Coronavirus/COVID-19 Pandemic: Impact on Commercial Contracts in the US and in Common Law Countries

To stop the spread of the COVID-19 (Coronavirus) pandemic governments closed ports, borders and "non-essential businesses", restricted travel and imposed "lockdowns" or "stay-at-home" orders. In cases where the COVID-19 virus or government measures have interfered with commercial contracts, it is necessary to carefully analyze the state of affairs to determine the appropriate remedy. This article briefly summarizes the legal situation for commercial contracts affected by the COVID-19 pandemic in the United States and in other common law countries (UK, Hong Kong and Singapore).

1. United States

US 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.

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. The wording of the force majeure clause thus determines whether the COVID-19 pandemic is covered by the clause.

In the absence of a force majeure clause, notably the common law doctrines of impossibility and "frustration of purpose" may excuse non-performance. The doctrine of impossibility excuses a party's non-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.

Frustration of purpose is a doctrine that excuses a party's non-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.

The doctrines of impossibility 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.

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

Force majeure is principally a matter of contract law in the common law jurisdictions UK, 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 Paragraph 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 Paragraph 3 (e) ICC force majeure clause (long form) to encompass pandemics *a minore ad maius*. If a party can successfully invoke 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.

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. The doctrine of frustration has, however, a very limited scope.

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. 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.

3. Commercial Contract Affected by COVID-19?

In order to determine whether the spread of the COVID-19 pandemic and the measures taken by governments had an impact on a commercial contract, it is generally essential to first 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 performance problem is impossibility rather than difficulty and the more the direct cause of

the problem is objective rather than subjective the stronger is the case for a force majeure defense under the applicable law or contractual clauses.

4. Key Takeaways

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 does not cover pandemics, the applicable law determines the available remedies. The remedies and legal requirements for commercial contracts affected by the COVID-19 pandemic differ in common law countries and in New York. Their legal doctrines, excusing the non-performance or releasing or discharging the performance of commercial contracts, have in common that they are construed narrowly. 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.

In light of the high thresholds for a force majeure defense under common law and New York 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. 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 pandemics trigger the force majeure consequences. However, in consideration of the current second wave of the COVID-19 virus, the parties may also agree that effects and governmental measures due to COVID-19 are not covered by their force majeure clause. In any case, a good starting point for future "tailor-made" force majeure clauses in commercial contracts is the balanced ICC force majeure clause.