



## COVID-19'S EFFECT ON CONTRACTS - CAN PARTIES ESCAPE THEIR OBLIGATIONS UNDER AGREEMENTS?

The global pandemic, COVID-19, has put businesses in uncharted and certainly unanticipated territory.

As a result of the government's measures, which seek to restrain COVID-19's spread, parties to some agreements may find themselves in a position where they are struggling to fulfil their obligations. In usual circumstances, if a party fails to perform its obligations, the parties may issue proceedings for breach of contract.

However, the current situation could not be further from the norm. As a result, the question on a lot of our clients' minds is "what options are open to parties when one of them is unable to perform its obligations?".

Several of our clients' initial response to such difficulties is, "what about force majeure?". But how does this work in practice, and are there other legal options available to parties who find themselves in this situation?

This article seeks to give a brief overview of three key principles which may be of relevance at the current time:

- a) force majeure;**
- b) frustration; and**
- c) failure of basis** (a form of restitution which is often referred to as 'failure of consideration').

### 1. FORCE MAJEURE

Often, but not always, agreements contain a "Force Majeure" clause. For most businesses, this is likely to be the 'go-to' clause in the current situation. Although very much dependent on its drafting, such clauses relieve you or the other party from any consequences following a failure to perform your respective obligations under the agreement, where such failure arises as a result of events beyond the party's control. It is important to remember that these events must mean that you are genuinely unable to perform your obligation. If the force majeure event just makes it more expensive or difficult to do so, the clause is unlikely to apply.

Just because there is a Force Majeure provision in an agreement does not mean it can automatically be relied upon as a silver-bullet. Force Majeure clauses are carefully drafted and vary in a number of different ways, so they will not always be applicable. For example, the current crisis may prevent a party from carrying out certain obligations (for example, provision of certain types of services or goods), but would not prevent the performance of other obligations (for example, an obligation to make an up-front payment on a set date).

This distinction is often not fully understood by businesses. If a party to a contract is seeking to rely on any Force Majeure clause, it is critical to properly analyse the wording to decide whether it is applicable in the circumstance. Failure to do so could leave a party exposed and at risk of legal action.

## 2. FRUSTRATION

If your agreement does not contain a force majeure clause, the parties may be able to argue that the contract has been “frustrated” as a result of COVID-19 and should therefore be treated as terminated. An agreement is frustrated when an event beyond the parties’ control has rendered it impossible or illegal to fulfil, or results in the proposed performance being radically different from that contemplated by the parties at the time of the contract. If an agreement is frustrated, the contract will come to an end immediately and the parties will be discharged from any future obligations.

Given the magnitude of the implications of this doctrine, frustration can be quite difficult to prove. However, extraordinary events such as COVID-19 may well satisfy the test. For clarity, an agreement may only be “frustrated” where:

- **the frustrating event occurred after the agreement’s execution;**
- **the event is beyond what was contemplated by the parties when entering into the agreement;**
- **the parties are not at fault or responsible for the frustration; and**
- **as a result of the event, it is impossible or illegal for the agreement to be performed, or the proposed performance will be radically different from that contemplated by the parties at the time of the contract.**

If the test can be met, then the agreement will be ended automatically. Remember, just because an obligation is more difficult to perform does not mean that the agreement has been frustrated. Frustration is an extreme remedy and so it comes with a high hurdle to overcome. It is possible that mere delay can be sufficient to frustrate a contract, however there are specific considerations to take into account when deciding whether a delay is sufficient to frustrate the contract.

### **If I have paid money under a frustrated contract, can I get it back?**

The Law Reform (Frustrated Contracts) Act 1943 bites in relation to most contracts in England. If the Act applies, and you have paid or have received money under a contract prior to any frustrating event, the paying party will be due a refund, less any expenses incurred by the party who has received payment in connection with the performance of their contractual obligations.

## 3. FAILURE OF BASIS

A further possibility under the current crisis could be the common law claim for “Failure of Basis” (which has been traditionally known as “Failure of Consideration”). In short, “Failure of Basis” could come into effect where a sum has been paid by a party for the purposes of a transaction, and the receiving party has wholly failed to perform the basis of what was bargained for by the paying party. In such circumstances, the paying party will be able to recover the paid sum.

However, it is important to remember that the agreement under which there has been a failure must have been discharged, and the failure must be total. Therefore, if one of the parties has part completed a service following payment, then any claim for repayment of sums would likely fail.

## CONCLUSION

Whether any of the above remedies are available to parties can be very fact specific, and the remedies can often be mutually exclusive or complementary. In order to achieve the best outcome for you, it is important to properly analyse your objectives and the likelihood of success before arguing them.

If you would like any further assistance or guidance on any of the above, then please contact **Samuel Flack** ([samuel@brandsmiths.co.uk](mailto:samuel@brandsmiths.co.uk)) or **Jacob O’Brien** ([jacob@brandsmiths.co.uk](mailto:jacob@brandsmiths.co.uk)).