

CLYDE & CO

FORCE MAJEURE AND FRUSTRATION CLAUSES IN CONTRACTS



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Force Majeure & Frustration

Force Majeure

- Not a term of art in English law
- No stand alone Force Majeure regime
- Only exists as contractual right
- In absence of a Force Majeure clause, a party would have to rely on Frustration

Frustration

- Common law doctrine that operates to bring a contract to an end
- In reality has a limited application in English law. Quite difficult for a contract to be frustrated
- But it will apply automatically if a frustrating event occurs

Where does this concept come from? – The old, old, old law

- Paradine v Jane [1647]
- The rule as to “absolute contracts” – *“When the law casts a duty upon a man which, through no fault of his, he is unable to perform, he is excused from non-performance; but if he binds himself by contract absolutely to do a thing, he cannot escape liability for damages for proof that as events turned out, performance is futile or even impossible”*
- Courts slowly introduce flexibility
 - Taylor v Caldwell [1863] – *Hire of music hall*
 - Krell v Henry [1903] – *Coronation of Edward VII*

The modern elements of frustration

What is Frustration?

A contract is frustrated where:

- A supervening event takes place
- Parties remaining obligations are significantly changed from those contemplated in contract
- Would be unjust to hold them to the literal sense of the contract in the new circumstances

The effect is that the contract is discharged and neither party has to perform

Frustration

However:

- Supervening events must not be caused by either party's default or be provided for the contract
- It is the “nature” of the contract that must be changed from what was originally contemplated, not just expense or onerousness of the contract
- Performance under the new circumstances must be “radically different” from performance envisaged in the contract

Where frustrating events have caused contracts to be discharged

Destruction of cargo

- Where loaded on a vessel, and then destroyed, a charterparty is frustrated
- However, where lost before shipment charterparty is not frustrated. Charterers must find an alternative cargo

Failure to find any cargo

- Only if there is no other possible source of cargo for the vessel will the charterparty be frustrated
- Cargo would have to be very particularly described
- Would not be frustrated where Charterers' suppliers simply failed to supply. Charterer still has to find alternative cargo
- Same is true of sale contracts

Where frustrating events have caused contracts to be discharged

Impossibility of intended routes

- Would have to be a peculiar set of circumstances
- “The Eugenia” voyage from Genoa to India via Black Sea. Suez War shuts Suez Canal. Charterparty not frustrated because ship could have proceeded round Cape of Good Hope.
- The fact that it was much more expensive for Owners was not a cause of frustration
- Increase must be so great that the conclusion is that the performance of the contract had become radically different

Force Majeure clauses - Introduction

- Contractual provisions that relieve parties from performing a contract
- Their effect depends entirely on the words used
 - “Usual force majeure clause to apply” – void
- As a exception clause, they will be interpreted narrowly

FM Clause - Operation

- Stage 1:
 - Party relying on the FM must prove the occurrence of the event bringing the case within the FM
- Stage 2:
 - Party relying must prove
 - The event falls within the definition of a FM event in the clause; and
 - By reason of the occurrence performance has been “*delayed, prevented restricted or affected*”

FM Clause - Operation

- Stage 3:
 - Party relying must prove:
 - Non-performance was due to circumstances beyond his control (if at fault, no FM); and
 - That there were no reasonable steps he could have taken to avoid or mitigate the event or its consequences

FM Clause - Notice

- Many FM clauses impose an obligation to report the event
- This obligation can be framed by way of a “condition precedent” – if no compliance, no right to rely on the clause
- Courts are lenient with FM notices, so if you want it to have the effect of a “condition precedent”, clear language required

FM Clause - Effect

- Parties can tailor the remedial consequences of a FM event in the clause
 - Time extension to perform
 - Variation of a particular obligation under the contract
 - Option to cancel at a specific point in time
 - *“In the event the Force Majeure Event exceeds thirty (30) days, either party shall be entitled, by written notice to the other party, to terminate the Agreement without any further action or formality being required”*

US Sanctions (1)

US-Iran Sanctions

US Persons

- **US citizens/entities are prohibited from involvement in exports to Iran** by way of **ITSR**, administered by **OFAC**
 - (i) US Persons and non-US Persons are prohibited from exporting US-origin agricultural commodities to Iran
 - (ii) US Persons (but not non-US Persons) are prohibited from exporting non-US-origin agricultural commodities to Iran
 - (iii) US Persons is prohibited from facilitating the export of agricultural commodities to Iran by a non-US Person.
- Also applies to foreign entities that are “**owned or controlled**” by US Persons if the conduct is engaged in “**knowingly**”, meaning “**with actual knowledge or reason to know**”.

US Persons are required to block the property and interests in property of, and thus are generally prohibited from dealing with, persons designated as Specifically Designated National (**SDNs**)

US Sanctions (2)

General Licence

- Authorises US Persons and non-US Persons to export to Iran US-origin agricultural commodities and authorises US Persons to export to Iran non-US-origin agricultural commodities. Agricultural commodities here means (i) food for humans or animals (ii) seeds for food crops (iii) fertilizers or (iv) reproductive material.
- Certain agricultural commodities are excluded.
- Export of agricultural commodities to military/law enforcement/SDNs/narcotics trafficking programs is not authorised.
- Authorised transactions under the General License must be shipped within 12 months of signing the export contract and the payment terms and financing are strictly limited.

Non-US Persons

- Only exposes to US-Iran sanctions if they: (i) cause a violation of the ITSR, (ii) violate ITSR prohibitions regarding US-Iran-related trade or (iii) engage in activities targeted by secondary sanctions.
- No secondary sanctions target transactions related to the export of agricultural commodities to Iran.

EU Sanctions

EU-Iran Sanctions

- **16 January 2016** – EU lifted all nuclear-related economic and financial sanctions against Iran

Existing EU Sanctions (Reg. No. 267/2012)

- This contains prohibitions relating to:
 - (i) **Export and import of certain goods and technology** (not including agricultural commodities)
 - (ii) **Restrictions on transport** (e.g. provision of bunkering or ship supply services)
 - (iii) **An asset freeze imposed on specified entities, bodies or persons** (i.e. a prohibition against “making economic resources available, directly or indirectly to any designated person”).
- Agricultural commodities are capable of being consider an economic resource.

Blocking Regulation (Reg. No. 2271/96)

- Prohibits EU persons from complying with secondary sanctions imposed by the US which are directed at investment and trade with Iran.
- If an entity is affected by a EU based counterparty’s decision to comply with these secondary sanctions, it may be able to take assistance from the Commission and compensatory payments by way of damages.

Sanctions and frustration

Melli Bank v Holbud Ltd (2013)

- A customer had refused to make a payment to Melli Bank, arguing that the agreement had been frustrated due to the fact that Melli Bank was directly subject to sanctions.
- It was held that though Melli bank was designated under EU sanctions, the agreement was not rendered incapable of performance as a licence could have been sought and could be expected to be forthcoming.
- The licence/permission regime had been put in place so that performance could be enabled under a contract that may otherwise be a contravention of a sanction.

Companies should be mindful that they may have to exhaust alternative options to secure contractual performance prior to seeking to rely on frustration as a basis to terminate a contract.

Sanctions and *force majeure*

Arash Shipping Enterprises Co Ltd v Groupama Transport (2011)

- It was held that an insurance company had validly terminated its marine insurance policy as a result of the introduction of EU Regulation 961/2010 imposing sanctions against Iran.
- The policy entitled the insurer by virtue of a *force majeure* clause to cancel the policy “*where the Assured had exposed or may, in the opinion of the Insurer, expose the Insurer to the risk of being or becoming subject to any sanction*”.
- It was held that the clause was wide enough to cater for this sanction imposed by the EU.

Parties should therefore ensure that force majeure clauses are carefully drafted to provide for the type of risks that could arise out of the imposition of sanctions.



430+

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1800+

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worldwide

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continents