

DRSTM

Alternative.
Legal.
Solutions.

Gone Viral

Gone Viral

As we see the transmission speed of novel coronavirus and the occurrence of self-sustaining outbreaks ever closer to home, contract lawyers are bound to consider possible consequences. Given the current typical response of authorities, it is far from inconceivable that a financial firm's head office and its disaster recovery site may both be subject to protracted lockdown. This situation is exacerbated by the common practice of firms "sharing" sites on the somewhat unsafe assumption that they would be highly unlikely to need one at the same time.¹

The ancient Roman concept of vis major, commonly known by its French civil law appellation Force Majeure (both translate to "Superior Force"), is the legal equivalent of a panic button. Force Majeure (FM) is a recognition of the principle that all obligations are limited by possibility (ad impossibilia nemo tenetur²), i.e. no one should be expected to perform the impossible. While FM is generally implied into contracts under civil law jurisdictions, under



common law systems the concept only exists in contract. Accordingly, under English law FM will not be considered in the absence of specific contractual terms and provisions, the interpretation of which will be governed by the normal rules of construction- strictly and contra preferentem³.

FM clauses traditionally refer to extreme circumstances beyond the parties' control- acts of God and Governments, wars, strikes, abnormal weather and other events that render performance impossible. A recent trend has seen FM clauses drafted in anticipation of more specific events such as cyber-attacks or market disruption which may make performance commercially impractical. Taking these developments into account, the party applying for force majeure must generally show the following three elements:

1. The event prevented, hindered or delayed performance.
2. The party is/was unable to control the inability to perform.

¹ Thank you to Ronald Burley for this interesting point.

² The limit to the basic concept of "pacta sunt servanda" (agreements must be kept)

³ In the case of ambiguity, interpretation will be against the party which proposed/drafted the clause

3. The event and its consequences could not have been avoided by any reasonable action.

The application of FM will be dictated by the terms of the clause. “Hindered” is clearly a lower (if legally imprecise) bar than prevention which requires physical or legal impossibility. Contrary to popular opinion, there is no strict rule as to the possibility of foreseeing the event. However, foreseeability clearly raises questions as to what extent consequences may have been mitigated or avoided. The general effect of a successful claim under FM is the suspension of affected obligations while the event’s consequence persists.



Frustration/Impossibility

In the absence of a FM clause, under English, New York and Hong Kong law the defences of frustration and/or impossibility may potentially apply. Each require proving that:

1. The subject matter of contract or the means if its performance have been destroyed to an extent to render performance objectively impossible; or,
2. The contract has so diverged from the parties’ initial contemplation, performance has become commercially or physically impossible.

Frustration is notoriously difficult to prove under English law. A recent case between Canary Wharf and the European Medicines Agency concluded in the decision that the Agency’s lease would not be frustrated by its forced relocation due to Brexit⁴. Note that some civil law jurisdictions i.e. France and Germany implicitly allow for adaptation, potentially even termination of a contract if an unforeseen event makes performance impossible or excessively onerous.

FM and the ISDA(s)

The 2002 ISDA MA first introduced an FM provision following the destruction of the World Trade Centre. Section 5(b)(ii) defines FM as any act of state or force majeure that makes it impossible

⁴ *Canary Wharf (BP4) T1 Ltd v European Medicines Agency* [2019] EWHC 335 (Ch)

or impracticable for the relevant Office of a party to perform any of its obligations under the agreement, or for the party or its Credit Support Provider to perform any of its obligations under a Credit Support Document. FM is defined as a termination event, as opposed to Event of Default, triggered by a payment falling due or the expiry of the Section 14 eight day waiting period.

The 2002 MA does not list any specific examples of FM and instead only reiterates that the event must be beyond the control of the relevant Office, party or Credit Support Provider (the relevant entity), and entities must use ‘all reasonable efforts’ (undefined) to try and overcome the impossibility or impracticability. The precise scope of the clause has not been defined by case law, but is generally accepted to cover: Regulatory change, natural disaster, war, strikes and other circumstances outside of the parties’ control.

Note that the 2002 ISDA cites “impracticability” and “impossibility” of performance; it does not extend to unprofitability.

FM clauses and epidemics



As usual in contract law, the devil is in the detail, the scope of FM and the likelihood of a successful claim will depend on the exact wording and triggering circumstances. If the eruption of an epidemic or crisis is listed as an FM event then it will be more likely to be effective. Inclusion does not guarantee enforceability, which will depend on drafting, the parties’ intention and the circumstances at inception.

The next step will be to see whether the epidemic has hindered or prevented performance of the contract, and whether there were any reasonable steps that the party could have taken to avoid its effects. Again, it should be noted that a mere increase in the cost of performing the contract would be unlikely to trigger FM.

Post the outbreak of the SARS virus, Chinese courts held that SARS was a valid force majeure event (Tong Zhong Min Er Zhong Zi No. 00030; Zui Gao Fa Min Zai No. 220). In 2014, the outbreak of the Ebola virus in West Africa caused a range of contracts to be terminated under FM clauses. In these cases the acceptance of the Ebola virus as FM acted to halt business, representing its own form of mutually beneficial lockdown.

Conclusion

As containment of coronavirus increasingly looks more of an ideal than reality, attention turns to practical response. Unsurprisingly, a number of law firms recommend that clients revisit all their

FM clauses to provide certainty as to potential exposure. However, financial contracts are typically highly standardised, FM clauses are rarely subject to negotiation. FM “catch-all” wording and notification periods are unlikely to materially deviate from the market standard. Time might be better spent in revising employee health and safety duties, travel policies, and remote working facilities. In the case that you wish to claim FM or are being claimed against:

1. Revisit the affected contract
2. Ensure your own (or your counterparty’s) compliance with relevant notice terms
3. Assess the likelihood of acceptance or enforceability

Given the difficulty involved in fulfilling the criteria for FM, combined with the courts’ consistently tough stance on the matter, assertion of FM should be regarded as a legal last resort. Should the other party decide to dispute the claim, a company could be stuck fighting a legal battle that could prove more damaging than the effects of the event itself.

Foreseeability in respect of this particular outbreak clearly precludes any immediate utility in amending legacy contracts. However, firms should decide whether to include epidemic as a specified item in new contracts or as part of other repapering exercises.

Appendix- Leading and recent FM case law

Case	Principle
Yrazu v Astral Shipping Company (1904)	A miscalculation by a ship master to leave with insufficient coals was not an example of FM.
Tennants (Lancashire) Ltd v G.S. Wilson & Co. (1917)	For a FM clause that states that the trigger event must ‘prevent’, the performance must be legally or physically impossible, not just difficult or impossible.
Lebeaupin v Crispin (1920)	FM includes all circumstances beyond the will of man, and those which it are not in his power to control: floods, war, epidemics and strikes are all cases of FM
Caltex Oil v Howard Smith Industries Pty Ltd (1973)	‘other circumstances beyond the control of the parties’ would include an industrial strike

Asia Pacific Resources Pty Ltd v Forestry Tasmania (No 2) (1973)	Party cannot invoke FM due to 'circumstances beyond the control of the parties' which, to the knowledge of the parties seeking to rely on the clause, were in existence at the time the contract was made.
National Carriers Ltd v Panalpina (Northern) Ltd (1981)	Categories of FM are not set in stone – extreme inflation in some cases can discharge performance obligations (left open the possibility)
Channel Island Ferries Ltd v Sealink UK (1988)	Clause referring to events 'beyond the control of the relevant party' could only be relied upon if that party had taken all reasonable steps to avoid its operation or mitigate its results.
Reardon Smith Line Ltd v Ministry of Agriculture, Fisheries and Food (1998)	Contrasts with Asia Pacific Resources v Forestry Tasmania by stating there is no settled rule of construction that a specific exception, such as strike or war, could not be relied on if it were operative at the time when the contract was made. Even if there were such a rule, it would not apply in this case because the parties would not be able to predict (at that point of time) that it would lead to the consequences that occurred.
Thames Valley Power Ltd v Total Gas & Power Ltd (2005)	A change in economic or market circumstances that affects the profits of the parties will not be regarded as a FM event
Gardiner v Agricultural and Rural Finance Pty Ltd (2007)	Stated that commercial impracticability may not be sufficient (citing Hyundai Merchant Marine Co Ltd v Dartbrook Coal (Sales) Pty Ltd (2006))
Tandrin Aviation Holdings Ltd and Aero Toy Store LLC and others (2010)	Purchaser was not able to rely on the financial crash as an FM event that made them unable to complete the purchase of their aircraft.

Tong Zhong Min Ew Zhong Zi No. 00030 (2015)	From 28 April 2003 to 20 May 2003, SARS counted as a FM event and that contractual parties would not be liable for losses in this period
Zui Gao Fa Min Zai No. 220 (2016)	SARS was declared to be an FM event in this specific case
Classic Maritime Inc v Limbungan Makmur SDN BHD & Anor (2019)	The 'but for test' applies – an exceptions clause requires the party seeking to rely on it that it would not be in breach had the exception relied upon not occurred.

DRS is an alternative legal services provider to the financial services sector. Trusted by banks, asset managers, funds and trading firms across the globe, we provide solutions that deliver rapid and efficient negotiation and remediation of document portfolios.

We achieve this by channelling deep industry knowledge and experience through hiring outstanding people, implementing a rigorous process and applying state-of-the-art technology. Our clients achieve these results without any capital expenditure or infrastructure costs.

Our team is led by industry practitioners with extensive legal and financial services expertise. We negotiate, amend and analyse contracts, in large scale or in low volumes – delivering high quality, high-value solutions on a 'business as usual' or project basis.

Please visit drs-als.com for more information about our services or contact knowledgehub@drs-als.com.

This communication is private and confidential. It is for your information only, and is not for publication elsewhere. It has been prepared solely for informational purposes and is prepared from generally available information believed to be reliable, but we do not guarantee the accuracy of the information, which should not be relied upon, and may be incomplete or condensed. Document Risk Solutions Ltd. accepts no liability for any loss or damage occurring from the use of this information. *Copyright © Document Risk Solutions Ltd. 2019*