CONTRACTS IMPACTED BY COVID-19 - FORCE MAJEURE, FRUSTRATION, TERMINATION OR RENEGOTIATION?

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Just a few short months ago, none of us could have foreseen the times we now find ourselves in. Many commercial contracts, including for suppliers, events, media, sponsorship and advertising, were signed in times when we could not have envisaged the economic impacts and market disruptions caused by COVID-19. Lockdown rules and border closures have forced rapid change on businesses and severely impacted the market for goods and services. Is this an opportunity to revisit some of those agreements that are no longer possible to carry out, or are severely hamstrung due to COVID-19? Is it possible (legally) to exit some of those more onerous contractual obligations that no longer seem viable? What about contracts that remain viable but are increasingly non-commercial or less profitable? What clauses and legal rights can help here? Suddenly, the humble '*force majeure*' clause, not given much attention in usual times, has come into the spotlight and everyone wants to know about it.

In this publication we have addressed some of these issues: *can contracts be set aside for deals that are dead in the water due to COVID-19? What are the legal mechanisms available for terminating or renegotiating these contracts? What exactly is a 'force majeure' clause? When is a contract 'frustrated'?*

Can contracts impacted by COVID-19 be set aside?

OK, so first things first: COVID-19 is definitely not a 'get out of contract free' card. There is not necessarily an automatic right available to avoid contracts that have become unprofitable or more difficult because of the COVID-19 market environment. However, we are seeing circumstances where there are opportunities to re-evaluate certain contracts and trigger rights that are available. The negotiation of sports broadcast rights playing out in the media demonstrate how previous commercial models may no longer be sustainable. Parties are starting to re-evaluate contracts and look for ways they can exit, amend or renegotiate them in response to current conditions. Generally it will depend on the exact terms of the contract and all of the facts in the particular case. We will explore some of these avenues below.

What is a 'force majeure' clause?

Many commercial contracts will include a 'force majeure' clause in some form. The term 'force majeure' derives from the French and translates literally as 'superior force'. Essentially, a 'force majeure' event is an event that is outside of the reasonable control of the parties. A 'force majeure' clause is generally included in a contract to provide that a party will not be held liable for a delay or a failure in the performance of its obligations, if this is caused by an event outside its reasonable control. The provision will normally include a definition of 'force majeure', and this is vital to understand. There is no 'default' or automatic force majeure protection under the common law or in contracts, and each contractual force majeure clause (and each definition of "force majeure") is different. Under the law of contract, force majeure clauses are interpreted strictly by reference to the wording of the clause - accordingly, the application and impact of such a clause to current events will depend on the specific wording of the clause. A 'force majeure' definition may be a closed list of specific events (more of a rare scenario and generally recommended against) or (more typically) it may be an open list of events beyond the reasonable control of a party which include, without limitation, a number of examples such as 'act of God', 'war', 'sabotage', 'riot', 'insurrection', 'terrorism', 'strikes or other industrial disturbance', and so on. This list may or may not specify

'pandemic', or 'act of government', so it is critical to look closely at the wording to assess its application to the current context.

A 'force majeure' clause will typically provide that the event must have been beyond the reasonable control of the parties, and then provide a process by which a party affected needs to notify the other party and take steps to mitigate the impact of the force majeure. The clause often also includes the right of one or each of the parties to terminate the contract if the force majeure continues beyond a specified period.

Does COVID-19 constitute a 'force majeure'?

In general, the 'force majeure' must have not been reasonably foreseen by a party, and it must be completely beyond the control of a party. However, a party may not invoke a 'force majeure' clause if the event was caused by their own act or omission. For COVID-19, a 'force majeure' clause will apply if force majeure is defined to specifically refer to 'infectious disease', 'pandemic' or similar. It can also be argued that the disruptions caused by COVID-19 may also indirectly lead to other events such as "government action", 'national emergency' and other events specifically listed. General catch all wording such as "events outside the reasonable control of the parties' or 'act of God' may also be construed in our view, to cover the current COVID-19 pandemic.

However to rely on the clause a party's non-performance must be caused by the 'force majeure'. The courts have generally confirmed that a change in economic or market circumstances affecting the profitability of a contract, or the ease with which parties can perform their obligations, are not 'force majeure' events. The fact that a performance of a contract becomes uneconomical is also not a 'force majeure event'. A 'force majeure' event cannot be merely an economic event, there must be a legal or physical limitation. From the case law therefore, it is unlikely that financial hardship alone will constitute a 'force majeure' event.

Taking from the above, let's look at some scenarios. So, let's say a communications agency has entered into an agreement with a client, where it is required to meet specific deliverables or KPIs, and these are no longer possible to meet. For instance, because a physical office has had to be shut down so it can no longer meet physical service requirements. Or because lock down measures have meant that retail sales are no longer possible, and certain products are simply unavailable as they cannot be manufactured at the present time, so it can no longer meet sales targets. Or because an event can no longer be held because of social distancing rules. There may well be an opportunity to exercise 'force majeure' rights, to ensure that the agency is not held liable for a delay, or a failure in meeting those contractual obligations. The agency would need to be careful in exercising those rights, with the following very important considerations:

- it will need to follow the mechanisms set out in the agreement for triggering the clause effectively (including notice requirements – an email may not be sufficient);
- it will need to ensure that it mitigates as far as possible, the impacts and consequences of the 'force majeure';
- it should also be conscious of any right of the other party to terminate the agreement if the 'force majeure' continues past a certain time;
- obviously it would be important to get legal advice in advance to check the strength of your claim to rely on 'force majeure'.

It is also important to note that all contracts are different – while the force majeure clause may or may not be applicable to a certain situation, other rights of a party to suspend delivery, reduce services or otherwise delay performance may be more applicable, and ultimately more valuable at a time such as this. It is imperative to take a detailed look at the entire contract, with the facts of each case in mind.

What about contractual 'frustration'?

Another possible recourse here is the doctrine of frustration, which is a common law contractual principle and does not need to be mentioned in the contract.

Frustration will only occur if, through no fault of either party, the circumstances in which performance of the obligation is required is radically different from those originally contemplated by the parties.

It is important to consider this carefully as, if you successfully invoke this, the impact is that your agreement is terminated entirely. Any expenses incurred or costs paid in the performance of an obligation prior to frustration, cannot be recovered. There is legislation in the states of NSW, SA and Victoria that applies when a contract is frustrated also, which aim to adjust each party's rights to allow for a more equitable outcome for all parties.

Does COVID-19 amount to frustration?

The bar is very high to make out frustration, and difficult to prove. Frustration will usually not occur if there is an existing 'force majeure' clause in the contract that covers the circumstances. Generally, courts have held that the effects of economic downturn (including delay in supply or reduced earnings) or increased expenses do not amount to frustration. Transient circumstances cannot amount to frustration. A delay in performance is not generally frustration unless the delay is for an unreasonable amount of time.

It will depend on the facts of the case and whether COVID-19 has made it impossible for a party to perform its contractual obligations. It is not enough that COVID-19 has just made it more difficult or inconvenient to perform. An example of a good case of frustration, is where a company has been contracted to provide signage displays for a one-off concert that can no longer go ahead due to government bans.

Termination rights?

If a contract is no longer viable the parties will be looking at termination rights. Many contracts will have the express right to terminate for breach. If you have signed up to a service that is no longer capable of being delivered (e.g. a service that requires physical performance which cannot be done due to lock down rules), you may have the right to notify of a breach and terminate the contract if this cannot be remedied. You may also have termination for convenience rights, which can be exercised by serving a notice of a specified period as set out in the contract. There may be termination rights for other agreed triggers. Check your contract's termination rights and ensure you follow the process, as if you wrongfully terminate a contract you may be exposed to damages.

Are there any other clauses that can apply here?

As flagged above, other contractual clauses may assist here depending on the contract and the service obligations in each case, such as:

- Variation clauses. Many agreements will have a clause that set out a process whereby the parties can renegotiate or impose a change or variation to the agreement.

- Suspension clauses. Many service agreements contain provisions allowing the recipient of services (i.e. the client) to put services on hold, under suspension for a certain period.

- Material impact clauses. Some agreements will have clauses that expressly provide for a process whereby a party can seek to renegotiate certain provisions (such as KPIs or service levels or minimum commitments) if there are material changes to the market conditions. These may assist depending on the scenario and the wording of the clause.

- Dispute resolution clauses. These may set out a path for resolving issues.

Renegotiation and evaluation of contracts

Given the above, it is prudent to have a look at those contracts you have on foot that may be unviable or impossible to perform as a result of COVID-19. On the client side there may be opportunities to have a look at contracts where your suppliers are no longer able to provide key deliverables and what rights are available to exit those arrangements or have the suite of services, the fees or the time frame for delivery renegotiated – you may not need to be locked into paying for services that are no longer being rendered as required, or that you simply no longer require at this time. On the supplier side it may pay to review your contracts and ensure that you are able to meet contractual obligations, and if these have been rendered impossible to perform due to COVID-19, begin a pathway now to mitigating those impacts and exercising any rights available to reduce your legal exposure.

In many cases the best first scenario would be to contact the other party to negotiate a compromise on commercial grounds. Most contracts provide for a process where the parties may vary terms. During those negotiations, some important considerations are:

- Consider your business needs and goals and what you would like to achieve (is it termination, or reduction of the fees, a pause on fees, extension of the contract term, or a change to the services?).
- Check the clauses on varying the agreement. If the variation clause provides the contract can only be varied by a document signed by the parties then an email exchange may not be enough. Any renegotiated arrangements should be documented properly to avoid dispute later down the track.
- Know your legal position. If you are making claims of 'force majeure', breach or frustration, consider the strength of your legal rights so you can proceed with confidence and develop a commercial strategy in line with this.

Contact us

If any of the above information is of interest to you or you have follow up questions please let us know, by contacting the author at your convenience.

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