SEFTON FROSS

COVID - 19 SERIES

COVID-19 PANDEMIC - IMPACT ON PERFORMANCE OF CONTRACTS

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INTRODUCTION

COVID-19 was declared a global pandemic on 11 March 2020. To curb its spread, many countries around the world declared national lockdowns on practically all forms of social and business activities. With this, businesses around the world have been affected directly or indirectly by this turn of events and consequentially, the ability of parties to perform their contractual obligations may have been severely affected and impaired.

Not surprisingly, there is a rising level of uncertainty as to the enforceability of commercial contracts or transactions which may have been impacted as a result of the national policies adopted to curtail the spread of the virus. Even as the immediate focus for many businesses is to determine how to continue to operate in spite of the challenges, parties to agreements may find themselves in positions where the performance of their contractual obligations are now arguably impossible or onerous to fulfil.

As the global economy continues to groan under the effects of the pandemic, it is becoming apparent that parties may seek to delay and/or avoid performance of their contractual obligations and/or terminate contracts, either because COVID-19 has legitimately prevented them from performing their contractual obligations, or because they are seeking to use it as an excuse to avoid an otherwise bad transaction. This article explores when the concept of ***force majeure*** and the ***doctrine of frustration*** may legally excuse a party from performance, in light of the disruption caused by the COVID-19 pandemic.

Force Majeure

The expression ´**Force Majeure**´ is a French term which literally means ´superior force´. It is a common clause in agreements that frees parties from certain liabilities, where an extraordinary event or circumstance which is beyond their control occurs in a manner and way that limits their ability to perform or fulfill their contractual obligations. Force Majeure clauses are drafted to cover an imagined range of supposedly impossible events such as ´acts of God´, floods, earthquakes amongst others, and are relied on to insulate business relationships or contracts from the shock of unexpected, unimaginable or unforeseen happenings.

Does your contract provide for an event of force majeure?

Force majeure is a contractual term, the broadness and limitation of which is agreed between the parties. Whether the COVID-19 pandemic would qualify as a force majeure event will depend on the drafting and construction of the force majeure clause in a contract. In other words, the wording of the force majeure clause must specifically mention plagues, epidemic, pandemic, acts of government or include a sweeping phrase like "acts beyond the parties' reasonable control". Such sweeping phrase will however be subject to interpretation by the courts.

In the English case of *Peter Dixon and Sons, Ltd. v. Henderson Craig and Co.*, Ltd[1], where the force majeure clause in the contract provided for acts "beyond the control" of the parties, the court held that the inability of sellers of wood-pulp to deliver goods from Canada to England due to the ongoing First World War was squarely within the meaning of the force majeure clause in the contract. In deciding the case, the court established that the scope of a force majeure clause would be construed expressly and where necessary, by applying the ejusdem generis rule to clarify what the parties intended.

1 (1919) 2 KB 778

What is the impact of the COVID-19 pandemic on the ability to perform under a contract?

It is not enough to prove that the COVID-19 pandemic qualifies as a force majeure event, more importantly, the party must prove that the pandemic or the resultant government lockdown and preventive directives prevented, hindered or delayed it from performing its obligations under the contract. Furthermore, difficulty to perform, higher cost of performance, that performance would make the contract less profitable are not enough to declare a force majeure. However, the party claiming the COVID-19 pandemic as a force majeure event must show that it was physically or legally impossible to perform the contract.

What must a party seeking to rely on a contractual force majeure show?

In addition to proving that the COVID-19 pandemic or the government restrictions that followed it - which can rightly be said to amount to circumstances beyond a party's control - made it impossible for the party to perform or delayed performance, the party must also show that there were no reasonable steps it could have taken to mitigate the force majeure event or its consequences.

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For instance, inability to perform under a contract for services classified as "non-essential" under COVID-19 government restrictions may amount to force majeure where performance would require the non-performing party to breach government directives, while non-performance may not be excused for services classified as "essential" in similar circumstances, even though the essential services becomes more difficult or expensive to perform. However, if the non-performing party has not complied with the government's COVID-19 directive or other good practice, then that may prevent that party from relying on the contractual force majeure.

Also, the non-performing party must explore all reasonable avenues or alternatives to fulfill its obligations under the contract notwithstanding that the alternative is more difficult or more expensive. In *Globe Spinning Mills Nigeria Plc v. Reliance Textile Industries Limited* [3], the court held, per Ndukwe-Anyanwu, J.C.A.[4] that "*force majeure is generally intended to include occurrences beyond the reasonable control of a party, and therefore would not cover …any result of the usual and natural consequences of external forces*".

In that case, the court held that the reasons given by the non-performing party, (influx of illegally smuggled fabric into the country and lack of access to power to run its business operations as an excuse for failure to deliver a predetermine amount of fabric monthly) are the usual vicissitudes of the trade in Nigeria, and the result of the usual and natural consequences of external forces, which must be put into consideration by anyone doing business in Nigeria, and thus not force majeure.

3 (2017) LPELR-41433(CA)
4 (P. 27, Para. E)

Finally, a party seeking to rely on force majeure must consider the procedure under the contract and follow it. For example, most contracts provide that the party relying on force majeure must give of notice within a period of time and give regular updates on steps taken to mitigate the effects of the force majeure event. Failure to give such notice will prevent the party from later relying on force majeure.

What is the effect of invoking the force majeure clause?

The effect of activating the force majeure clause will depend on the letters of the contract. Typically, parties agree to suspend performance, or excuse liability for non-performance, instead of triggering an automatic discharge of the contract. Sometimes, there would be wording for a long stop date and at other times there is no longstop date. The general result is that a party is excused from its obligation without damages being payable to the other party.

THE DOCTRINE OF FRUSTRATION

As mentioned above, whether the COVID-19 pandemic and the resultant effect would qualify as a force majeure event will depend on the drafting and construction of the force majeure clause in a contract, and where the contract did not anticipate a pandemic and the resultant government restrictions, a non-defaulting party will not be able to rely on the express terms of the contract to excuse its non-performance. The common law doctrine of frustration may however be a ground for avoiding contractual obligations in that situation. At common law, a contract may be discharged on the ground of frustration when an unforeseen event outside of the control of the party occurs which renders it physically or commercially impossible to fulfil the contract or transforms the obligation to be performed into a radically different obligation from the one undertaken at the time the contract was executed.[5]

This was not always the case under the common law. Before the decision in Taylor vs. Caldwell[6] ,the law in England was extremely rigid and courts rarely reached the decision that a contract has been frustrated. A contract had to be performed, notwithstanding that it had become impossible to perform because of some unforeseen event which happens after it was made. It was also irrelevant that the unforeseen event was not the fault of either of the parties to the contract.

This rigidity of the common law to uphold the absolute sanctity of contract was relaxed by the decision in the case of *Taylor vs. Caldwell*[7] where a party to the contract was not able to provide a hall for the purpose of a show as a result of a fire outbreak which engulfed the building. Blackburn J held that:

> *"Where from the nature of the contract, it appears that the parties must from the beginning have known that it could not be fulfilled unless, when the time for the fulfilment of the contract arrived, some particular specified thing continue to exist, so that when entering into the contract they must have contemplated such continue existence as the foundation of what was to be done, then, in the absence of any express or implied warranty that the thing shall exist, the contract is not to be construed as a positive contract but as subject to an implied condition that the parties shall be excuse in case, before breach, performance becomes impossible from the perishing of the thing without default of the contractor".* [8]

5 Krell v Henry [1903] 2 KB 740
6 (1863) EWHC QB J1
7 supra
8 ibid at para. 22

With this decision, if some unforeseen event occurs during the performance of a contract which makes performance impossible, such that the fundamental basis of the contract goes, it need not be further performed, as insisting upon such performance would be unjust.

Test for Frustration

In deciding whether a contract has been frustrated, courts typically support an approach which takes account of all the facts and circumstances of the case. For instance, in *Wing v Xiong*[9], a 10-day isolation order prevented the claimant from reaching his flat in Kowloon, Hong Kong. The claimant said that this frustrated the lease and discharged him from having to pay any further rent. The court disagreed because the lease was for 2 years and a 10-day exclusion from the property was "insignificant" in that context 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. Also, in *WEMA Bank Plc v. Alhaji Sola Oloko*[10], the Appellant wrongfully dishonoured the Respondent's bank draft and blamed it on the limitation on the movement of its clearing officer because of the restriction on movement imposed by Government during the census exercise. In reaching its decision, the trial judge noted that the Sagamu branch of the Bank was working in spite of the restriction on movement and so the bank could not invoke the doctrine of frustration to escape liability for its wrongful act. In affirming, the trial court's judgement, the Appeal Court reiterated that what constitutes frustration must be totally or entirely beyond the mutual contemplation of the contracting parties at the time of entering into the agreement.

Frustration and the COVID-19 Pandemic

Indeed, with the impact of the pandemic on the global economy, there might be possibilities for the doctrine of frustration to apply in many cases, depending on the circumstances of the relevant transaction. However, parties must be able to prove that, as a result of the COVID-19 pandemic, it became impossible to perform the contract. Thus, in the context of the COVID-19 pandemic, the party relying on the doctrine of frustration has the burden to prove the impossibility of fulfilling its obligations as a result of the pandemic. For instance, in Poussard v Spiers and Pond[11] where an opera singer fell ill and was not able to perform on the opening night on 28 November 1875 but recovered by 4 December 1875, Blackburn J held that her contract with the opera company was frustrated because "it must have been of great importance to the defendants that the piece should start well". According to the learned judge, the illness left the singer unable to perform and went to the "root of the matter" between the parties[12]. Also, in the context of the COVID-19 pandemic, impossibility of this sort may also arise because there are insufficient staff, raw materials, transport providers, etc. to perform a contract as a result of government directives to curb the spread of the pandemic.

Effect of relying on the Doctrine of Frustration

Once a contract is adjudged frustrated, the obligations of the parties under the contract are immediately ended. This position is buttressed in AG Cross River State v. AG Federation & Anor[13] where the court held that:

> "a contract which is discharged on the ground of frustration is brought to an end automatically by the operation of law, irrespective of the wishes of the parties"

9 (DCCJ 3832/2003, Hong Kong District Court)
10 (2015) ALL FWLR [pt.778] 980 at 992-3, 999-1003
11 (1876) 1 QBD 410
12 Ibid at para. 414
13 (2012) LPELR-9335(SC)

Whereas force majeure clauses usually temporarily suspend a contract or provide for specific effects of the clause, frustration discharges the contract and brings it to an end. In other words, all current and prospective rights and obligations under the contract are cancelled. So, essentially, once frustration is invoked and upheld, the contract is discharged immediately, and the parties would be free from their future obligations under the contract even after the government restrictions are removed or the COVID-19 pandemic abates. However, it is important to mention that frustration does not work retrospectively at common law. So, although the contract is discharged, past performance is not automatically unwound nor is the contract void ab initio.

What if your force majeure clause does not cover pandemics?

Where a contractual force majeure provision in a contract does not include pandemics such as COVID-19, the parties may need to consider whether the contractual doctrine of frustration discussed above can still apply.

Whether a party is relying on the impossibility to perform or frustration of purpose as highlighted above, one of the most important factors courts consider to decide whether to excuse performance is if the intervening event was foreseeable when the contract was signed. Essentially, if the intervening event was not foreseeable and rises to the level of destroying the object of the contract or dramatically changes the expected value of the contract, it is possible that contractual performance may be excused, even without the protection of a *force majeure* clause. On the flip side, if the intervening event was foreseeable and was not expressly addressed in the *force majeure* clause, the courts may direct strict contractual compliance. Having said that, whether the COVID-19 pandemic and the myriad adverse effect was or should have been foreseeable at the time of entering into the contract is a question that will certainly be litigated upon all over the world in the not too distant future.

CONCLUSION

As a result of the COVID-19 pandemic, businesses and economies of countries worldwide have been adversely affected. The government of affected countries have had to roll out measures to combat the pandemic and prevent the spread of the virus. The Nigerian government on 16 April 2020 ordered the lockdown of Lagos State, Ogun State and the Federal Capital Territory.

Some other States in the country have also replicated this measure by declaring a lockdown on all business activities except essential services. It is expected that this will put a strain on a lot of businesses and contracts where workers are not able to go to work. Without a doubt, the COVID-19 pandemic will lead to a wave of disputes as to which party bears the risks of non-performance of the contract. From the foregoing, there are clearly key principles of law which would assist parties to determine the likely outcome of those disputes.

It is important to note that merely invoking the contractual force majeure clause or the common law doctrine of frustration as grounds for non-performance may not suffice to excuse parties from fulfilling their obligations under existing contracts, as each circumstance would be analyzed based on the agreed terms and the circumstances of the parties. More so, improperly invoking the force majeure clause could itself amount to a breach and entitle the other party to damages or a right to terminate the contract in and of itself. Similarly, invoking the doctrine of frustration may also be commercially undesirable in some circumstances, since its effect, regardless of the wishes of the parties, is to bring all parties' obligations under the contract to an end immediately.

RECOMMENDATION

COVID-19 is a global pandemic, and no one can deny the constraints it has put on businesses world over. Consequently, the preferable option to the extent possible would be for parties to forebear one another, keep their contract alive and avoid bringing claims against each other in respect of the difficult circumstances that the pandemic has foisted on them. To achieve this, parties may want to consider varying or renegotiating the terms of their contract. If they elect to do this, it is important that they comply with any relevant requirements of the contract, such as reducing any variation into writing, and carefully considering the long-term effect of any proposed changes. The parties should also consider the implications of varying terms of the contract and the overall business plan, how varying an aspect of the contract would affect the completion of the contract and the implications for other contractual obligations owed to other persons.

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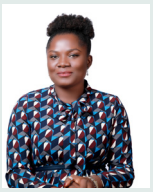

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