

COVID-19 and Contract Law

How does it affect you?

The health implications and measures put in place to reduce the risk and spread of COVID-19 will continue to have a serious impact on businesses and their workforces. Under this environment businesses' ability to achieve contractual obligations may be threatened.

This document reviews common contractual provisions which may respond to performance issues caused by the COVID-19 virus.

It is imperative to understand the wording of each individual contract to ascertain whether and how the contract is likely to respond as individual contracts will vary considerably in their wording.

Force Majeure

The World Health Organisation has declared the outbreak of COVID-19 as a pandemic, which may be enough to trigger a Force Majeure clause.

A Force Majeure clause typically excuses a party from performance of the contract following a certain event which is beyond the reasonable control of that party, making performance difficult or impossible. The underlying principle is that where such an event occurs, that party will not be liable for its failure to perform its contractual obligations.

These clauses may not necessarily completely suspend the requirement for performance, and typically require the affected party to continue to perform its obligations to the extent not prevented by the event. It may also suspend contractual obligations while the force majeure event is occurring. In some contracts, termination may be permitted after a period of a prolonged event of force majeure.

The specific wording of what constitutes a Force Majeure under a contract will need to be considered in determining whether the clause will operate.

WARNING

Incorrectly claiming and enforcing a Force Majeure event when the contract doesn't contemplate the specific situation can constitute a breach of contract typically entitling the other party to damages or termination.

Change of Law clauses

Some contracts contain a "change of law" clause which contemplates situations where unforeseen legal requirements affect the ability of a party to perform its contractual obligations.

NOTE

A state or federal declaration of a health emergency, or the exercise of emergency or public health order powers, are unlikely to constitute a 'change of law' under a contract as they usually utilise legislation which is already in place (although seldom used).

A change of law clause may be of assistance if federal or state-based changes to legislation or new legislation are enacted which affect the jurisdiction within which the contract operates.

It is important to check the wording of the clause and whether any limiting language has been used in what constitutes a 'change of law'. In most cases, the change of law clause does not relieve the obligated party from meeting their obligation but allows them to claim the increased costs in doing so.

Material adverse change clause

A Material Adverse Change (**MAC**) clause is often found in financing agreements and is a common way of allocating the risks presented by adverse business or economic developments occurring. Where there has been a MAC, it entitles parties to terminate the agreement before completion or renegotiate its terms.

Whether COVID-19 constitutes a MAC event is open to debate and will depend on the precise wording of the contract. As such, it is important to consider the precise wording of the MAC provision to work out whether the clause can be invoked and the repercussions for doing so.

Doctrine of Frustration

Even if a contract does not expressly deal with the impacts of external events on performance, a party may still be able to rely on the common law doctrine of frustration. This will apply where an event outside the control of the parties makes a contractual obligation incapable of being performed because the circumstances would make performance radically different from that which the parties intended.

Its application is narrow. An event that simply makes performance more difficult or costly will not amount to frustration. A temporary delay will also not amount to frustration.

Unlike typical Force Majeure clauses, a contract which is frustrated allows a frustrated party to immediately end the contract.

How COVID-19 impacts the ability of a party to meet their contractual obligations and what has been done by the business in response to that will need to be considered in each circumstance. It is important to consider both the probable length of the delay and the estimated time remaining on the contract to determine whether or not the delay amounts to frustration. Disruption to the workforce as a result of social distancing or isolation is of itself unlikely to constitute frustration.

WARNING

Frustration is unlikely to be applied to a contract if that contract already contains a Force Majeure clause or similar.

What should you do?

- Review your contract. Determine whether it includes a force majeure, change of law or MAC clause.
- Consider your notice obligations under the contract.

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