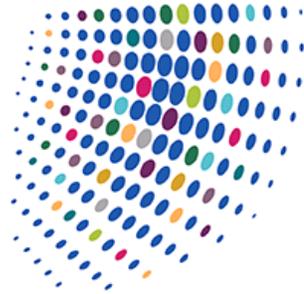


Alerts & Publications



Possible Impact of a Coronavirus Disease (COVID-19) Pandemic on Contractual Obligations

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COVID-19 has been declared a Public Health Emergency of International Concern by the World Health Organisation (WHO).^[1] There is now a global reach of the virus.^[2] What could that mean for existing obligations under contracts governed by laws of English common law jurisdictions such as England & Wales, Hong Kong, Australia, or Singapore?

Contractual obligations in the event of a pandemic

As the global impact of the outbreak worsens, causing disruption to international trade and other commercial activities, the risk of businesses being unable to perform their contractual obligations increases. When a breach of contract arises, the innocent party would normally sue the defaulting party for compensation. However, if the failure to perform the contract is caused by a pandemic, the defaulting party might be relieved by invoking the following as a defence:

- the pandemic has triggered the *force majeure* clause under the contract; or
- the contract has been frustrated by the pandemic,

such that the innocent party will not receive compensation for non-performance of the contract.

The scope and operation of a *force majeure* clause in the event of a pandemic

The purpose of a *force majeure* clause is to relieve the defaulting party (or all parties) from performing the contract or the remainder of the contract when an exceptional event or circumstances beyond the reasonable control of the parties prevents or hinders the performance of the contract. Sometimes, a *force majeure* clause does not seek to relieve the parties from the contract entirely, but only suspend its performance until after that event or circumstances.

There are two ways in which a *force majeure* clause could cover a pandemic:

- **the contractual definition of a *force majeure* event expressly includes a pandemic** – adding a pandemic to the list of *force majeure* events can ensure clarity as to whether a viral outbreak would trigger a *force majeure*

clause in a contract. In that situation, if the WHO or a state agency declares the outbreak to be a pandemic, there will usually be no question that a *force majeure* event has occurred; or

- **the *force majeure* clause covers extraordinary events or circumstances beyond the reasonable control of the parties** – such general, catch-all wording may be sufficient if it is determined that the factual circumstances caused by the pandemic are beyond the reasonable control of the parties.^[3] It is also possible that the consequences of or relating to a pandemic (e.g. government policies, travel restrictions, etc.) could themselves amount to a *force majeure* event if they are beyond the reasonable control of the parties.

Whether a *force majeure* clause would apply depends on the wording regarding the triggering event. If the clause provides that the triggering event must “*prevent*” the performance of the contract, the party relying on it would usually need to prove that the performance is physically or legally impossible. The fact that the event has made the performance difficult or unprofitable is unlikely to be sufficient to trigger a typical *force majeure* clause.

On the other hand, if the clause provides that an event that causes the performance to be “*hindered*” or “*delayed*” could trigger the clause, it is likely to be adequate to demonstrate that the performance is substantially more onerous. However, an increase in the cost of the performance *alone* is still unlikely to be sufficient to trigger the *force majeure* clause.

Furthermore, the party invoking the *force majeure* clause should demonstrate that it has taken all reasonable steps to mitigate the event as well as its effect on the performance of the contract (e.g. identifying alternative sources or keeping a sufficient reserve of materials that could become limited in supply).

It is worth noting that:

- The China Council for The Promotion of International Trade has announced that it would issue *force majeure* certificates to any qualifying applicants.^[4] For example, it has recently issued such a certificate to an auto parts manufacturer based in Huzhou.^[5]
- The Indian Ministry of Finance also declared that any solar project developers that could not perform their contractual obligations by relevant deadlines due to the outbreak of COVID-19 can invoke *force majeure* clauses.^[6]

These type of announcements are likely to encourage parties to rely upon *force majeure* clauses, but it is ultimately a matter for construction under the contractual governing law.

Frustration of contract by a pandemic

A contract is frustrated when there is a supervening event that changes the nature of the outstanding contractual rights and/or obligations to the extent that the parties could not have reasonably contemplated such change at the time of the execution of the contract.^[7] In that situation, a party may be excused from performing the contract because the primary purpose of entering into the contract and its performance have been rendered radically different.

The change in circumstances must be attributable to an external event that is not caused by the default of the party relying on it. In that situation, the *force majeure* clause may be triggered if the contract does not make sufficient provision for such supervening event. Therefore, if a COVID-19 pandemic fundamentally changes the principal purpose for the parties to enter into the contract such that its performance is radically different from what could have originally contemplated, the defaulting party may be excused from performing the frustrated contract.

Frustration of contract should only be invoked in the event of a pandemic if the contract does not contain a *force majeure* clause or the clause does not cover a pandemic as discussed above. The scope of the application of frustration is narrow; this is because the courts would not invoke the doctrine of frustration lightly “*to relieve contracting parties of the normal consequences of an imprudent commercial bargain*”.^[8] If the contract already provides for a pandemic event (under a *force majeure* clause for instance), such express provision would usually prevent the contract from being frustrated.

Frustration of a contract would not occur merely because the event has made the performance difficult, more costly, or onerous. Nor would a contract be frustrated simply due to an unforeseeable event that did not otherwise change significantly the outstanding contractual rights or obligations from what the parties could reasonably have contemplated at the time of the execution of the contract.^[9] When a contract is frustrated, that would be the end of the contract: it is not possible to suspend the performance of a frustrated contract only for the duration of the frustrating event (unlike some *force majeure* clauses).

Other considerations

Businesses should identify and review key contracts in order to assess the risk of contractual breach by them and/or their counterparties due to the COVID-19 pandemic. They should then devise pre-emptive measures, such as identifying alternative sources of key materials, so as to minimise the possible impact of the pandemic to the extent they are reasonably foreseeable.

Where there is a risk of failure in the performance of contracts, businesses should consider the ramifications of non-performance clauses within those contracts, such as liquidated damages clauses, under which the amount of compensation for non-performance has been predetermined and agreed by the parties when entering into a contract. If a liquidated damages clause is considered enforceable, steps should be taken to minimise the likelihood of triggering the clause, or preparations should be made in terms of enforcement of such clause.

[1] Available [here](#).

[2] Available [here](#).

[3] *Tandrin Aviation Holdings Limited v Aero You Store LLC., Insured Aircraft Title Service, Inc.* [2010] EWHC 40 (Comm) (in *obiter*); a flu pandemic is “some form of *force majeure*”: *Clifford Gardner v Clydesdale Bank Limited* [2013] EWHC 4356 (Ch)

[4] Available [here](#).

[5] Available [here](#).

[6] Available [here](#).

[7] *National Carriers Ltd v Panalpina (Northern) Ltd* [1981] AC 675.

[8] *Pioneer Shipping Ltd v BTP Tioxide Ltd (The Nema)* [1982] AC 724; *Lee Chee Wei v Tan Hor Peow Victor* [2007] SGCA 22.

[9] *Li Ching Wing v Xuan Yi Xiong* [2004] 1 HKLRD 754: it concerns the impact of a 10-day isolation order due to the SARS outbreak on a 2-year tenancy agreement of an apartment in Amoy Gardens, the first residential location of a SARS community outbreak in Hong Kong in 2003.

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