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Force Majeure and Frustration in English Law M&A Agreements in the Context of COVID-19

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The impact of the COVID-19 outbreak is being felt across the globe and has been recognised by the World Health Organisation (WHO) as a global pandemic. Like many other governments worldwide, on Monday, 23 March, the UK implemented strict curbs on day-to-day life in the UK to tackle the spread of the virus, many of which may prevent many businesses from fulfilling existing contractual obligations.

The current outbreak of the coronavirus (also known as COVID-19), recognised by the WHO as a global pandemic, has already had a significant effect on certain businesses and appears likely to have an even greater impact, raising concerns about parties' ability to meet contractual obligations and parties' willingness to perform obligations where it is no-longer commercially beneficial to do so.

Unique and critical considerations are raised for parties to M&A transactions operating in these unchartered waters, both those who exchanged on a deal before the crisis unfolded which is yet to complete and those looking to enter into a transaction in the near future. With a focus on M&A agreements governed by English law, this advisory summarises the concept of force majeure and discusses whether force majeure clauses in contracts could be triggered by the ongoing coronavirus outbreak and the global containment measures imposed. Frustration, an alternative legal avenue for relief from contractual performance is also discussed and practical steps parties may wish to consider are set out.

The Concept of Force Majeure

Contracting parties may try to rely on a force majeure clause in their agreement if the contract has become impossible to perform due to the occurrence of an event outside its control. In English law, the term force majeure has no inherent meaning unless it is defined in the relevant contract and force majeure clauses are not implied into contracts but must be expressly included to apply. As a result, the scope of force majeure and the circumstances in which it is triggered varies from agreement to agreement and will depend on the terms of the specific contract in question.

Force Majeure Clauses in Contracts Governed by English Law

By including a force majeure clause in an agreement, the parties try to prepare for the unpredictable to circumvent certain risks that are out of their control. Such a clause will set out a number of specified events that, if they occur, would make the performance of the contract impossible and may excuse the obligor from performing their obligations. Typically, such lists are non-exclusive and may include an act of God, an epidemic, pandemic or disease or any law or action taken by a government or public authority. Notably, English law does not require the force majeure event to be unforeseeable — whether this is a condition for a force majeure event to occur in any given case depends on the wording of the relevant clause.

Will COVID-19 Trigger Force Majeure?

Whether the circumstances a business finds itself in as a result of the COVID-19 outbreak and/or the containment measures imposed on them as a result will trigger a force majeure clause depends on the drafting of the clause in the relevant contract, the factual context and the intentions of the parties.

Firstly, one must consider whether the outbreak falls within the scope of the force majeure clause. The inclusion of "pandemic" or "epidemic" in the list of force majeure events will almost certainly include COVID-19, especially given that the coronavirus outbreak was designated a pandemic by the WHO on 11 March 2020. "Disease" may be relied upon too, while "act of God" is more uncertain. The inclusion of "law or action taken by the government" as a force majeure event may be sufficient if the reason for non-performance is the containment measures imposed by the relevant authority in relation to the COVID-19 outbreak. Each force majeure clause is subject to the interpretation of English courts for determination of its meaning and effect and courts will interpret the words to reflect their ordinary and natural meaning whilst also considering the intentions of the parties at the time they entered into the contract.

Secondly, COVID-19 must have affected performance of the contract in the manner specified in the force majeure clause. Force majeure clauses vary in terms of the trigger required to be able to rely on the clause, but are likely to require the party seeking to rely on it to be 'prevented' from performing the contract.

Thirdly, the party seeking to rely on the clause bears the burden of proving that COVID-19 caused its inability to perform the contract force majeure is unlikely to be triggered unless the event relied upon is the sole cause of the party's inability to perform — if there are other causes, it is unlikely to be available. The basis for invoking a force majeure provision (e.g., quarantines, travel restrictions or other government measures) will likely be scrutinised with a focus on whether the force majeure event has rendered a party unable to perform its obligations under a contract at the time of giving notice of force majeure. In this context, a potential area for dispute between parties is whether any governmental measures that are being relied upon as evidence of the alleged performance difficulties are mandatory or advisory in nature.

Impact of Triggering a Force Majeure Clause

Typically, if a force majeure clause is triggered, the non-performing party will be excused from performing the contract (or certain parts of it) while the force majeure event subsists. Depending on the drafting of the clause, either party could also be entitled to terminate the agreement.

It is advisable to tread carefully before seeking to rely on a force majeure clause. A declaration of force majeure that a party is not contractually entitled to exposes it to the potential for a claim for repudiatory breach of contract by the counterparty, who may be entitled to damages.

Parties to existing deals could instead seek to engage with their counterparty, for example, to explore whether certain completion deliverables can be waived in the circumstances, or to vary the terms of the agreement to ensure deadlines for meeting any conditions take into account any anticipated delays.

Steps to Consider Now

Contract parties should consider the likely impact of the COVID-19 outbreak on M&A agreements and other contracts.

As a result of COVID-19 and/or containment measures, parties who have already signed a binding sale and purchase agreement, but have not yet completed the transaction, may find themselves unable to meet completion deliverables — for example, to obtain regulatory approvals and third-party consents — or comply with restrictive covenants in the period between signing and closing — such as a covenant that the target continues to operate in the ordinary course of business (i.e., as it has done on a day-to-day basis in the past). Buyers and sellers to such agreements should look closely at the terms of their contract, considering in particular:

- if a force majeure clause is included, which events are included in the list of force majeure events and whether this list is exhaustive or non-exhaustive;
- if a force majeure clause is invoked, which obligations the parties are relieved from — they may be relieved from some but not all of their obligations under the contract — and whether the occurrence of a force majeure event gives a party a right to terminate the contract;
- any requirements to provide notice to the other party when relying on a force majeure clause; and
- reasonable steps that should be taken to mitigate losses caused by the force majeure event and any records to be kept of any steps taken.

Parties negotiating new agreements should be aware of force majeure clauses, ensure one is included and pay particular attention to the trigger events — for instance, check whether the clause covers only unforeseeable events or contains express reference to COVID-19 as a force majeure event.

Frustration — An Alternative Legal Mechanism

Where there is no express force majeure provision in a contract, the legal doctrine of frustration may be available to a defaulting party in very limited circumstances. The doctrine is intended to relieve parties from performing their contractual obligations where an unforeseen event, which is not the fault of either party, has made performance of the contract impossible or radically different to that originally agreed between the parties.

When Will a Contract Be Frustrated?

It is applied narrowly by the English courts and there is a very high threshold for proving a contract has been frustrated. The factual background underpinning the event in question must be considered alongside the obligations of the parties in the relevant contract. A contract will not be frustrated simply because it has become more difficult or more expensive to perform or performance is delayed.

To establish frustration, there must be an event which occurs after the contract has been concluded (meaning it will not automatically apply to contracts agreed after the outbreak of COVID-19) and which:

- is fundamental to the contract and was not contemplated by the parties when the contact was formed;
- is not due to the fault of either party; and
- results in performance being impossible, illegal or radically different to that contemplated by the parties when the contract was formed.

The current lockdown across the United Kingdom and many other countries could mean many contracting parties may be able to establish frustration, and certain knock-on consequences of COVID-19 may also satisfy the requirements set out above. For example, if the government's measures result in a factory having to close, with the effect that it is impossible for the factory to meet the level of production required to supply goods under a contract, then the obligor may be able to argue that the contract is frustrated.

Where a contract is deemed to have been frustrated, it comes to an end permanently and the parties are automatically freed from further performance of future obligations.

Businesses should consider whether alleging frustration is a sensible commercial approach, especially in the context of long-term contracts or where the obligations to be performed have not been made impossible to by the COVID-19 outbreak.

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