

Commercial & Tech Law Blog

Inability to perform contractual obligations as a consequence of COVID-19: frustrated yet?

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Many organisations of all sizes across the world will have actual or potential exposure to liabilities under their commercial agreements as a consequence of either their own or their counterparty's inability to perform contracts due to COVID-19 or the impacts arising from it.

In this blog, we identify some of the key legal and commercial risks that contracts may be exposed to as a consequence of COVID-19. We consider possible legal grounds for avoiding contractual obligations in the current climate and in particular, the common law doctrine of frustration. We also give some practical suggestions to consider.

This note is not intended to provide an exhaustive list of issues. Nor should it be relied upon as legal advice. Please do contact us if you require legal advice on any specific issues.

What are the key risks under contracts?

The key risks are set out below.

- Delay or failure to perform a contract giving rise to financial liability in the form of penalties for missing agreed service levels, liquidated damages or claims and indemnities for breach for non-performance.
- Termination of a contract.
- Calls to re-negotiate the contract price, delivery obligations, payment obligations or other key commercial provisions.

This is before we consider the knock-on effect of back-to-back contracts, where an obligation in one contract could have an immediate impact on the ability to perform under another.

What are the possible legal grounds for avoiding contractual obligations?

As discussed in our blog '[*Force Majeure and COVID-19*](#)

(<https://web.archive.org/web/20200721015439/https://commercialandtechlawblog.ey.com/2020/03/27/force-majeure-covid-19/>)', a force majeure clause in a contract is one way for contractual obligations

to potentially be lawfully suspended or even brought to an end.

Under English law, there is also the common law doctrine of frustration.

What is the doctrine of frustration?

According to this doctrine, a contract may be discharged or “frustrated” if something unexpected occurs after the formation of the contract which renders it physically or commercially impossible to fulfil the contract or transforms the obligation to perform into a radically different obligation from that undertaken at the time the contract was entered into.

Could COVID-19 frustrate a commercial agreement?

A party might seek to argue that one or more of the grounds set out below exist to run an argument that a contract has been frustrated by the COVID-19 pandemic.

- A person (or object) that is essential for performance of the contract is unavailable. This would most obviously frustrate a contract, where the contractual terms dictate that it was to be performed by a specified person only at, or within a specified time period, and that the time of performance was the essence of the contract.
- The subject matter of the contract is to be obtained from a specific source which is unavailable due to no fault of either party. This could arise where goods are to be imported from a particular country, where import is impossible due to factors beyond the parties’ control (e.g. war, natural disasters, or prohibition of export).
- The contract provides a method of performance which is impossible. The courts have held that a contract will not be frustrated where performance is possible by a different method and the difference between the two methods of performance is not sufficiently fundamental.
- The contract is illegal as a result of changes in law. Some contracts may also contain a “change in law” provision which addresses circumstances where there has been a change in law that makes it impossible for the party to perform its contractual obligations. Given the continued global spread of COVID-19, it is possible that laws may be passed in order to contain the spread of the virus, but which also prevent a party from performing its contractual obligations (e.g. travel restrictions, border closures, export restrictions or nationwide quarantine and self-isolation). A party’s entitlement to remedies will depend upon the scope of the change in law provision drafted in the contract.

Case law shows that a very high threshold must be met before a contract will be considered to be frustrated. It is not sufficient that it is simply difficult or uneconomic to perform the contract, or that a degree of hardship or inconvenience is involved.

In a 2003 SARS epidemic-related case *Li Ching Wing v Xuan Yi Xiong* [2004] 1 HKLRD 754, a Hong Kong court rejected a tenant’s claim that a tenancy agreement was frustrated because the premises were affected by an isolation order by the Department of Health due to the outbreak of SARS, which meant that it could not be inhabited for ten days. The court held that a ten-day period was insignificant in view of the two-year duration of the lease, and that whilst SARS was arguably an unforeseeable event, it did not significantly change the nature of the outstanding contractual rights or obligations of the parties in the case.

What practical issues should be considered?

As the current global emergency continues to unfold, it would be worthwhile taking the steps set out below.

- **Review.** Check your contracts for force majeure or change of law provisions.
- **Assess.** Consider where your risks lie and those of your counterparties – what aspects of the contract are you not able to perform? Is the inability to perform because of COVID-19 (and not a different reason)?
- **Mitigate.** Consider what steps you can take to mitigate the impact of the event on your ability to perform the contract. Maintain demonstrable evidence.
- **Strategize.** Consider your strategy carefully. For example, a wrongful exercise of a force majeure clause or claim of frustration could have serious consequences, including breach of contract or a repudiation of the contract which may entitle the other party to claim damages or to terminate the contract.
- **Notify.** Speak to your counterparties.
- **Assess.** Check what other contracts or arrangements are affected as a consequence. Consider whether you need to notify your insurers or lenders. Check whether your insurance covers any of the expected loss.

What other legal and commercial contractual issues are there to be aware of?

You or your contractual counterparties may seek to invoke other contractual provisions as a consequence of COVID-19. Examples are set out below.

- **Adjustment of price, volume of goods/services.** Parties may seek to adjust all or part of the contract price for a commodity due to increased costs because of COVID-19. Parties may seek to reduce volume of goods/services.
- **Limitation or exclusion of liability.** Parties may seek to rely upon limitation or exclusion clauses to limit or exclude liability for non-performance.
- **Material adverse change clause.** Parties could claim that COVID-19 triggers a material adverse clause (MAC) in a contract, entitling a party to walk away if there is a material adverse change in one of the parties' position or circumstances. The ability to invoke a MAC clause and the effects, will depend on the wording of the clause and how the clause is construed.

How we can help

This note sets out some of the key contract law issues that have arisen, and which may arise, as the current situation continues to unfold. These issues are also likely to be arising in other jurisdictions because of the international nature of commerce and the effects of COVID-19 on international commerce. If you have any questions in relation to this note or want to discuss how COVID-19 could affect your commercial agreements, please do get in touch with us.

□ Posted in [Commercial contracts](#)
