BUSINESS IN THE TIME OF CORONA: EXPLORING EXIT OPTIONS IN CONTRACTS

The Novel Coronavirus or COVID-19 has caught the entire world off-guard and unprepared, whether as individuals and families, or companies, organisations or nations. On 11 March 2020, the World Health Organization rang its loudest alarm bells by labelling the outbreak a "pandemic". The unprecedented 'anti-virus' measures, such as suspension of travel privileges, mandatory quarantine and stay-at-home measures, cancellation of events and social gatherings, have all affected us, dismayed us, or worse still, impacted us financially.

In this article, we examine the possibility of categorizing the pandemic as a '*force majeure'* event. Is it a situation of 'frustration of contract', or just a frustrating turn of events with no recourse in law? This note provides a brief overview of the possible legal remedies available to individuals and companies, under common law jurisdictions such as Singapore and India.

FORCE MAJEURE

Contracts are meant to be performed in good faith. *Force Majeure* is a type of clause commonly found in contracts and is (loosely translated) French for "*act of god*". When unforeseeable events occur, *force majeure* clauses in contracts allow for suspending, deferring or releasing a party, without liability, from the duty to perform its obligations under a contract.

Force majeure was originally a Civil Law[i1] concept (followed by countries such as France, Switzerland and The Netherlands) that has been imported into Common Law[2] and is now recognized by most Common Law countries including England, India and Singapore.

Force majeure can *only* be used as a defense where such a clause exists in the contract. In other words, *force majeure* (generally) must be expressly written in a contract and cannot be implied. The extent of a *force majeure* clause's operation depends on the wording of the clause itself and often includes events such as a pandemic.

The existence of a *force majeure* event has to be reviewed in light of the governing law of the contract. However, different national laws treat *force majeure* differently. For instance, a Chinese court is likely to use the test of unforeseen, insurmountable and unavoidable situation to assess whether a *force majeure* event exists; whereas an Indian court is likely to use the test of whether the change in circumstances totally upset the very foundation of the parties' agreement. Though these tests may appear deceptively similar, they often lead to different results when applied to the same facts.

While there are some key differences in how different jurisdictions treat *force majeure,* the **common principles** that emerge are that the party claiming *force majeure* must demonstrate that:

a) The contract has a *force majeure* clause and the situation is covered therein;
b) The alleged *force majeure* event was beyond the party's control;
c) The performance of the contract has become impossible (not merely onerous or less profitable), as a direct consequence of the *force majeure* event;
d) Best efforts were made to avoid and/or mitigate the loss, explore alternatives and that there was no negligence on behalf of the party seeking *force majeure*;

[1] 'Civil Law' is a legal system originating in Europe, intellectualized within the framework of Roman law, the main feature of which is that its core principles are codified into a referable system which serves as the primary source of law.

[2] In Common Law legal systems, the intellectual framework comes from judge-made law, with precedential authority given to prior court decisions, on the principle that it is unfair to treat similar facts differently on different occasions.

Points (c) and (d) above are subjective assessments which often require a large amount of documentary evidence to prove.

Further, the parties and the courts/tribunals have to consider:

e) Whether the *force majeure* clause, and the factual situation relieve the parties of their obligations *or* merely suspends them; and

f) Whether a timely *force majeure* notice was required to be given, and was in fact given.

The above assessments would apply to many types of contracts, from the mundane consumer contracts such as like airline tickets (planes cannot fly if there are lockdowns imposed on flights) and online orders (delivery delayed or suspended indefinitely), to more complicated commercial contracts for goods and services.

Some government agencies, in various countries (including Singapore and India) have proceeded to issue directives in form of general circulars and individual certificates endorsing the existence of a *force majeure* event *a la* the virus outbreak. However, these are likely to only provide cold comfort as such governmental directives cannot create a *force majeure* defense where none exists in the contract. Moreover, even in contracts where a *force majeure* clause exists, the validity and weightage of such directive would have to be considered in light of the governing law of the contract.

Separately, while there exists an argument that the doctrine of *force majeure* is a general or transnational principle of international law and thus applicable to international disputes notwithstanding its absence from the contract. Such an argument is an uphill battle as it attempts to selectively apply, possibly incompatible elements of Civil and Common Law. In our experience, Common Law courts and arbitrators from Common Law jurisdictions are more inclined to take a stricter view of these clauses, often restricting their interpretation to only the situations mentioned in the clause.

In sum, the defense of *force majeure* is likely to be available only to parties which have incorporated such clauses in their contract or foreseen the possibility of an Act of God in the nature of what has actually brought the world to a unprecedented halt. For instance, contracts where the words "*Epidemic*" or "*Pandemic*" or "*Public Health Emergency*" etc. are explicitly mentioned in the definition of *force majeure.*

FRUSTRATION OF CONTRACT

In situations where there exists no *force majeure* clause in the contract and/or the factual circumstances are unlikely to be covered within the clause, the parties can try to avoid obligations through the application of the 'doctrine of frustration'.

The 'doctrine of frustration' is a legal principle that is well accepted in Common Law countries. In effect, it frees the parties from their obligations in situations where unforeseen events render the performance commercially impossible or transforms the obligation into a radically different obligation.

The standard of proof, and the quality and quantity of evidence required to demonstrate that a contract has been 'frustrated' due to an impossibility is generally much higher than straight-forward *force majeure* situations.

Whether a contract has been frustrated would depend on the severity of impact on its performance and is a highly subjective assessment. In other words, it would depend on whether the contract's performance has been rendered impossible or simply unviable and unprofitable as a direct consequence of an unforeseen, supervening event.

POTENTIAL ACTIONS TO CONSIDER

The true impact of the COVID-19 outbreak will be understood only in hindsight. It is possible that the present epidemic may become a textbook example of a *force majeure* event and or instance of

frustration of contracts. There is also scope for development of transnational jurisprudence in this area, whether harmonized or not, in due course.

As we write this, in early April 2020, we anticipate that there may be some potential exit options from contracts where the ability to perform an obligation is severely impacted in the wake of the virus, and measures taken by governments to tackle the virus.

If a contract includes a *force majeure* clause, a party can try to invoke it. Alternatively, a party can argue that the contract has been 'frustrated' under the applicable law.

By taking timely actions, parties can safeguard their interests and avoid the risk of unpleasant knee-jerk reactions to an inability to fulfil a contractual obligation, and the grim prospect of a protracted legal battle. Remedies for a *force majeure* event or the frustration of contract may range from the extension of time for performance of obligations, to the complete discharge of all obligations, depending on the facts of the particular case.

At this stage, companies would be well-advised to:

a) Evaluate business and legal risks regularly in light of the rapidly changing landscape;
b) Prepare protocols to handle foreseeable situations and implement contingency plans;
c) Explore potential alternatives to the imminent breach of contracts and maintain records of seeking alternatives to avoid a breach;
d) Keep communication lines open with vendors and buyers so as to be able to foresee upstream and downstream disruptions;
e) Review the existing insurance plans and re-evaluate the scope of coverage;
f) Consider ways to prevent and efficiently resolve any disputes that may arise and seek professional advice if you receive a virus-related notice or intimation.

We wish everyone good health, a safe environment and mental strength to navigate these uncertain times. Please do not hesitate to contact us if you require any clarifications or have any queries.

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