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IT BYTES

ANSWERING YOUR COMMON IT CONTRACT LAW QUESTIONS

WHAT IS THE DIFFERENCE BETWEEN FORCE MAJEURE AND FRUSTRATION?

WHEN DOES THIS QUESTION TEND TO ARISE?

In situations where a party to a contract is prevented from performing its contractual obligations by an event beyond their control, the concepts of force majeure and frustration come into play. However, there are key differences in:

- **the legal basis of the concepts;**
- **the situations in which they apply; and**
- **the outcome for each party in these situations.**

These differences should be considered at the outset, during the negotiation and drafting of the contract, so that the parties are aware of how risk will be allocated in the event of an unexpected disruption due to outside forces.

WHAT DOES THE LAW SAY?

Force majeure is a contractual mechanism, rather than a rule of law. For force majeure to apply, there must be a specific force majeure clause in the contract which sets out:

- the situations which amount to force majeure;
- the implications of a party being prevented from performing its contractual obligations due to a force majeure event (as defined in the contract), including the extent to which the affected party will be relieved from its contractual obligations and the steps which the affected party must take to rely on the relief position; and
- the rights that the other party will have if performance of the contract is prevented due to a force majeure event (including rights to terminate if the force majeure continues beyond a specified period, and whether fees will remain payable).

By contrast, frustration is a rule of law, rather than a contractual construct (although its application can be affected by the way that the contract is framed). It results in the automatic termination of a contract, and parties are (generally) required to bear their own losses.

The below table explains further distinctions between force majeure and frustration:

	FORCE MAJEURE	FRUSTRATION
Legal basis	Governed by contract and therefore varies based on drafting. Not separately recognised at common law.	Governed by common law (or statute in some jurisdictions).
Legal test	Performance is prevented by an event beyond the affected party's control (as defined in the contract).	Performance must be impossible.
Which situations?	Parties must specify the situations that will amount to a force majeure event (the term 'force majeure' itself is not a term of art that carries a special pre-defined meaning).	Defined by common law to cover situations fundamentally beyond the parties' contemplation at the time of contracting. For this reason, to the extent the situation is covered by a negotiated force majeure clause, it is unlikely that the doctrine of frustration will have much scope to apply as the parties will have already contemplated the position and agreed on the appropriate treatment via the force majeure clause.
Result	Parties must specify consequences and obligations which follow a force majeure event.	Frustration results in automatic termination of contract.
Allocation of loss	Allocation of loss is defined by the contract. The party affected by the force majeure event will typically be relieved of liability to the extent they are prevented from performing their contractual obligations.	Loss lies where it falls, unless it would be unjust for one party to retain the benefit of the other party's performance.

WHAT ARE THE IMPLICATIONS FOR YOUR CONTRACT?

While similar, force majeure and frustration will apply in different situations and will lead to different results for parties. While negotiating and drafting IT contracts, parties should:

- understand key supply and delivery risks and consider whether any should be addressed under a specific force majeure regime - these could include cybersecurity threats, government directives relating to COVID-19 or other pandemics, and international conflict;
- consider how broadly to draft the scope of force majeure events to which relief applies. Broad drafting is favourable to the party which is more likely to rely on the force majeure clause (typically in an IT contract this will be the supplier, as the supplier will be subject to more performance obligations);
- carefully craft the obligations of each party when a force majeure event occurs (as defined under the contract), including giving consideration to which party should bear the costs of mitigation steps, the interaction with any disaster recovery / business continuity provisions in the contract (which should usually continue to apply irrespective of the position, as they are fundamentally intended to help respond to unexpected interruptions) and the procedural requirements which must be met for a party to rely on the force majeure clause (including notifying the other party);
- consider the interaction of the force majeure clause with the rights of each party to terminate the affected service or the contract as a whole if the force majeure event continues for an extended period – a customer will typically resist the service provider having a right to terminate for the service provider's own continuing force majeure given the customer's reliance on the services being performed; and
- be aware of jurisdictional differences in frustration rules. As a common law concept, the law governing frustration varies between Australian states and internationally. The parties should also be aware that the doctrine of frustration may have limited application where a comprehensive force majeure regime has been negotiated and agreed. In most cases, that will be preferable as it will give the parties greater control over the outcome – where it applies the doctrine of frustration is a relatively blunt instrument, as it results in automatic termination even if that may not be the outcome that the parties most desire.

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