

## Contracts and Commercial Law – Covid-19

### Contractual position

English law contracts that require ongoing performance are, in principle, absolute; that is, a party affected by the Covid-19 outbreak is required to perform its obligations and will be potentially liable to its counterparty for a failure to do so.

There are two key exceptions to the rule: the operation of any **force majeure** clause in a contract; and the common law concept of **frustration**.

**Force majeure.** The clause buried in the back of the contract. The purpose of a **force majeure** clause is to excuse a party from performance of the agreement following the occurrence of an event beyond the reasonable control of the party which has hindered performance or made it impossible. It will also determine whether the agreement continues, is **suspended or is terminated**.

Where a contract contains a force majeure clause, it will usually deal specifically with how the parties' obligations are affected by an event that affects one of the party's ability to perform. Force majeure clauses differ, so the particular clause will need to be considered. However, key factors to consider include:

- Whether the Covid-19 epidemic is specifically covered as a force majeure event in the contract (doubtful). Even if it is covered, other requirements may still need to be satisfied to constitute force majeure.
- If the Covid-19 epidemic is not specifically covered as a force majeure event, whether it is the type of event that would fall under general force majeure wording, or whether there has been a government decision or administrative action preventing performance that meets the political interference language which is commonly included in definitions of force majeure.
- Whether the contract excludes events that could have reasonably been provided against, avoided or overcome. If so, some commentators have suggested that this could require comparison with actions taken after the SARS coronavirus outbreak in 2003. The word "reasonably" will need to be considered objectively in this regard.
- Whether causation has to be established. The party that is seeking to rely on force majeure must usually establish that the force majeure event has prevented or hindered it from performance of the contract. This is mostly a factual question but, again, will also turn on the exact wording of the clause. For example, some force majeure provisions require performance to have been rendered impossible, so the burden on, for example, a contractor to show that it could not have sourced staff, equipment or materials from elsewhere will be high. Generally, force majeure clauses are not so generous as to offer relief where services or goods will simply be more expensive to perform or obtain.

- What mitigation duties apply. The party that is claiming force majeure relief is usually under a duty to show that it has taken reasonable steps to mitigate or avoid the effects of the force majeure event.
- What notice requirements apply. Parties will wish to ascertain whether prompt notification is a contractual condition precedent to relief or not.
- What the consequences of establishing force majeure are. In most contracts, establishing force majeure will lead to relief from performance, thereby avoiding the risk of a default termination, and an extension of time to target dates. Commonly, parties bear their own costs arising from any force majeure delay but there are exceptions where compensation may be payable after a certain duration or certain costs are payable from one party to another. Extended periods of force majeure can lead to a right for one or more parties to terminate the contract. If the parties do not wish this to happen, it is important to engage in discussions sooner rather than close to the deadline. It may be preferable for these to be held on a without prejudice basis.
- The impact on the contract of any change in law. In some contracts, decisions or actions taken by governments and public authorities in response to the epidemic may trigger change in law relief and compensation, although often this relief is restricted to changes in law in the project or host country.

**Frustration.** In the absence of a force majeure clause, contract parties might have recourse to the common law doctrine of frustration. This provides that a party is discharged from its contractual obligations if a change in circumstances makes it physically or commercially impossible to perform the contract, or would render performance radically different. This sets a high bar and the courts have confirmed that the circumstances where it can be invoked are narrow (*J Lauritzen AS v Wijsmuller BV (The Super Servant Two)* [1990] *Lloyd's Rep* 1).

Undoubtedly, the bar will be reached in some situations arising from Covid-19, for example, where the contract requires performance in a region that is subject to a state-imposed lockdown but, in many other instances, parties will need to refer to contractual force majeure clauses. If frustration applies, the consequences are set out in the Law Reform (Frustrated Contracts) Act 1943, which allows recovery of monies paid under the contract before it was discharged, subject to an allowance, at the court's discretion, for expenses incurred by the other party.

### **Insurance issues**

A business that suffers a loss as a result of disruption arising from Covid-19 should review its insurance to determine if it has cover. Insurance commonly has strict provisions requiring notification to insurers of actual or potential claims within a particular timeframe, together with duties to mitigate loss and to consult with insurers before taking action, and therefore it is key to identify these issues early.

Classic business interruption insurance may not cover Covid-19. Typically it is not sold as a standalone policy but is added to a business's property, or all-risks, insurance programme, and covers loss of income that a business suffers as a direct result of physical damage to insured property. This may mean that an insured's counterparty is able to invoke frustration or a force majeure clause to excuse performance of its contractual obligations, but the insured is unable to claim under its business interruption insurance as Covid-19 has not caused any physical loss.

Businesses therefore need to review their policy wording carefully. Business interruption policies can provide broader cover, often as an extension, for interruption caused by non-physical events, and bespoke contingency cover or events insurance is also available which provides insurance for losses arising from the cancellation, abandonment, postponement or interruption of particular events. If this type of cover is in place, insureds will need to consider carefully the triggers for cover, in particular, whether cover is provided for losses that result from an outbreak of an epidemic or whether these losses are expressly excluded.

Morton Legal

T: 01904 428725

W: [www.mortonlegal.co.uk](http://www.mortonlegal.co.uk)