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Resiling from Contractual Obligations under English Law: *Force Majeure* and Frustration in Tumultuous Times


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Introduction

2020 has been a tumultuous year. Along with COVID-19, there have been a record number of natural disasters, extreme volatility in commodity prices and, in Europe, continued uncertainty surrounding the UK's exit from the European Union ("**Brexit**"). In uncertain times it can become more difficult and sometimes impossible for contractual obligations to be fulfilled, and parties may look to try to be excused from existing obligations and protect themselves from future ones.

This chapter looks at the principles of *force majeure* and of frustration,[1] and when these concepts can be relied upon to bring about the suspension or termination of contractual obligations, looking at recent potential *force majeure* and/or frustrating events to provide context, namely the COVID-19 pandemic and Brexit.

Force Majeure

What is *force majeure?*

Very generally, *force majeure* refers to an event that is external to the contracting parties, unforeseen at the time of contracting, and which has unavoidable effects on contractual performance. In civil law jurisdictions, there are codified principles that dictate the impact of such events on contractual obligations. Under English law, there is no such generally applicable principle; whether and the extent to which a *force majeure* event impacts on contractual obligations depends on whether the contract contains a *force majeure* provision, and precisely what it says. As *force majeure* clauses are a common feature of English law contracts, case law provides guidance on the normal requirements for a valid clause.

Force majeure clauses and *force majeure* events

In general, a *force majeure* clause will set out a list of events, often followed by a catch-all general provision (e.g. "*any other event beyond the parties' control*"), and a description of what the effect of such events will be on the contract.

Force majeure events are generally either natural (e.g. fires, explosions, natural disasters, pandemic/epidemic) or human (e.g. war, riot, strikes, changes in law, terrorism). These events must be expressly stated: a clause that is too vague, for example one providing that the contract is "*subject to force majeure conditions*", may be considered void for uncertainty.

Force majeure events must generally be supervening, i.e. not foreseeable or predicted at the time the contract was entered into, although there is no absolute rule to this effect.

When a *force majeure* clause will, and will not, apply

A *force majeure* clause will usually set out what impact an event is required to have on the contract before it can be considered a *force majeure* event. It is common for clauses to provide that the event must "*prevent performance*", or alternatively "*prevent, hinder or delay performance*" (or such similar formulation). The first formulation imposes a significantly higher burden than the second, requiring performance to be legally or physically impossible; whereas to show hindrance or delay it may be sufficient if performance has become substantially more difficult, albeit it remains possible.

English case law is clear that it is exceedingly difficult for a party to rely on a *force majeure* provision simply because an unforeseen event has made it much more expensive, or even uneconomic, for it to perform its obligations, or has affected the ease with which the obligations can be performed (unless the clause includes "*explicit terms*" to this effect).

A party will generally not be able to rely on a *force majeure* clause if performance is only temporarily prevented or only one means of performance is prevented (unless this is the only means allowed under the contract).

Generally, where a *force majeure* provision provides that a party is to be automatically discharged from future performance if a *force majeure* event occurs, there is no need for the party to prove that they could have performed, but for the event. However, where the provision serves only to excuse the party from its non-performance, and only suspends performance obligations, they may have to prove that they could have performed, but for the event, in order to rely on the provision. This is especially so if the clause provides that the disruption must "*result from*" the event, or that the event must "*directly affect performance*" (or similar).

Invoking *force majeure*

It is common for *force majeure* clauses to set out what a party is required to do in order to invoke *force majeure*. Normally, a party will be required to serve notice of the *force majeure* event and may be required to serve other documents, e.g. those required to evidence that the *force majeure* event has or will affect performance. Often, the clause prescribes when the notice must be served (normally within a short period after the occurrence of the *force majeure* event, even if performance has not yet been affected), to whom, and the precise format. The English courts generally interpret notice requirements strictly, so parties should make every effort to comply and to document their compliance.

Further obligations may also be imposed on the party invoking the clause, for example, to provide periodic updates on their (in)ability to perform, or to try to mitigate the losses arising

from the *force majeure* event. In the absence of express wording, the courts may imply wording to this effect. The steps required will depend on what is reasonable in the circumstances. In practice, this may require the party invoking *force majeure* to consider the "*commercial interests*" of its counterparty, and not only its own interests, particularly whether its counterparty's commercial interests would be best served by it attempting to perform by alternative means. Even where there are no or limited notice requirements, it may nonetheless be advisable for a party affected by *force majeure* to enter into a dialogue with its counterparty to discuss whether alternative means of performance are possible, and appropriate mitigation steps (whilst being careful not to waive any contractual rights).

What happens to the contract once *force majeure* is invoked depends on the wording of the clause. The entire contract, or individual performance obligations, may be automatically terminated. However, it is more common for obligations to be suspended for a prescribed period, or for so long as the *force majeure* event, or its impact upon the suspended obligations, continues. Sometimes, clauses may not specify for how long obligations are suspended, or what will happen if the disruption persists until it makes no sense for the contract to continue. Generally, termination rights will accrue where the *force majeure* event or its impact on performance persists for a protracted period (and frustration may also apply).

Clauses may be silent as to what happens to payment obligations when performance is temporarily impacted. This can cause problems, particularly where the contract provides for regular payments for a continued service, and the duration of the impact is uncertain. Where payment is made in advance of performance, and there is no eventual performance, the paying party should be entitled to restitution, or some *pro tanto* relief, such as abatement or pro-rating of price; but this depends on the contract, facts, and circumstances. It may be that there needs to be apportionment, a review of whether the contracts are severable or not, and the introduction of theories such as unjust enrichment.

A wrongful declaration of *force majeure* is likely, in and of itself, to constitute a repudiatory breach of contract, entitling a counterparty to terminate the contract and/or claim damages for losses arising out of the breach. Further, declaring *force majeure* under one contract may have unintended consequences on other contracts. Particular care must be exercised where there are chains of contracts, as exposure to damages claims becomes greater in these circumstances, particularly where the *force majeure* provisions up and down the chain differ and/or where a party is involved in a chain where others in the chain are acting as their agents.

Frustration

What is frustration?

Frustration is a common law concept that can apply by default to almost any contract governed by English law to bring about the termination of that contract.

When a contract will, or will not, be frustrated

There is no definition of the criteria required in order for a contract to be frustrated. Generally:

(i) performance of the contract must have become impossible, illegal or radically different from that which was contemplated by the parties at the time of contracting (striking "*at the root of the contract*");

(ii) any supervening frustrating event(s) affecting performance must have occurred after the contract was entered into, and not be the product of the default of any party; and

(iii) the contract must not contain any provisions dealing with the impact of the frustrating event(s) on the contract (for example, by way of a *force majeure* clause).

When considering whether a contract has been frustrated, the English courts will adopt a "*multi-factorial*" approach:

"*Among the factors which have to be considered are the terms of the contract itself, its matrix or context, the parties' knowledge, expectations, assumptions and contemplations, in particular as to risk, as at the time of contract, at any rate so far as these can be ascribed mutually and objectively, and then the nature of the supervening event, and the parties' reasonable and objectively ascertainable calculations as to the possibilities of future performance in the new circumstances.*"[2]

The sorts of events that can constitute frustrating events are the same as those that can constitute *force majeure* events, examples of which are listed above.

As with *force majeure*, it is exceedingly difficult for a party to argue successfully that a contract has been frustrated simply because an unforeseen event has made it much more expensive, or even uneconomic, for it to perform, or has affected the ease with which obligations can be performed, or where performance is possible by alternate means to those initially contemplated (unless the contract specifies a means of performance that has become impossible).

Even more so than is the case when trying to rely on *force majeure*, proving frustration is difficult because the court will take as its starting point that (i) the parties have already allocated the risk of the relevant supervening event(s) within the contract itself (in which case the event(s) cannot be said to have frustrated the contract), or (ii) the very fact that the parties had the opportunity to so allocate the risk but chose not to means that the parties intended for the risk to lie where it falls (and it therefore ought to). As such, the bar is high.

Invoking frustration

If frustration is invoked successfully, it brings the contract to an end automatically and all parties to the contract are released from further performance obligations under it, other than those which accrued prior to the frustrating event(s), which must still be performed.

Once a contract is frustrated, losses will generally lie where they fall. That is, unless there has been a total failure of consideration[3] (or where allowing losses to lie where they fall would otherwise result in one party's unjust enrichment), in which case it may be possible for a party to recover prior payments made, or otherwise obtain payments.[4]

As with *force majeure*, a party relying on frustration will generally be required to show that it has taken reasonable steps to mitigate the effect(s) of the frustrating event (which ties in with the general requirement for frustrating events to be beyond a party's control).

Application to Recent Events

COVID-19

The question of whether COVID-19 is a *force majeure* event will depend on the wording of the relevant *force majeure* clause. If the clause lists pandemics, epidemics, or diseases, then COVID-19 is, in principle, capable of being a *force majeure* event. In our experience, it has been relatively rare for commercial contracts to

contain such wording, and parties have sought to rely on more general formulations; for example, references to "*Acts of God*" or "*any other event beyond the parties control*".

However, for most commercial contracts it will not be COVID-19 itself which has affected performance but rather some by-product, such as government action through lockdowns or orders, states of emergency, shortages of supplies, unavailability of workers, and/or an inability to travel. If that is the case, a party seeking to invoke *force majeure* will need to analyse carefully what precisely has affected their capacity to perform, and review the applicable *force majeure* clause in light of this.

This analysis can be complicated. For example, where businesses have taken decisions as a result of COVID-19 but in advance of formal government restrictions (for example, cancelling events or closing factories due to concerns for the safety of attendees/staff), they may face difficulties in arguing that COVID-19 itself was the event which actually prevented, hindered or delayed performance (as the case may be), rather than their election not to perform. So too if businesses have merely followed recommendations of government which are not backed up by statutory (or other) provisions forcing compliance. Further, "*impossibility*" may well change over time depending on the nature of the constraints imposed, in circumstances where these are changing in many countries on a daily basis.

Parties seeking to resist a counterparty's reliance on COVID-19 as a *force majeure* event may try to argue that the pandemic was generally foreseeable, or that its impact on performance was foreseeable as at a specific moment in time. It remains to be seen how the English courts will treat these types of arguments.

In the absence of applicable *force majeure* wording, the relevant considerations as to whether COVID-19 is capable of frustrating a contract are similar to those for *force majeure*. In principle, COVID-19 could be a frustrating event for contracts entered into before the COVID-19 pandemic emerged, or before its impact on performance was foreseeable, howsoever defined (if the contract was entered into after this point, it will be difficult to claim frustration). Certainly, where government restrictions have directly rendered performance impossible or illegal, frustration is arguable.

However, a party invoking frustration needs to be confident that it is COVID-19 itself (or legislation arising directly out of it) which has affected performance, and not a by-product, which may fall outside of scope (or be covered by existing contractual provisions). Similarly, if the only impact is to make performance more costly or difficult, that will not normally be enough; and so, for example, increased tariffs on goods or new checks or delays on goods crossing borders are unlikely to suffice (unless such delays are so abnormal as to fall outside the scope of anything contemplated at the time of contracting, which in part will depend on what is normal in the given industry; double-to-triple time delays in construction, for example, are not generally seen as extreme). It is also critical to consider whether COVID-19 has only prevented one method of performance; if so, the contract is unlikely to have been frustrated, even if other possible performance methods are more difficult or expensive to pursue.

Parties should have these sorts of considerations in mind each time there is a material change in circumstances arising out of the pandemic, for example, as regulations change in response to subsequent "waves", to ensure that their response remains appropriate. This may necessitate new or repeated declarations of *force majeure*, or a resumption of performance. Some contracts may provide termination rights only if multiple periods of *force majeure* disrupt performance for a specified period, and the cause of the disruption may also need to be the same throughout.

It is advisable to document decisions taken regarding *force majeure*, frustration, and mitigation (including why certain steps were considered but discounted), as this may prove helpful if faced with a later challenge. However, it is equally important not to create documents that might prove unhelpful if disclosed in later proceedings (for example, those discussing missed mitigation opportunities) and to maximise protections afforded by legal professional privilege, if applicable.

As there is no prescribed format for a *force majeure* clause, there is scope for creative drafting to ensure that provisions remain relevant as circumstances change. Therefore, parties who have found their existing *force majeure* provisions have not adequately protected them during the COVID-19 pandemic may wish to consider, when entering into new contracts, whether to amend their standard provisions, or draft new bespoke provisions that better respond to the specific disruptions they have experienced or envisage potentially experiencing as a result of COVID-19, including where the nature of these disruptions may be intermittent or uncertain. For example, it may be possible to draft a *force majeure* clause to respond to future government measures taken in response to COVID-19, whatever form these measures take.

Brexit

As with COVID-19, the question of whether "Brexit" is a *force majeure* event will depend on the wording of the relevant *force majeure* clause. Many of the considerations are also the same, and these are not repeated here. However, Brexit also poses novel problems.

In our experience, it is rare to see contracts that were entered into before the Brexit Referendum in the UK that specifically list "Brexit" as a *force majeure* event (and even if Brexit is listed, there is uncertainty as to what it means, and even when it did, or will, occur!). Therefore, parties seeking to invoke *force majeure* as a result of Brexit will likely have to construe Brexit, or more accurately the relevant by-product of Brexit affecting performance, as falling within the scope of other terms, or catch-all wording.

This is likely to be difficult, especially for contracts entered into after the Brexit Referendum, as counterparties will have a strong argument that from (at least[5]) this point, Brexit was a foreseeable event, and if the parties to the contract had wanted to make it a *force majeure* event they would/should have included it expressly in a *force majeure* clause, or otherwise provided for how it would impact on the contract.

Relying on Brexit as a frustrating event may be more advisable. This is especially so if an effect of Brexit is to make a contract illegal to perform; for example, because a decoupling of English and EU regulation makes it illegal to sell a product that is the subject of the contract into an EU Member State. In this case, if performance under a contract would be unlawful under English law, an English court is very unlikely to find that the party is obliged to perform. However, when it comes to illegality under foreign law (such as that of an EU Member State), the general rule is that a contract governed by English law will not be frustrated or terminable if a change in foreign law renders that contract unlawful as a matter of foreign law. While several exceptions may be applicable, including if the obligation is specifically required to be performed in an EU Member State in which that performance would be illegal, the question of the impact of illegality is more complex and nuanced than is often assumed and requires careful consideration.

It may also be possible to rely on Brexit as a frustrating event where an effect of Brexit is to make a contract impossible to perform. However, once again it is important to remember that the English courts set a high bar when considering impossibility. This was made clear in the first English case to grapple with the issue of Brexit as a frustrating event: *Canary Wharf v European Medicines Agency* ("**EMA**").[6] Here, the EMA, an agency created by EU law with the function of facilitating patient access to medicine, and at the time headquartered in London (and due to move to Amsterdam), argued that Brexit would give rise to a supervening illegality which would frustrate its lease (governed by English law) of office premises in London, and sought a declaration in these terms allowing it to cut the lease short. Part of the EMA's argument was that it would not be able to perform because it would be prohibited by EU law from occupying the premises, as it would be situated in a non-EU country.

However, the court found against the EMA on three principal bases:

- First, it found that the EMA would not lack capacity to occupy the premises or otherwise perform its obligations under the lease, notwithstanding that it accepted there were many and good (but irrelevant) reasons why the EU would not want to headquarter one of its institutions outside the EU, and as such there was no supervening illegality.
- Second, even if EU law did prohibit the EMA from occupying the premises or performing its obligations, this supervening illegality was not capable of amounting to frustration because it would not arise under the governing law of the contract or render performance of the obligations illegal in the place of performance.
- Third, even if Brexit could amount to a frustrating event, the court found that this would have been self-induced and therefore insufficient, as it was the EU itself that moved the EMA's seat from London to Amsterdam.
- Additionally, it was important that it had been foreseen in the lease that the EMA might involuntarily need to leave the premises during the term, and there were provisions covering this.

This case is likely to be a key source of guidance for Brexit-related disputes in the coming years, relied on in particular by those arguing that Brexit does not frustrate a contract.

Conclusion

Many of the events of 2020 will have a long-lasting impact, affecting contracts and contractual obligations for many years to come. Parties should regularly monitor whether they or their contractual counterparties are at risk of not being able to perform their obligations. If this is the case, careful consideration is required of the contracts affected to identify what options are available to mitigate the impact of non-performance and to minimise any attendant liabilities. One option may be to declare that there has been a *force majeure* event, or that a contract has been frustrated; however, it should be remembered that the English courts set high thresholds for these and a wrongful declaration/assertion can have damaging implications. In general, precisely how an event has affected performance under a contract is of paramount importance.

Endnotes

1. Alongside *force majeure* clauses, other terms may also be relevant in the event of unforeseen circumstances, most obviously material adverse change clauses, but also terms relating to limitation of liability, costs sharing, price reopening, or change of law.
2. *The Sea Angel* [2007] EWCA Civ 547; [2007] 2 Lloyd's Rep 517 at [111].
3. For example, where payment is made in advance under a sale of goods contract, and no goods (or other value) has been received by the buyer by the time the contract is brought to an end.
4. For example, in respect of valuable benefits already conferred, under the Law Reform (Frustrated Contracts) Act 1943.
5. Whether the UK's withdrawal from the EU was a foreseeable event as at 5 April 2011 was at issue in *Canary Wharf (BP4) T1 Limited and others v European Medicines Agency* [2019] EWHC 335 (Ch). The court decided that it was foreseeable as a theoretical possibility but was not relevantly foreseeable (in other words, sufficiently foreseeable to meet the legal test for frustration). The issue of whether Brexit was foreseeable at some point after this, but prior to the Brexit Referendum, may need to be determined in another case.
6. *Canary Wharf (BP4) T1 Limited and others v European Medicines Agency* [2019] EWHC 335 (Ch).

Greg Lascelles is an experienced litigator whose practice covers international and domestic commercial litigation and arbitration, with particular emphasis on the financial services sector. Mr. Lascelles has advised on investor and partnership disputes, corporate restructurings and disputes relating to equity, fixed income, interest rate, foreign exchange and commodities products. He has also advised on international arbitration matters, both *ad hoc* and institutional, under the LCIA, ICC, CIETAC and ICSID rules.
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