

# COVID-19 and Contractual Obligations

Force Majeure & the Doctrine  
of Frustration in Cyprus Law

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*/ We All Stand Together*

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## Introduction

The recent outbreak of Covid-19, which the World Health Organisation classified as a pandemic, has brought to the fore significant issues for businesses. The disease has a profound impact on the performance of businesses and their underlying contractual relationships.

Generally, a party to a contract cannot be discharged of its obligations thereunder and it will be potentially liable to its counterparty for a failure to comply with its contractual obligations. Nonetheless, scenarios like the one we are currently witnessing may also bring the following two concepts into play:

- (1) the concept of force majeure
- (2) the concept of frustration

In the following analysis, the two concepts are analysed from the standpoint of the Cyprus law currently in force. As the concepts may be interpreted and applied differently in different jurisdictions, the governing law of the relevant contract is crucial. Parties to such transactions are encouraged to seek legal advice and guidance on the matter from a competent law firm.

In Cyprus, *force majeure* provisions may be invoked when supervening events exist, affecting the ability of a contractual party to perform its contractual obligations. However, it is important to note that the concept of *force majeure* requires the existence of a relevant clause in a contract. Hence the application of the concept depends on the explicit terms used in the *force majeure* contractual clause. A *force majeure* clause may excuse one or both parties from performance of the contract in some way following the occurrence of the *force majeure* event. Thus, the party so excused, will not be liable for failure to perform its respective obligations under the contract.

On the other hand, in the absence of a *force majeure* clause in the contract, the advent of an external, unpredictable and serious event may give grounds to the parties to invoke the doctrine of frustration. In particular, this is the case when such an event renders it physically or commercially impossible for a party to a contract to fulfil its obligations thereunder, or when it transforms the obligation to perform into a radically different obligation from that undertaken at the moment of entry into the contract.

## Force Majeure

Force majeure is a civil law concept which had been applied and used in common law systems like Cyprus, but without a definite meaning and without a consensus as to its definition. Many contractual provisions set out a specific list of *force majeure* events which are deemed to be events beyond the control of the parties, such as war, strike, riot, hurricane, flood etc. Contracts usually include language to ensure that any list of events is not treated as an exhaustive list.

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A party seeking to rely on the force majeure clause, shall be prepared to prove that:

- (1) the event falls within the scope of the *force majeure* clause; and
- (2) the event has impacted performance to the extent required by the relevant clause (e.g., prevented or hindered performance, as per the wording used in the force majeure clause).

The consequences for the parties where a valid *force majeure* event has occurred will depend on the consequences and remedies expressly contemplated by the *force majeure* provision in the contract.

Remedies in the case of a *force majeure* event typically include an extension of time to perform those obligations or suspension of contractual performance for the duration of the *force majeure* event (thus avoiding the risk of a default termination).

### **Covid-19 & Force Majeure**

In line with the above, the first question to be asked is whether the Covid-19 specifically or pandemic in general is covered by the relevant *force majeure* clause as a *force majeure* event or whether there has been a government decision or administrative action preventing performance, which meets the political interference language which is commonly included in definitions of *force majeure* (i.e. governmental orders enforcing quarantine, mandatory shutdown of businesses, travel bans/restrictions etc).

Secondly, it must be established that performance of the contract at question is prevented or hindered (as per the requirement of the clause) as a result of the *force majeure* event (i.e pandemic, quarantine, travel bans/restrictions etc).

Thirdly, caution shall be taken in case any additional requirement is set out by the relevant clause (i.e. the contract may require that the party declaring force majeure must notify the other party etc). Finally, the party who invokes the *force majeure* clause must have taken all reasonable effort to deal with the new circumstances.

### **Frustration**

It is accepted that frustration occurs whenever a contractual obligation has become incapable of being performed because the circumstances in which performance is called for, would render it a thing radically different from that which was undertaken by the contract.

In this case, the frustrating event must:

- Occur after the contract has been formed; and
- Be so fundamental as to be regarded by the law both as striking at the root of the contract and as entirely beyond what was contemplated by the parties when they entered the contract; and

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- Not be due to the fault of either party; and
  - Render further performance impossible, illegal or makes it radically different from that contemplated by the parties at the time of the contract.

The doctrine of frustration is recognised by Cyprus law in article 56 (2) of the Cyprus contract law (Cap. 149) which states that:

*“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), becomes unlawful, shall be considered to be void when the act becomes impossible or unlawful.”*

Whereas the Cyprus doctrine of frustration derives from a statute, Cyprus Courts' interpretation of the doctrine is similar in spirit to the common law doctrine of frustration.

The doctrine of frustration is applied strictly by the Courts. This is to say, that disappointed expectations even of both parties to a contract do not lead to frustrated contracts. Similarly, an increase in expense is not a ground of frustration. A contract is not frustrated merely because the circumstances in which it was made are altered. Also, it is accepted that the Courts will not be willing to absolve parties from performing a contract merely because it has become onerous on account of unforeseen circumstances. The doctrine is generally applied when the contract becomes impossible of performance by reason of the non-existence of the state of things which form the foundation of the contract.

It is also worth mentioning that, where the parties have included a *force majeure* provision in their agreement which covers the situation, this might be regarded as an explicit expression of the party's intention on the allocation of risk between the parties and therefore prevent the concept of frustration from being applied.

If the supervening event does not frustrate the contract, the party required to perform (and has not) is in breach of contract. To the contrary, if a contract has been frustrated, it is automatically discharged and the parties are excused from their future obligations. When a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it, to the person from whom he received it (article 65 of the Cyprus Contract Law, Cap. 149).

### **Frustration & Covid-19**

Although the circumstances under which frustration can be invoked are narrow, it is not unlikely that there will be some situations arising from Covid-19 that can lead to frustration of contracts. This depends on the individual circumstances of each case including how seriously Covid-19 affected performance.

### **Example-Lease Agreement**

For instance, the operation of business such as restaurants, shops and cafes is expected to be affected as a result of Covid-19 or mandatory shutdown. If the premises used for such a business are premises leased to the owner of the business from another party, it would be reasonable for the lessee to wonder whether he/she is still liable for the rental payments for as long as the operation of his/her business remains suspended because of Covid-19 or mandatory shutdown of the business.

As a general rule, the lessee shall not be discharged of its obligations to pay the rent, unless its lease agreement contain a force majeure clause excluding the lessee from its liability to pay the rent. Such a force majeure clause shall cover the possibility of the lessee not being able to use the premises for the intended purpose because of the force majeure event (being the Covid-19 or the mandatory shutdown).

In the context of frustration, whilst frustration could technically apply to a lease, this is likely to be very difficult to prove in practice. In considering this, the contractual terms and the factual background of the particular case shall be taken into account, including an assessment of how Covid-19 or the mandatory shutdown rendered performance of the lessee' obligation radically different from what was contemplated by the parties at the time of entering into the lease contract.

Overall, it seems that more and more countries introduce protective measures and restrictions in order to manage the Covid-19 outbreak, businesses may find that they or their counterparties struggle to meet their contractual obligations.

Parties to a Cyprus law contract may wonder how they can shield themselves from becoming unable to comply with their contractual obligations. Force majeure clauses and the doctrine of frustration are both relevant. However, both routes have a high bar to success and parties should take careful and tailored advice before pursuing either one of them.

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