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**Covid-19 and supervening events in commercial contracts**

  

**Supervening events in commercial contracts**

1. One of the consequences of the global Covid-19 pandemic will be a wave of disputes where one party is unable to perform a contract or a party does not want to pay for performance. The issue will be which party to the contract bears the risks of non-performance as a result of the pandemic and the UK Government’s emergency measures.
2. The law on supervening events can be separated into three categories:
3. force majeure;
4. frustration; and
5. supervening illegality.
6. The starting point for solicitors will be to check the commercial contract for any force majeure clauses. Such clauses should resolve disputes over non-performance caused during the Covid-19 pandemic by contractually allocating the risk and will affect any argument about frustration.

**Force Majeure**

1. Force majeure is used in commercial contracts to describe supervening events, possibly affecting the contract, which are outside of the control of the parties. Such clauses do not have to be expressly labelled “Force majeure” and they are often generic clauses that anticipate that there may be a supervening event, either factual (staff illness during the pandemic) or legal (UK Government restrictions on the transportation of workers and supplies in an attempt to stop the spread of the disease), which may cause non-performance of the contract. Currently, most force majeure clauses will not specifically mention diseases, epidemics or pandemics, but this is highly likely to change in future contracts as a result of the present Covid-19 pandemic.
2. The non-performing party seeking to rely on a force majeure clause will bear the burden of proof to demonstrate:
3. The scope of the clause;
4. That the facts in question fall within that scope;
5. That they had not assumed responsibility for the breach; and
6. There were no reasonable steps which could have been taken to avoid or mitigate the event or its consequences.
7. Force majeure clauses are construed restrictively and are often subject to limitations. For example, a clause referring to delays “howsoever caused” did not cover substantial delays caused by the First World War and was only intended to cover minor delays (*Metropolitan Water Board v Dick Kerr & Co [1918] AC 119*). Similarly, in employment contracts which included a clause that suspended salary when the employee was absent from work due to sickness or incapacity, the clause was not engaged where the employee had a heart attack which lead to permanent disability (*Notcutt v Universal Equipment Co (London) Ltd [1986] 1 WLR 641*).
8. Many of the phrases that regularly appear in Force majeure clauses have been well-litigated. For example, an ‘Act of God’ is said to mean

“*such a direct and violent and sudden and irresistible act of Nature as the defendant could not, by any amount of ability, foresee would happen, or, if he could foresee that it would happen, he could not by any amount of care and skill resist, so as to prevent its effect*”

(*Nugent v Smith (1876) 1 CPD 423*; Cockburn CJ at paragraph 426).

Historically, Acts of God have been linked to natural disasters such as floods, earthquakes and volcanic eruptions. However, given that plagues are mentioned in the Bible as Acts of God (see the 10 plagues of Egypt) and it is arguable that global outbreaks are natural disasters simply with a microscopic rather that meteorological cause, the current Covid-19 pandemic is likely to be covered by the use of this phrase.

1. Many force majeure clauses exclude certain foreseeable and foreseen events. While it is foreseeable that that a highly rare natural or microbiological disaster might occur, the parties cannot have intended such a broad meaning of foreseeability or the force majeure clause would never be satisfied and would have no effect. The more foreseeable the event, the more it might be preventable and avoidable (and remain within the defaulting party’s control). However, the Covid-19 pandemic is not likely to be deemed to have been foreseeable unless the commercial contract was entered into after developments in the Wuhan province began to be reported in the international media, but even then it is likely to be a matter of fact and degree.
2. Compliance with UK Government’s emergency measures in response to the Covid-19 pandemic will be highly relevant when establishing if reasonable steps could have been taken, especially when the performance date under a contract is missed during a time when Government restrictions apply. If the non-performing party has not complied with government guidance or other good practice, then that may debar that party from relying on force majeure. For example, if a company attempts to rely on a force majeure clause in an employment contract that states they do not have to pay their workers during a period that the company is shut-down, but the company then fails to apply to the Government to furlough the employees’ wages during the Covid-19 pandemic, they are unlikely to be able to rely on the clause.
3. The consequences of the force majeure clause will depend on the construction of the clause itself. There will not usually be an automatic discharge of the contract, but the clause may allow the parties to agree to suspend performance or excuse liability for non-performance. If the pandemic was to cause an indefinite suspension of the contract under a force majeure clause, the parties may need to consider whether the contract should be terminated.

**Frustration**

1. Where the contract does not contain a force majeure clause, or the clause does not apply, such that the contract does not itself determine the allocation of risk, it will be necessary to consider the issue of frustration.
2. It may be that the coronavirus pandemic and its societal effects renders a contract commercially impossible (or its operation radically different to what was envisaged at the time of contracting) such that it is “frustrated”. Though a less desirable avenue than reliance on a force majeure clause due to the high thresholds which are required to be met, frustration of a contract does afford a more comprehensive result, namely:
   1. As opposed to force majeure clauses, frustration of a contract does not (in most cases) merely *temporarily suspend* the operation and performance of contract, but rather discharges a contract and, accordingly, the parties’ rights and obligations.
   2. Section 1(2) of the Law Reform (Frustrated Contracts) Act 1943 provides for a claim to be made by a non-defaulting party for money paid to the other party before discharge. Any payments due to be made at the time of the supervening event are no longer payable.
   3. Section 1(2) of the Act also provides an avenue for claims by parties to recover money already spent towards performance of the contract prior to the supervening act.
   4. Section 1(3) of the Act provides for a claim to be made against a party who has obtained a valuable benefit from the other party’s actions in or for the purpose of their performance of the contract, providing for an award reflecting the value of the benefit.
3. That being said, and as foreshadowed, the test to establish a frustrated contract is a high one and generally condensed into the following three statements:
   1. Performance of a contractual obligation must be rendered **impossible** or the operation **radically different** to what was envisaged at the time of contracting due to an unforeseen and supervening event;
   2. The supervening act cannot be due to either party; and
   3. The contract must not provide an appropriate force majeure clause or provide for the allocation of risk arising in the event of the coronavirus pandemic.
4. With regard to condition (a) and in the context of coronavirus, disputes over whether contracts have been frustrated are likely to centre around whether performance is actually rendered impossible. For example, a public house is not likely to establish frustration of a contract concerning the delivery of beer *merely* because it now has a diminished ability to sell it; the contract still being capable of performance in substantially the same manner as that envisaged. Should delivery of the consignment be prevented or prohibited, this may in contrast provide fertile ground for an assertion of frustration.
5. With regard to condition (b), a party wishing to establish frustration is likely to encounter counter-argument that actions could and should have been taken to enable performance of the contract. This is particularly pertinent in the current circumstances where a manufacturer of goods becomes insolvent, impacting the supply-chain. A distributer may encounter difficulties in claiming that eventual delivery of goods to an end-purchaser, pursuant to a contract making time of the essence, has been rendered impossible due to the insolvency of the manufacturer. Should goods be obtainable from an alternative manufacturer within the relevant timeframe, the distributor should take steps obtain those goods to enable delivery in time.
6. With regard to condition (c), notwithstanding the presence of a force majeure clause, parties may still be able to establish frustration. This is particularly the case where such clauses specifically envisage the supervening act or similar, however, “full and complete” provision for the effects of the relevant event has not been afforded (see: *The Florida* [2006] EWHC 1137). Given that most contracts will not envisage pandemics of this nature, and even less so the effects upon the parties’ rights and obligations, there may be much scope in asserting frustration even in matters concerning contracts which include force majeure clauses.

**Supervening Illegality**

**What have the changes to the law been?**

1. The law most likely to affect individuals and businesses is that set out in the Health Protection (Coronavirus, Restrictions) (England) Regulations 2020/350, which came into force on 26th March 2020 at 1pm. These brought into force most of the legal changes that have impacted everyday life.
2. Regulation 4 deals with the closure of restaurants, pubs and bars, but the wider ranging restrictions are in regulation 5:

A business, which is not one of the exceptions listed in Part 3 of Schedule 2, which is offering goods for sale or for hire in a shop, must, during the emergency period:

1. Cease to carry on that business or provide that service except by making deliveries or otherwise providing services in response to orders received-
   1. Through a website, or otherwise by on-line communication,
   2. By telephone, including orders by text message, or
   3. By post
2. Close any premises which are not required to carry out its business or provide its services as permitted by sub-paragraph (a);
3. Cease to admit any person to its premises who is not required to carry on its business or provide its service as permitted by sub-paragraph (a)

This does not apply to any business which provides hot or cold food for consumption off the premises.

1. The list in Part 3 of Schedule 2 is fairly wide, and includes food retailers, off-licences, homeware and building supplies stores, car repair shops, bike shops, banks and post offices.
2. Restrictions on movement are dealt with in Regulation 6, namely that no one may leave the place they are living without reasonable excuse. However, there is a long list of what would qualify as ‘reasonable excuse’. This does not include the requirement for example to carry out one shopping trip a week or exercise for no more than one hour, which have been referred to by Ministers and in the press.
3. Restrictions on gathering are dealt with in regulation 7, namely that, and again subject to exemptions, no person may participate in a gathering in a public place of more than two people.
4. The main point to take away is that there are quite extensive exceptions carved out in the regulations and that they do not necessarily reflect either the public perception or police perception of the law, or what ministers have suggested people should do.

**Supervening illegality**

1. A contract governed by English law is discharged if its performance becomes illegal by operation of English law. However, this is only if illegality *prohibits* performance, it is insufficient for the changes to the law to make performance more difficult. This may well be an important distinction for, for example, small mail order businesses where performance is likely to be more difficult but not unlawful. This means that very careful consideration has to be given to the regulations as supposed to the local conditions which businesses find themselves in (for example the closure of post offices is not legally mandated but might be a local reality).
2. It is important to note that in *Canary Wharf (BP4) T1 Limited v European Medicines Agency [2019] EWHC 335* the court stated that:

“post contractual events and actions which indicate that certain options – that might have ameliorated the frustrating event- have been closed off by the acts or omissions of the party claiming frustration”

will prevent a party from claiming frustration. The simple point here in relation to illegality is that if you seek to rely on illegality careful consideration should be given to the scope of the legislation and its exceptions to decide whether there would be actions that could be taken to either ameliorate loss or perform in a different way.

1. Following *Patel v Mirza [2016] UKSC 42*, to argue that a contract is void for illegality at the time of contracting the court will examine the position as follows:

“it is necessary (a) to consider the underlying purpose of the prohibition which has been transgressed and whether that purpose will be enhanced by the denial of the claim, (b) to consider any other relevant public policy on which the denial of the claim may have an impact and (c) to consider whether denial of the claim would be a proportionate response to the illegality, bearing in mind punishment is a matter for the criminal courts.”

Whether a similar position would be taken to illegality which arises at the time of *performance* as supposed to the time of *contracting* is something that remains to be seen.

1. If it is, then there are some principle based arguments that could be deployed to defend against, for example, the suggestion that a party did not have to pay for performance because such performance was illegal.

**Conclusion**

1. Covid-19 is the worst pandemic that most individuals and companies will have experienced, but it may not be the last. When future commercial contracts are drafted, drafters will have to consider the wording of clauses to prepare for supervening events.
2. This briefing note will assist solicitors in settle disputes over which party in a commercial contract bears the risks of non-performance as a result of the Covid-19 Pandemic, but it cannot cover all of the issues that will arise as a result of the pandemic. For further advice on the impact of Covid-19 on commercial contracts, please contact Alice Martin, Civil Team Clerk, on 020 7427 6821 to discuss instructing Counsel.

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