



# Is coronavirus likely to be a valid basis for avoiding contractual obligations?

On 31 December 2019, the World Health Organisation (“**WHO**”) received its first [reports](#) of novel coronavirus (also known as COVID-19) from Wuhan City, Hubei Province of China. On 30 January 2020, following the spread of the virus to [18 countries](#), the WHO [declared](#) that coronavirus was a [Public Health Emergency of International Concern](#). As at [2 March 2020](#), there are 88,948 confirmed cases of coronavirus across 65 countries (including the UK, US, France and Germany), with the majority of cases concentrated in China (80,174 cases) and the Republic of Korea (4,212 cases), with Italy the worst affected European country.

As well as the significant human cost, the economic cost is mounting. To date the electronics sector and motor industry have been the most significantly impacted, given China's major role in parts manufacturing and assembly. However, the virus will ultimately impact almost every sector due to supply chain issues and suppressed demand resulting from uncertainty, travel restrictions and general disruption to ‘business as usual’. This is reflected in the [performance of the global financial markets](#), which have suffered significant losses since the outbreak of the virus, and the recent [surge in the price of gold](#), reflecting investor nervousness.

We expect to see (and, in some instances, have [already seen](#)) businesses exposed to a heightened risk of legal implications arising across their supply chain. In particular, counterparties may seek to delay and/or avoid performance (or liability for non-performance) of their contractual obligations and/or terminate contracts, either because coronavirus has legitimately prevented them from performing their contractual obligations, or because they are seeking to use it as an excuse to extricate themselves from a bad deal. Parties may also cite coronavirus as a basis for renegotiation of price or other key contractual provisions (eg volume of materials exported from or imported into affected areas due to shifts in supply and demand).

The virus may also trigger conflict with other legal obligations, eg employers reconciling the steps they need to take to ensure business continuity with their duty of care towards their employees.

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## Table of contents

1. Possible bases for avoiding contractual obligations under English law	2
2. Other consequences for contracts	3
3. Other consequences for businesses	4
4. Contacts	4

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## 1. Possible bases for avoiding contractual obligations under English law

English law offers a limited range of remedies for avoiding contractual obligations where a contract becomes difficult or impossible to perform. Two such remedies are (1) the common law doctrine of frustration; and (2) the presence of a contractual force majeure clause.

### Frustration

- At common law the doctrine of frustration will operate to terminate a contract automatically when a subsequent event occurs, which is (1) unexpected; (2) beyond the control of the parties; and (3) makes performance impossible, or renders the relevant obligations radically different from those contemplated by the parties at the time of contracting.
- In a 2003 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 10 days. The court held that a 10 day period was insignificant in view of the 2-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.
- A party might seek to argue one or more of the following established grounds operate to found a claim that a contract has been frustrated by the novel coronavirus outbreak:
  - **Temporary unavailability** – a person (or object) that is essential for performance of the contract is temporarily unavailable. This would most obviously frustrate a contract, where the contractual terms dictate that it was to be performed only at, or within a specified time period, and that the time of performance was the essence of the contract;
  - **Failure of a specific source** – if the subject matter of the contract is to be obtained from a specific source, which becomes unavailable due to no fault of either party. Case law suggests that this could arise, if goods are extracted from a particular crop which fails due to drought or disease; or where goods are to be imported from a particular country, where import is prevented by factors beyond the parties' control (eg war, natural disasters, or prohibition of export);
  - **Method of performance impossible** – if the contract provides a method of performance which becomes impossible. However, 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;
  - **Illegality** – if the contract becomes illegal as a result of changes in law.
- It is possible to see how parties might seek to make these sorts of arguments given the scale and impact of the virus, particularly in China. See, for example, [claims](#) by car manufacturers that they could run out of car parts usually imported from China in a matter of weeks.
- Ultimately, whether a party would be successful before the English courts would depend on the facts of the case, including as to whether in the particular circumstances performance is rendered impossible or radically different from what was envisaged.
- If successful, the effect of frustration is automatic termination of the contract. The Law Reform (Frustrated Contracts) Act 1943 provides that parties are able to recover monies paid under the contract before it was discharged (subject to an allowance for expenses incurred by the other party at the court's discretion).

### Force Majeure

- As a practical matter, given the limited applicability of the doctrine of frustration, parties will often include a force majeure clause in their contracts. Such clauses excuse one (or both) parties to a contract from performance of their obligations following the occurrence of unexpected events or circumstances which are outside of that party's control.

- A typical force majeure clause will provide that a party is excused where it is prevented (or hindered or delayed) from performing its obligations due to the occurrence of an event beyond the reasonable control of the parties. The contract may include a list of such events, by way of example or exhaustively, eg an Act of God, war or conflict. What is covered will therefore depend on the precise drafting of the clause. Note that the [International Chamber of Commerce](#) includes “epidemics” within the scope of their sample force majeure clause.
- As to whether the coronavirus outbreak is likely to amount to a force majeure, the [China Council for the Promotion of International Trade](#) (“CCPIT”), a quasi-governmental foreign trade and investment promotion agency, has encouraged businesses which have failed to perform on time or failed to fulfil an obligation in an international trade contract, to apply for a “force majeure certificate”. These [seek](#) to “*exonerate[] companies from not performing or partially performing contractual duties by proving they are suffering from circumstances beyond their control, which can prove that there were objective facts such as delayed resumption of work, traffic control, and restricted dispatch of labor personnel.*” The CCPIT has reportedly issued over 1,600 such certificates, seeking to shield Chinese companies from legal claims.
- However, whilst such a certificate may assist evidentially, it will not automatically trigger force majeure contractual provisions. Indeed, a number of international businesses have [reportedly](#) already rejected such certificates from Chinese importers seeking relief from taking delivery of liquefied natural gas cargoes.
- Whether a party would be successful before the English courts will ultimately depend on the impact of coronavirus on the performance of the contractual obligations; and the precise wording of the contract and specific force majeure clause (eg as to whether the relevant triggering event must “prevent” performance or meet the lower standard of “hinder” or “delay”). Given the fact-specific nature, this is likely to result in disputes.
- Depending on how it is drafted, successful reliance on a force majeure clause may have some of all of the following consequences:
  - Entitlement to suspend performance while the force majeure event continues;
  - Non-liability for the non-performance or delay in performance while the force majeure event continues;
  - Extensions of any deadlines under the contract while the event continues (eg for completion of a project);
  - An express or implied obligation to mitigate, whereby the party seeking to rely on the clause must show that it has taken all possible steps to avoid the event or the impact of its consequences;
  - A right to terminate the contract if the force majeure event continues for a specified period.

## 2. Other consequences for contracts

Coronavirus may also give rise to attempts by counterparties to invoke other contractual provisions, for example:

- **Price adjustment clauses** - parties may seek to adjust all or part of the contract price for a commodity due to increased costs (eg due to increased supply chain strain) as a result of coronavirus.
- **Limitation or exclusion clauses** - parties may increasingly seek to rely upon limitation or exclusion clauses (especially in the absence/inapplicability of a force majeure clause) to limit or exclude liability for non-performance.
- **Change of law clauses** - a party could rely on a “change of law” clause in a contract (entitling either party to terminate or renegotiate the contract, where a change in the applicable law makes it impracticable or impossible for a party to perform its contractual obligations).

- **Material adverse change (“MAC”) clauses** – the outbreak of coronavirus could trigger a MAC clause in a contract, entitling parties to call a default if there is a “material adverse change” in one of the parties’ position or circumstances. The ability to invoke this provision, and repercussions for doing so, will depend on the wording of the clause, and how the clause is construed.

### 3. Other consequences for businesses

Coronavirus may also have the following consequences for businesses, potentially also giving rise to conflict with their contractual obligations:

- **Employer duty of care** – employers are responsible for [health and safety management](#), and are required to do whatever is reasonably practicable to protect the health, safety and welfare of their employees and other people who might be affected by their business. This means that employers must take proportionate action to protect employees, which may include cancelling work trips to areas affected by the virus; and otherwise protecting the safety of their employees. Failure to do so could expose the business to negligence or health and safety related claims, and could invalidate insurance policies.
- **Disruption to supply chain** logistics – if existing supply chains fail or are significantly impacted, businesses will be forced to find alternative solutions. [Reports](#) suggest a major automotive manufacturer is flying components in in suitcases.
- **Distress/Insolvency** – the spread of coronavirus has already resulted in an increase in companies experiencing financial distress as they try to mitigate the financial impacts of supply chain issues coupled with lower customer demand. Companies with already high debt levels are finding existing credit lines withdrawn at a time when they are needing to pay suppliers who are able to deliver on time while not receiving customer payments. We have already seen companies file for Chapter 11 protection, citing coronavirus as contributing to supply chain problems (see, for example, the recent [bankruptcy filing of Valeritas Holdings Inc.](#)). Likewise, planned refinancing and distressed M&A activity is being delayed (as a result of travel restrictions and other measures), with the result that companies are finding it more challenging to execute and implement time critical turnaround plans. As a result, companies may be forced to seek formal and informal protection from their creditors and we expect to see, in more distressed cases, increased insolvency on the horizon.

### 4. Contacts



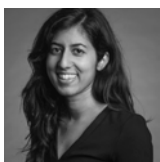
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