Covid-19: Is it a force majeure event or ground for frustration of contract?

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The recent COVID-19 outbreak which has been declared a pandemic by the World Health Organization on 12 March 2020 has caused major disruptions in the business world. In an effort to minimize the outbreak, the Government of Malaysia has on 16 March 2020 issued a Movement Control Order ("**MCO**") which entails *inter alia*, closure of non-essential businesses, restriction of travel in and out of the country and restriction of movements throughout Malaysia from 18 March to 31 March 2020.

Some of the measures implemented under the MCO have raised a lot of concerns, especially for businesses. In this Alert, we will briefly discuss the impact of the COVID-19 outbreak on the performance of contract, in two situations, one where the contract contains a *force majeure* clause, and the other, where such clause is absent.

Force Majeure Clause

A *force majeure* clause is a common contractual provision found in most (but not all) contracts. It is not implied by law and has to be expressly incorporated into a contract by agreement of parties.

A *force majeure* clause caters for certain unforeseeable events that would render the parties' obligations under the contract impossible to perform. The wording of the clause is important as it has to specify events where performance is "*prevented*", "*hindered*", *or* "*delayed*". Such events may include "*acts of God*", "*epidemics*", "*natural disasters*" and "*quarantine*", depending on how the clause is drafted.

A party seeking to invoke a *force majeure* clause bears the burden of showing that an event has occurred which is beyond his reasonable control, and which actually causes a delay or inability to comply with the obligations under the contract. By invoking this clause, the party may relieve himself from the performance of his obligations totally or for a specific period, as provided in the contract.

A *force majeure* clause also usually confers a right on the counterparty to terminate the contract if the *force majeure* event subsists beyond a specified period. It may even provide that the contract is automatically terminated (see *Continental Grain Export Corp v S.T.M Grain Ltd* [1979] 2 Lloyd's Rep 460 and *Classic Maritime Inc v Limbungan Makmur Sdn Bhd and another*, [2019] 2 All ER 622 (QB)).

Is the COVID-19 Outbreak a Force Majeure Event?

There is no blanket rule as to whether the COVID-19 outbreak can be considered a *force majeure* event. It depends entirely on the wording and scope of the *force majeure* clause in the contract. Words such as "*disease*", "*epidemic*" or "*pandemic*" should be sufficient to include the COVID-19 outbreak. On the other hand, words such as "*acts of God*" are arguably insufficient, as an act of God is "*an accident due to natural causes, directly and exclusively without human intervention, and which could not have been avoided by any amount of foresight and pains and care reasonably to be expected of*" (*8 Halsbury's Law of England (3rd Ed) at p 183*).

A *force majeure* clause will not be construed in isolation, but as a whole together with the other provisions in the contract. Thus, the court would consider the underlying purpose of the contract and see whether steps have been taken to mitigate the situation before allowing the defaulting party to invoke the *force majeure* clause (*Crest Worldwide Resources Sdn Bhd v Fu Sum Hou dan satu lagi* [2019] MLJU 512, HC).

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It is interesting to note that in *Global Destar (M) Sdn Bhd v Kuala Lumpur Glass Manufacturers Co. Sdn Bhd* [2007] MLJU 91, the High Court Judge held that a "*depressed economy*" does not come within the expression "*other circumstances*" in a *force majeure* clause. This is because "*the ups and downs of business or economic climate are part of the risk of doing business*". This view was confirmed by the Court of Appeal in *Malaysia Land Properties Sdn Bhd (formerly known as Vintage Fame Sdn Bhd) v Tan Peng Foo* [2014] 1 MLJ 718.

A contracting party seeking to rely on the COVID-19 outbreak as a *force majeure* event should first determine whether the contract has a *force majeure* clause, and if yes, whether the clause is wide enough to cover the COVID-19 outbreak. A notice invoking the *force majeure* clause must be given to the other contracting party. Further, it is important for such contracting party to show that it has taken reasonable steps to mitigate the effect (where possible).

Absence of Force Majeure Clause

If there is no *force majeure* clause in the contract, then parties may only resort to the doctrine of frustration of contract. A contract is frustrated where some irresistible or extraneous circumstances has brought a contract to an abrupt stop, and the continuance of performance becomes impossible or unlawful. In this regard, section 57(2) of the Contracts Act 1950 states, "*[a] contract to do an act which, after the contract is made, becomes impossible, or by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.*"

The doctrine of frustration has a similar effect as a *force majeure* clause, in the sense that it relieves a party from his contractual obligations if an intervening event has disrupted the continued performance of the contract. However, the Courts are generally reluctant to disturb the bargain between the parties and thus, circumstances resulting in the frustration of a contract are narrowly construed. For example, a contract is not frustrated merely because its performance has been rendered more difficult to perform (*Pacific Forest Industries Sdn Bhd & Anor v Lin Wen-Chih & Anor* [2009] 6 MLJ 293, FC).

When a contract has been frustrated, the performance of the contract ends permanently. This consequence is more drastic as compared to a *force majeure* event, which only suspends the performance of the contract for the period that the event subsists, unless the contract provides for automatic termination or is terminated by the counterparty exercising its right to do so under the contract.

Conclusion

As the COVID-19 outbreak is a fairly recent occurrence, there is presently no reported case in Malaysia as to whether the outbreak falls within the scope of a *force majeure* clause, or is a ground for frustration of contract. However, we can already anticipate commercial disputes arising from non-performance of contracts due to the COVID-19 outbreak being litigated in the coming months.

If you have any queries, please contact our Ms. Claudia Cheah (cpy@skrine.com) or Cik Aufa Radzi (aufa.radzi@skrine).

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