“The COVID-19 pandemic and commercial contracts”

To stop the spread of the COVID-19 (Coronavirus) pandemic governments closed ports and “non-essential businesses”, restricted travel and imposed “lockdowns” or “stay-at-home” orders. In cases where the COVID-19 pandemic or government measures disrupt commercial contracts, it is necessary to carefully analyze the state of affairs to determine the appropriate remedy. A considerable number of articles have already been written on contracts affected by the COVID-19 pandemic, and now it is time to summarize the legal situation for commercial contracts in the most important jurisdictions in a nutshell. This article therefore addresses legal remedies for commercial contracts affected by COVID-19, under the laws of common law countries (UK, Hong Kong and Singapore), Germany, France, Switzerland, United States and the CISG, which are commonly applicable to commercial contracts.

1. Common Law Countries (UK, Hong Kong and Singapore)

1.1 Force majeure clause

Force majeure is principally a matter of contract law in the common law jurisdictions England, Hong Kong and Singapore. Whether a force majeure clause is applicable in a particular situation and its consequences, depends primarily on the wording of the force majeure clause. For example, the ICC force majeure clause (long form) in no. 3 (e) “only” presumes an epidemic to be a force majeure event, but does not cover pandemics such as COVID-19. It remains to be seen whether arbitral tribunals and courts will interpret the term “epidemic” under no. 3 (e) ICC force majeure clause (long form) to encompass pandemics *a minore ad maius*.

The burden of proof is on the party invoking the force majeure clause as defense. Such a party has to demonstrate that a force majeure event occurred and that it had the stipulated effect on the contractual performance. If a party invokes a force majeure clause in a commercial contract, it releases the party from its contractual obligations when circumstances beyond its control have prevented, hindered or delayed its performance.

In case the COVID-19 pandemic falls within the scope of the force majeure clause, parties should carefully examine whether there are other relevant contractual terms affecting the application of the clause – in particular, whether there are any requirements to notify the other party before invoking the clause.

1.2 Frustration

Besides force majeure clauses, the main common law doctrine with potential relevance to the discharge of obligations in the light of unforeseen events – like the COVID-19 pandemic – is "frustration". According to the doctrine of frustration, a contract may be discharged upon the occurrence of an unforeseeable event that either renders the contractual obligation impossible or radically changes the basis upon which the contract was reached. However, the doctrine of frustration has a very limited scope.

1.3 Conclusion

Whether the "force majeure defense" can be invoked in relation to commercial contracts affected by COVID-19 depends in common law countries primarily on the wording of the force majeure clause and its requirements. The default rule of frustration has a narrow scope but may exceptionally be applicable in light of the unpredictable impact of the COVID-19 pandemic, depending on the specifics of the relevant commercial contract in question and the circumstances.

2. Germany

2.1 Impossibility

Pursuant to Section 275 German Civil Code (*BGB*) a party is not required to perform its obligations to the extent that performance is impossible. Section 275 German Civil Code applies not only if performance of the obligation is technically or legally impossible, but also in cases where performance is still technically and legally possible, but would require expenses and efforts which, considering the subject matter of the obligation and the requirements of good faith, would be grossly disproportionate to the creditor's interest of performance. In addition, Section 275 German Civil Code

governs temporary impediments, *i. e.* a claim for performance is excluded as long as performance is impossible. However, German courts respect the legal principle *"pacta sunt servanda"* and hence apply Section 275 German Civil Code narrowly, in order not to undermine the agreed contractual obligations.

2.2 Frustration of purpose

The doctrine of "frustration of purpose" (German "Störung der Geschäftsgrundlage") can be invoked in cases affected by the COVID-19 pandemic. Frustration of purpose under Section 313 German Civil Code will apply where the balance between performance and counter-performance of a contract is significantly changed in a way that was not foreseeable by the parties when the contract was concluded. Such a "frustrated contract" entitles the disadvantaged party to request the amendment of the contract. If an amendment of the contract is not possible or unreasonable, the disadvantaged party may rescind or terminate the contract. According to case law the principle of "contractual loyalty" requires a strict interpretation of Section 313 German Civil Code.

2.3 Conclusion

German courts interpret Section 275 and 313 German Civil Code narrowly, because the parties – in principle – are bound by their agreement. Notwithstanding the above, the consequences of the COVID-19 pandemic may fall within the scope of impossibility and the doctrine of frustration of purpose, as COVID-19 and governmental measures subsequently may have altered the basis on which the parties entered into their commercial contract.

3. France

3.1 Force majeure

Article 1218 French Civil Code (*Code civil*) addresses the concept of force majeure. According to Article 1218 French Civil Code, the debtor's performance is prevented by an force majeure event if three cumulative criteria are met:

1. The event must be beyond the control of the debtor;
2. It must be an event which could not reasonably have been foreseen at the time of the conclusion of the contract; and
3. The effects of the event could not be avoided by appropriate measures.

The legal consequence of Article 1218 French Civil Code is that if performance of the obligation is temporarily prevented, performance is suspended unless the delay justifies termination of the contract. In the event of permanent prevention, the contract is terminated by operation of law and the parties are discharged from their obligations.

3.2 Hardship

The recently introduced Article 1195 French Civil Code requires renegotiation of a contract if circumstances which were unforeseeable at the time of conclusion of the contract render performance excessively onerous for a party which had not accepted to bear that risk. If renegotiations fail, the parties may agree to terminate the contract, or request a court to revise or terminate the contract.

3.3 Conclusion

Overall, French courts tend to be rather strict on criteria for force majeure and hardship. The hardship requirements are broader than those for force majeure, but primarily oblige the parties to renegotiate the contract and – only if renegotiation fails – provide for termination as default rule. Whether the COVID-19 virus leads to force majeure or hardship under French law is determined in particular by the degree to which the impact of the pandemic on the commercial contract was foreseeable.

4. Switzerland

Swiss law has no statutory provision for force majeure events. In the absence of a force majeure clause in a contract, the applicable legal regime depends on whether the performance of the contract is impossible.

4.1 Impossibility

Pursuant to Article 119, 62 Swiss Code of Obligations (Obligationenrecht), the impossibility to perform a contract – due to circumstances not attributable to the debtor – releases both parties from their obligations to perform and leads to the unwinding of the contract according to the rules of unjust enrichment.

4.2 Impossibility for a limited time

In case the impossibility to perform the obligation lasts only for a limited time, the default provisions of Article 107 to 109 Swiss Code of Obligations apply. They provide that if one party is in default, the other party may set an appropriate time limit for the performance. If no performance is rendered during such a time limit, the other party may terminate the contract.

4.3 Not entirely impossible

When the performance of a contract is not entirely impossible, but has become extremely onerous, a party may rely on the legal doctrine *clausula rebus sic stantibus* (adaptation of the contract). It must be a situation which is not only extremely onerous but was also unforeseeable when the contract was concluded. In such circumstances, the parties may agree to amend or terminate the contract. In case one party insists that the contract remains unchanged, the other party may refer the matter before a court. If the requirement of *clausula rebus sic stantibus* are fulfilled, the court may order an amendment or the termination of the contract.

4.4 Conclusion

Impossibility either releases both parties from their respective contractual obligations or entitles one party to terminate the contract if the other party was in default and the time limit fixed has expired. Whether COVID-19 or government measures actually rendered the performance of a commercial contract impossible differs depending on the circumstances of each case, but the trigger point is rather high. Where performance of the contract is possible but “only” onerous – as in most commercial cases affected by COVID-19 – the doctrine *clausula rebus sic stantibus* rarely leads to a judicial termination or adjustment of the contract, as courts apply its requirements narrowly to ensure that the contractual equivalence is not changed subsequently.

5. United States

U.S. contract law is ordinarily a matter of state law. This part of the article focuses on New York law, as it is the law most commonly chosen by commercial parties to govern their contracts.

5.1 Contractual force majeure clauses

Force majeure clauses are contractual provisions that may excuse a party's non-performance when circumstances beyond the control of a party prevent performance. New York courts have held that force majeure clauses are to be interpreted in a narrow sense and that performance under a contract is ordinarily excused only if the event preventing performance is explicitly mentioned in the force majeure clause.

5.2 Applicable doctrines

In the absence of a force majeure clause, the common law doctrines of impossibility, impracticability and "frustration of purpose" may excuse performance.

5.2.1 Impossibility

The doctrine of impossibility excuses a party's performance only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible. The impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract. Impossibility is therefore a narrow legal doctrine.

5.2.2 Impracticability

The doctrine of impracticability is similar to the doctrine of impossibility, but it is more flexible in its application. According to the doctrine of impracticability, a failure to perform contractual obligations is excused, if a party's performance is made impracticable without its fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made. Courts have generally applied the doctrine of impracticability conservatively.

5.2.3 Frustration of purpose

Frustration of purpose is a common law doctrine that excuses a party's performance under a contract when an unforeseen event renders the contract "virtually worthless" to the affected party. Although a literal performance under the contract is still technically possible, the frustrated purpose must be so completely the basis of the contract that, as both parties understood, without it, the transaction would have made little sense. The threshold of the doctrine of frustration of purpose is high, because performance of the contract must be economically impossible.

5.3 Conclusion

The wording of the force majeure clause determines if the COVID-19 pandemic is covered by the clause. The doctrines of impossibility, impracticability and frustration of purpose are applied narrowly. Nevertheless, due to the serious consequences of the COVID-19 pandemic, the parties to a commercial contract may – depending on the case at hand – be able to invoke the defense of these doctrines. The legal consequence of these doctrines provides all-or-nothing in terms of loss allocation – either the party is fully excused from performance or fully obligated.

6. United Nations Convention on Contracts for the International Sale of Goods (CISG)

The CISG is applicable to contracts for the sale of goods between parties who have their place of business in different states, if these states are contracting states or if the rules of private international law lead to the application of the law of a contracting state and the CISG was not expressly excluded in the contract.

6.1 Strict liability

Contracts for the supply of goods under the CISG are governed by the strict liability of the debtor. It is therefore irrelevant for the liability of the debtor whether they are responsible for the improper performance or the non-performance of their contractual obligation.

6.2 Exemption of liability

In order to mitigate the strict liability of the debtor, Article 79 CISG provides for an exemption from the debtor's liability if the failure to perform any of their obligations is due to an impediment beyond their control. It is additionally required that they could not reasonably be expected to have taken the impediment into account at the time of conclusion of the contract or to have avoided or overcome the impediment or its consequences. Article 79 CISG is advantageous to the seller. If the non-performance of an obligation to deliver is based on a force majeure event, the seller is released from the obligation to perform the contract for the period of the impediment. Also, the seller is not obliged to pay damages, because the performance is prevented by the force majeure event. However, pursuant to Article 79 para. 4 CISG the seller must inform the buyer of the impediment and its effects on their ability to perform within a reasonable period of time after they have or should have become aware of the impediment. Otherwise, they are liable for damages resulting from such non-receipt. The burden of proof that a contractual obligation was not performed or was delayed as a result of the COVID-19 pandemic lies with the debtor.

International practice accepts epidemics as being beyond the debtor's typical sphere of control. Consequently, the COVID-19 pandemic could constitute *a minore ad maius* an impediment beyond control according to Article 79 CISG. Whether the COVID-19 virus exempts debtors from their obligation to perform the commercial contract depends on the individual case, since it requires a causal link between the impediment and non-performance.

6.3 Conclusion

On the one hand the debtor is strictly liable under the CISG. On the other hand, debtors can be excused by an impediment beyond their control in accordance with Article 79 CISG if they have informed the creditor of the impediment caused by the COVID-19 pandemic. It will depend on the specific fact of the case if the debtor can successfully invoke the Article 79 CISG defense.

7. Commercial contract affected by COVID-19?

In general to determine whether the spread of the COVID-19 pandemic and the measures taken by governments had an effect on a commercial contract, it is firstly essential to establish what actually affected the performance of the contract and secondly to determine what the direct cause of this problem was. The more the root cause of the problem to perform the contract is impossibility rather than difficulty and the more the direct cause of the problem is objective rather than subjective the stronger the case for a force majeure defense under the applicable law or contractual clauses.

8. Takeaway

The impact the COVID-19 pandemic will have on the parties' commercial contracts depends primary on the wording of their force majeure clause. In case of a force majeure event, the arbitral tribunals and the courts grant the terms of a commercial contract precedence over the applicable law. If a commercial contract does not contain a force majeure clause or the force majeure clause is not covering pandemics, the applicable laws determine the available remedies. The remedies and requirements under the applicable law for commercial contracts affected by the COVID-19 pandemic differ. National laws have in common that legal doctrines which amend or terminate contractual agreements are narrowly construed. The underlying consideration is that arbitral tribunals and courts are only exceptionally authorized to "rewrite" the contractual obligations of the parties. It is therefore decisive whether the contractual provisions comprise a force majeure clause covering the COVID-19 pandemic. Against this backdrop parties should commercial evaluate – based on the facts of each case – their options to invoke a force majeure defense or to perform, amend, or terminate their commercial contracts.

In light of the high thresholds for a force majeure defense under the applicable law, it is essential to ensure legal certainty by including a force majeure clause in commercial contracts covering epidemics and pandemics. In our globalized world, the next epidemic or pandemic will spread sooner or later – therefore a *lege artis* force majeure clause must cover epidemics and pandemics as force majeure events. In particular, the party that would be affected by an epidemic or pandemic in the performance of its contractual obligations should assure that the parties incorporate epidemics and

pandemics in their force majeure clause, to ensure a balanced distribution of risks. Where epidemics and pandemics are included in a force majeure clause, parties should refer to an objective criterion such as an epidemic or pandemic declared by the World Health Organization to define when epidemics and pandemic trigger the force majeure consequences. Good starting point for future “tailor-made” force majeure clauses in commercial contracts is the balanced ICC force majeure clause.