claim relief for a force majeure without telling the other party.

7. If there is a force majeure event, do read the payment arrangements to work out whether payments are due or not. The position will depend on the detail of the contract. You will want to understand the payment impact before claiming force majeure.

8. Read the rest of the contract. You may have other responsibilities (e.g. initiate a business continuity plan) or rights (you may be able to terminate or alter the price regardless of the force majeure).
9. Do not sit back. Once you have called a force majeure you need to keep trying to overcome the force majeure.

10. Consider if you have any relevant insurance.

We explain force majeure and frustration in more detail below and also set out some frequently asked questions (FAQ's).

**A cautionary note**

Force majeure clauses and the doctrine of frustration are deliberately intended to be invoked only in extreme circumstances. Your counterparty may also resist your doing so. If you terminate the agreement when you are not entitled to that will be a wrongful termination which will entitle the other party to bring a claim against you for its losses, which is most likely to be in the form of a claim for damages. Also consider the impact on future business relations in seeking to rely on force majeure - what will the consequences be in 6 months' time. It may be overall better to seek and agree a compromise (say, to defer delivery) than to call force majeure or claim frustration.

**Legal overview - force majeure**

**Jurisdiction**

Force majeure is not a general concept with a standard meaning under English common law - this differs to the position in some other jurisdictions (such as China), so you should check the governing law and jurisdiction of the contract first. In a contract governed by English law, whether or not a party can claim relief for a force majeure event and what constitutes a force majeure event depends on the terms of the contract itself. If there is no force majeure clause, relief for force majeure will not generally be available. Frustration might instead be available - see below.

**Definition**

If the contract does include a force majeure clause, the definition of force majeure will need to be considered carefully to assess whether Covid-19 and, in particular, whether the impact that COVID-19 is having on your or your supplier’s ability to perform is covered.

Most clauses will define force majeure as "an event outside of the reasonable control of a
party”. They may then specifically refer to various events such as war or Act of God, or, more relevant here, "epidemic" or "pandemic" or "quarantine". In a normal force majeure clause it does NOT need specifically to refer to an epidemic, or pandemic or quarantine to be a force majeure event - the key question is usually whether it is outside the reasonable control of a party.

Although COVID-19 is almost certainly for most contracts an event outside the reasonable control of a party that is not enough. COVID-19 itself will probably not hinder performance, it is the consequences that matter. A government decree which is legally binding ordering a factory shut is almost certainly for a pre-2020 contract an event outside the reasonable control of the parties. Mere non-binding government advice to close a factory might not be.

Most force majeure provisions then go on to say that such event has to "prevent" or "materially affect" a party's ability to perform. There may also be requirements to take steps to mitigate the effects of force majeure (and if no express requirement the courts will still expect the affected party to try to limit the impact). It is these provisions that may well prove the stumbling block for parties seeking relief. Where it has become impossible to perform the contract (e.g. because it is illegal), then it will be much easier to claim force majeure. Commercial considerations such as increasing costs (e.g. due to having to engage more labour or using different means of transport) do not, in themselves, prevent performance and are unlikely to be covered by the provisions. In fact, a party may actually be required to take such measures if there is a contractual duty to mitigate.

There are shades of grey to this depending on the circumstances - if an entire workforce is not available because they are severely ill, or self-isolating, that might be force majeure, but a moderate proportion of work force being unavailable might not be.

Bear in mind that the question is whether performance has been materially affected or prevented (or whatever it is that the clause requires). This means that just not wanting to perform is not enough. Buyers may want to cancel orders as they have a drop in onward demand, however a drop in demand for products due to COVID-19 is most unlikely to be a force majeure event - COVID-19 does not prevent the buyer paying for the products it has contracted to buy.

Another potential obstacle is whether the impact of COVID-19 could reasonably be anticipated. This will depend on when the contract was signed. It is unlikely that the parties to a 2019 contract could reasonably anticipate COVID-19 and the measures that have been introduced. However, if a contract was signed in mid-March 2020, it is probable the courts would consider it should have been reasonably anticipated, and be less likely to allow relief.
**Notice**

Check the notification requirements in the clause. Force majeure provisions often require immediate or prompt notice to the other party and a failure to do so might mean a party is then barred from relief.

**Consequences**

You also need to check the consequences of a force majeure event - it may allow a party to terminate after a sustained period or be relieved from performance temporarily, or both. Alternatively it may just relieve liability for breach (effectively the same outcome but legally different).

**Interaction with payment**

The usual starting point with force majeure is working out whether an issue with the supply of goods or services is a force majeure event.

But also consider what happens on payment. Normally payment is conditional on supply of the goods or services. But that is not always the case. There may for example be a fixed cost that is paid regardless of performance (or for example minimum volume obligations). Therefore it is important to carefully consider the price and payment arrangements.

**Legal overview - frustration**

Frustration is a doctrine which may - in very limited circumstances - be available to parties in an English law contract that contains no express force majeure provisions. Where there are force majeure provisions, Frustration is unlikely to be available as the Courts will determine that the parties have already considered and made express provision for this risk.

**Test**

The threshold for proving Frustration is high. In order to be able to claim Frustration there must be an event which occurs after the contract is formed and which:

1. Is fundamental to the contract and was not contemplated by the parties when the contract was formed.
2. Is not due to the fault of either party.

3. Results in performance being impossible, illegal or makes it radically different to that contemplated by the parties when the contract was formed,

Examples of events to which the doctrine may apply (as seen by cases) include destruction by fire of a venue at which events were to be held[1] and the cancellation of an expected event (such as the postponement of King Edward VII’s coronation[2] - although there is debate whether that case would be decided differently in the 21st Century).

Frustration is therefore not going to be available where, for example, there are simply changes in economic conditions or just as a result of a contract being more expensive to perform.

Normally the high test for frustration is not met, and this is why force majeure clauses are common. However certain consequences of COVID-19 might reach the bar. If the government has passed a law closing all venues then it has become impossible for the venue to open and therefore the venue hire agreement will likely become frustrated. Therefore unlike many other events of force majeure nature we may see that contracts are genuinely frustrated, at law, by COVID-19 issues.

**Consequences**

Frustration means that the contract is automatically terminated immediately and the parties no longer have to perform future obligations.

**FAQs**

- **We are a parts manufacturer, the government has made us shut our factory indefinitely so we cannot manufacture parts to supply to our customers.**

Although you would need to look at the specific terms of the force majeure clause in the contract, if the factory is your only means of manufacturing the relevant parts, this is likely to be a force majeure event.

Check the contract for the notice requirements and the consequences of force majeure (e.g. can you or the customer terminate and when - or does the clause just excuse liability for a default whilst the force majeure event continues); and, if a termination, what does the clause say about payment?).

If there is no force majeure clause, if the factory is the only means of manufacturing the goods,
it is also possible that the contract has been frustrated. This is because having a factory in which to manufacture the goods is fundamental to the contract, closure is not the supplier's fault and performance would be radically different to that contemplated by the supplier when it entered into the contract.

If you do have other means of manufacturing the goods, such as other factories which are viable/still open for business, it is less likely that you will satisfy the requirements of the force majeure clause or the doctrine of frustration. You will need to try to fulfil using those alternative means. And this might include not just other factories that you own or already rent from which you could manufacture, but other factories that you could, acting reasonably, now rent or access – that said, obviously with Covid-19, any government decree is likely to apply across all of the UK.

- **We are a customer in the retail sector, sales have dropped and I want to cancel orders from some of our suppliers.**

You should look at the relevant contracts to see if you have the contractual right to cancel orders irrespective of force majeure, as there may be a simpler way to cancel.

Otherwise, unless the force majeure clause (if there is one) specifically addresses falling demand from your customers in these circumstances, it is very unlikely that this will constitute force majeure as the drop in sales does not prevent you honouring your orders.

Frustration will not be available here, as again, honouring your orders is not impossible.

You will need to seek a negotiated arrangement with the suppliers, asking suppliers to share your short term pain in return for a longer term opportunity.

- **Can we pass our increased costs on to our customers?**

This depends on the terms of the contract.

Start by considering the position if there was no force majeure. If the price is fixed then the supplier will be stuck. However if the price has an open book element (e.g. fixed cost plus transport costs) then the price may well adjust.

Alternatively look at the force majeure clause. Normally each party bear its own costs. However sometimes the force majeure provisions may specify whether you can pass on your extra costs and expenses incurred as a result of force majeure.

All of that said, an increase in costs is very unlikely to allow for force majeure (absent very clear wording in the clause) or frustration.
We supply various healthcare products and are seeing unprecedented increased demand for our products. In most of our customer contracts we have various volume related incentive mechanisms such as rebates. Can we use the force majeure clause to scrap the rebates?

The simple answer to this is no; and the long answer is almost certainly not - force majeure clauses are not drafted or intended for use to improve the commercial terms of a contract for a party. Frustration will not be available as there is no issue of radical difference or impossibility of performance.

Contact us if you have any questions.


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