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Beyond Majeure. Legal implications of the COVID-19 epidemic on contractual obligations under Cyprus Law.

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The recent outbreak of COVID-19 epidemic is currently affecting Cyprus, Europe and is becoming an emergency in most other regions of the globe. Naturally the primary focus of any business will be on ensuring the health and wellbeing of their staff. Containment measures, including lockdowns, closures of public services, disruption in travel due to restrictions and cancellations of global events are having unprecedented impact on businesses and the economy affecting global supply chains.

We understand that businesses are facing an increasing number of legal and commercial challenges that need to be addressed and mitigated where possible. The legal implications are wide-ranging, complex and at this stage perhaps unknown. This article aims to identify certain key legal issues that may be important during these exceptional circumstances.

We should advise our clients and associates that whilst legal mechanisms exist to avoid performance of obligations under certain exceptional circumstances, the legal hurdles are high and the requirements will depend on each specific scenario. It is recommended to seek professional advice at an early stage.

Force Majeure Clauses

A “force majeure” clause is usually included in a contract to define the circumstances where one of the parties is entitled to suspend performance of its contractual obligations or to claim an extension of time for performance, following a specified event or events beyond its control. In certain cases, it may also facilitate termination of the contract, if it exceeds a specified duration or dramatically changes the mode of performance. The purpose of such a clause is to release a party from liability in the event they cannot fulfil the terms of their agreement for reasons beyond their control. Common examples include earthquakes, floods, war etc but in some cases, depending on the drafting of the clause and the intention of the parties we see inclusion of such matters as strikes, shortage of material and labour and other

matters that the parties consider as amounting to force majeure. The definition may also vary accordingly depending on the law of the agreement, if the parties have not otherwise, exhaustively defined the term.

Will a COVID-19 situation constitute a force majeure incident in a contract? Under Cyprus Law, there is no established definition of what constitutes a force majeure event and this is very much a case of interpretation of the relevant wording as well as the commercial context in which the contract operates. Even if an epidemic is mentioned in the clause, several other requirements may still have to be satisfied depending on the situation. The current situation has affected multiple areas ranging from travel (i.e. travel bans) to lockdowns and quarantines with wide-ranging effects that will need to be considered case-by-case.

One of the main questions will be whether there was any governmental and/or administrative action or supervening natural causes preventing performance, which meet the criteria set out in the contractual term actually used and reflects the intention of the parties. Under Cyprus Law a force majeure clause is not automatically included in the contract by implication.

In the particular instance we are dealing with a supervening health threat. To determine what the legal position would be one would have to look at the specific contract and also could require comparison with other similar situations faced in the past, such as the SARS epidemic in Asia. Also, it is important to consider whether the party with the burden to perform will require a full relief from performance (with risk of default termination) or an extension of time (given the current data on COVID-19 the disruption period is unknown and can only be estimated).

In contrast to the application of the doctrine of frustration below, the application of a force majeure clause depends on what the parties have or are deemed to have agreed. When interpreting a clause in which several physical phenomena are listed as instances of force majeure then applying normal rules of interpretation a widespread health crisis preventing performance will probably qualify. If there is no force majeure clause at all then we would have to rely on the doctrine of frustration.

Frustration of Contract

In certain businesses, COVID-19 is not preventing performance (rendering them unable to rely on force majeure) but nevertheless performing the contract would be financially undesirable. In such cases a party will not be able to argue that the contract is frustrated and therefore terminated immediately. The principle of frustration is a common law principle which has been transplanted and codified into Cyprus Law under section 56 of the Cyprus Contract Law (Cap. 149) and states that a contract will be deemed automatically discharged where it becomes illegal or otherwise impossible to perform (by an event unforeseeable at the time of contract).

Under normal circumstances, the use of frustration as a principle is rare as the threshold for frustration, as established by legal precedent, is very high. When claiming frustration, the party seeking to terminate the contract must prove that the obligations to perform certain actions have become impossible, illegal,

or radically different from what was contemplated when the contract was made. Further the party must be able to prove that applying prudent business sense, it could not have prevented or mitigated the causes leading to the frustration of the contract.

In the case of CoVid-19 there are also the various measures taken by governments making performance impossible. In such circumstances the doctrine of frustration would more easily apply as it is not a case of a merely more expensive way to perform; it is impossibility to perform. However, there will be a lot of "grey area" cases where the non-performance may or may not be the result of governmental intervention.

Material Adverse Change (MAC)

A material adverse change clause, when included in an agreement, gives a party the right to terminate the agreement in the event of its business and/or operations being affected by a significant event. This will largely depend on the wording of the applicable clause inserted in the agreement, as well as the circumstances of the agreement. It will again require a careful consideration of the clause and the specific facts which give rise to the material adverse change clause. The general rule applicable in such considerations is that it is harder to trigger the clause when the circumstances giving rise to the termination under such a material adverse change clause are known at the time the agreement is entered into.

Of course, the above-mentioned tests and principles will need to be applied within the context of a specific scenario, the contract in question and drafting of the relevant provisions therein, as well as the custom established within a specific industry. In any potential breach of contract situation, a careful assessment of the facts, the nature of the contractual provisions engaged will always be required.