

A comparative Perspective on Commercial Contracts and the impact of COVID-19 - Change of Circumstances, *Force Majeure*, or what?

Christian Twigg-Flesner, Professor of International Commercial Law, University of Warwick

Introduction: Contracts and the Pandemic

The COVID-19 pandemic which has spread rapidly around the globe will be devastating for millions of people. Some will contract the Sars-Cov-2 virus and a vast number will be affected by the wide economic consequences the pandemic will bring. A key issue affecting businesses (and consumers) is the impact of the pandemic and its consequences on many existing contracts, particularly those where performance is to occur over a period of time and/or to commence at some point in the future. For contracting parties, the pandemic and its consequences could not have been foreseen. A party which cannot perform as agreed will seek to be excused from doing so and to escape liability for breach of contract. In the context of many commercial relationships, there will be scope for negotiations and agreed adjustments to existing contracts.¹ Failing such negotiations, there are two common contract law devices which will be pressed into service: (i) contractual provision for unforeseen events in the case of *force majeure* or hardship; and (ii) provisions of the applicable domestic contract law dealing with unforeseen or unforeseeable events arising after a contract has been concluded. Where neither the contract nor the applicable law provides a solution, a failure to perform will trigger whichever remedies are provided by the applicable law as well as a duty on the aggrieved party to act to mitigate the extent of its losses.² The robustness of the contract laws around the world in providing workable solutions will be tested by the pandemic. This could prompt either a recalibration of existing doctrines or the development of new rules (whether limited to the consequences of this pandemic³ or as a

¹ For contract law scholars in the common law world, the implications for the doctrine of consideration, as well as promissory estoppel, will be interesting.

² Space precludes a discussion in this paper of the particular issues which might arise with regard to remedies for non-performance/breach of contract, e.g., in applying the remoteness test for contract damages, or the extent of the duty to mitigate.

³ For example, Germany has already made COVID-19 specific changes to the Introductory Law to the Civil Code which permit consumers and small businesses to withhold performance in certain circumstances. These changes are currently set to expire at the end of June 2020 (see Art.240, §1 “Moratorium”).

general revision of the law). This paper will provide a brief comparative perspective of relevant provisions for commercial contracts, focusing on the international dimension as well as selected national rules.

Contractual Risk Allocation: *Force Majeure* clauses

Most commercial contracts contain a *force majeure* clause of some kind to deal with events occurring after a contract has been concluded and which are beyond the reasonable control of the parties. The effect of such events will affect the ability of either or both parties to a contract to perform their obligations as agreed, whether that be by making performance more onerous, more costly, or altogether impossible. A *force majeure* clause will stipulate how the occurrence of such an event will affect the contract, e.g., by permitting the parties to suspend performance, requiring cost adjustments or the renegotiation of elements of the contract, precluding termination for breach where that breach is caused by the event, or even bringing the contract to an end.⁴ The precise effects of invoking a *force majeure* clause may depend on the duration of the event triggering the clause – if it is of limited temporary effect, then contract performance might merely be suspended, but if its duration cannot be determined, the contract may be terminated. The International Chamber of Commerce (ICC) issued an updated *force majeure* clause in March 2020 (an update to the 2003 version⁵) in response to the pandemic⁶ and recommended its use in international commercial contracts.

There is, however, no uniform conception of *force majeure*. The ICC's 2020 clause defines a *force majeure* event as “the occurrence of an event or circumstance that prevents or impedes a party from performing one or more of its contractual obligations under the contract.”⁷ The impediment must have been (i) beyond the reasonable control of the party seeking to rely on the clause and (ii) one that could not reasonably have been foreseen at the time of contract conclusion and (iii)

⁴ See e.g, the International Chamber of Commerce (ICC) *ICC Force Majeure Clause 2003* for a range of consequences arising from a *force majeure* event.

⁵ Available at <https://iccwbo.org/resources-for-business/model-contracts-clauses/force-majeure/> [accessed 13 April 2020]

⁶ Available at <https://iccwbo.org/publication/icc-force-majeure-and-hardship-clauses/> [accessed 13 April 2020]

⁷ Paragraph 1 of the *ICC Force Majeure Clause 2020*.

with effects that could not reasonably have been avoided or overcome by the affected party.⁸ The first two aspects are satisfied if one of the specific events listed in paragraph 3 of the clause has occurred. Indeed, *force majeure* clauses frequently spell out in some detail the kinds of events that will trigger it, often based on previous occurrences which had a significant impact on contract performance.

Relevant events might include political or societal disruption (war, border closures, closure of key shipping routes; strikes or rioting), legal disruption (major changes to the legal context for the transaction), or natural events (floods, earthquakes). Whether the particular event which has occurred triggers a *force majeure* clause will depend on the wording of that clause, i.e., whether the event which impedes performance is listed in the clause.

In the case of the COVID-19 pandemic, a *force majeure* clause which expressly mentions pandemics would be applicable and triggered by the COVID-19 pandemic. However, if the contract does not mention pandemic specifically, it may be possible for a party to rely on another event mentioned in the clause. The *ICC Force Majeure Clause 2003*, which will be the relevant clause in most international commercial contracts rather than the 2020 version, includes “epidemics” among the list of factors deemed to constitute a *force majeure* event but not a “pandemic”. This is also the case in the March 2020 version. However, as a pandemic is an epidemic of global proportions, the clause might still be triggered. Alternatively, other events, such as “prolonged break-down of transport”⁹ might trigger the clause: if the goods supplied under the contract rely on air freight and airports are closed because of the pandemic, the clause would apply on that basis. Some clauses contain a catch-all rider along the lines of “any other event beyond the control of the parties” or similar, which should cover the COVID-19 pandemic.

It will next be essential to establish a causal link between the trigger event and the ability of a party to perform the contract as agreed. The fact that an event listed in a *force majeure* clause

⁸ These aspects resemble the conditions under which a party is exempt from liability for non-performance under Art.79 CISG (see below).

⁹ Also mentioned in both the 2003 and 2020 versions of the *ICC Force Majeure Clause*.

has occurred will not suffice unless there is an impact on the ability of the parties to perform. It will be necessary to show that the reason why a party cannot perform is caused by the trigger event, so if the event relied upon in the clause is a “pandemic,” then the reason why the party is unable to perform must be related to the pandemic. For example, social distancing rules and restrictions to non-essential business activities might make it impossible to perform the contract during the period when these restrictions are in place. On the other hand, the fact that the price of goods or components required for performance has changed might not be sufficient.

Finally, the party seeking to rely on the *force majeure* clause would have to demonstrate that there are no reasonable alternative steps available to it to avoid the consequences of the trigger event, or at least to mitigate its effects. For example, it may be possible to source goods or components from a different supplier.

If a *force majeure* clause can be relied upon successfully, then the precise consequences will depend on the outcome the clause provides for. The clause may merely suspend performance without either party incurring liability for non-performance, exonerate a party from any liability for non-performance, or bring the contract to an end. Both the 2003 and 2020 versions of the ICC limit relief from performance and liability for non-performance to the duration of the impediment.

Legal rules for cases of unforeseen events after contract formation

Should a contract not contain a *force majeure* clause at all, or should the clause be drafted in such a way as not to capture the impact of the COVID-19 pandemic, the parties could seek to rely on the legal rules of the law governing the contract which deal with this situation. For example, in English Law, the doctrine of frustration applies in some narrow circumstances where an event occurs after a contract has been concluded which makes the contract impossible to perform¹⁰ (e.g., due to the loss of the subject-matter of the contract, or commercial impossibility), or would

¹⁰ *Taylor v Caldwell* (1863) 3 B & S 826.

make performance “radically different”¹¹ from what was agreed in the contract. Mere financial hardship for one of the parties would not suffice. The event in question must have been unforeseen, or even unforeseeable,¹² by the parties, and neither party must have directly or indirectly brought about the event relied on. Where the doctrine operates, the effect is that the contract is terminated as a matter of law. The threshold for engaging the doctrine of frustration is high,¹³ and it will not assist if one of the parties has assumed the risk of the event occurring, or its consequences,¹⁴ under the contract.

In contrast, Art.313 of the German Civil Code (BGB)¹⁵ deals with the consequences of a significant change in the circumstances forming the basis of the contract (“Störung der Geschäftsgrundlage”). If the parties would not have entered into the contract at all or only on different terms, had they foreseen this change, then modification of the contract can be demanded. This is subject to the requirement that, taking account of all the circumstances of the particular case including the contractual risk-allocation, upholding the contract would not be acceptable to one of the parties.¹⁶ If it is not possible to modify the contract, or if the modification cannot reasonably be expected to be imposed on the party affected, then that party may withdraw from the contract or, in the case of a long-term contract, terminate by giving notice.¹⁷ In French Law, Art.1218 of the French Civil Code contains a statutory provision for *force majeure* for events beyond the control of the parties which were unforeseeable at the time of contract formation and which make performance impossible. If performance would still be possible but unduly onerous on one party, then that party could plead hardship under Art.1195 of the French

¹¹ E.g., *Davis Contractors Ltd v Fareham UDC* [1956] AC 696 and *The Sea Angel* [2007] EWCA Civ 547.

¹² *Walton Harvey Ltd v Walker and Homfrays* [1931] 1 Ch 274; *Amalgamated Investment and Property Co Ltd v John Walker & Sons Ltd* [1977] 1 WLR 164.

¹³ *The Sea Angel* [2007] EWCA Civ 547.

¹⁴ See *Canary Wharf v European Medicines Agency* [2019] EWHC 335, a case arising out of the UK’s withdrawal from the EU. The European Medicines Agency, which was headquartered in London, moved to Amsterdam and sought to escape a 25-year lease on its premises. The judge concluded that, whilst withdrawal from the EU was not foreseeable in 2011, when the lease was entered into, the parties has foreseen the possibility that the EMA might vacate its premise early and provided for this in the lease. Consequently, the lease had not been frustrated.

¹⁵ An English translation is available at https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.htm [accessed 13 April 2020].

¹⁶ Art.313(1) BGB.

¹⁷ See Art.313(3) BGB,

Civil Code. Where *force majeure* is invoked, contract performance is either suspended if the event is temporary or the contract is terminated. In a hardship situation, the affected party can request renegotiation of the contract. Where this is rejected by the other party or unsuccessful, the parties can agree to request judicial assistance or terminate the contract.

In the context of international commercial law, Article 79 of the United Nations Convention on the International Sale of Goods (CISG)¹⁸ exempts a party from liability for non-performance where “the failure was due to an impediment beyond his control and ... he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it, or its consequences.”¹⁹ This exemption lasts for the duration of the impediment only.²⁰ The effect of Art.79 CISG is that there is no liability for damages but the other party can exercise any of the other rights in respect of non-performance.²¹ Consequently, if the impediment is such that the non-performance amounts to a fundamental breach,²² the contract may be avoided.²³

By way of comparison, according to Art.7.1.7 of the *UNIDROIT Principles of International Commercial Contracts* (UPICC), a party’s non-performance is excused if this was “due to an impediment beyond its control”.²⁴ This is subject to the proviso that the non-performing party “could not reasonably be expected to have taken the impediment into account at time of the conclusion of the contract”²⁵ or have mitigated the impediment or its consequences. Furthermore, Art. 6.2.2 UPICC deals with hardship, which occurs “where the occurrence of events fundamentally alters the equilibrium of the contract,” either because the cost of performing has increased or the value of the performance provided has been reduced. The event in question (i)

¹⁸ Applicable to international commercial contracts for the sale of goods; ratified by 93 states.

¹⁹ Art.79(1) CISG. Compare the definition of “force majeure” in the ICC’s *Force Majeure Clause 2020*, paragraph1 (see above).

²⁰ Art.79(3) CISG.

²¹ Art.79(5) CISG.

²² As defined in Art.25 CISG.

²³ Arts.49 and 64 CISG.

²⁴ Art. 7.1.7(1) UPICC.

²⁵ *Ibid.* Presumably, this includes making appropriate provision for this in the contract, suggesting that the impediment was not foreseen or reasonably foreseeable.

must have occurred or become known after the contract was concluded; (ii) could not reasonably have been taken into account before the contract was concluded; (iii) is beyond the control of the party suffering hardship; and (iv) must be one in respect of which the party suffering hardship did not assume the risk.²⁶

The examples from these legal regimes show that there are several common features, although there are differences in the detail, and their application will, of course, vary in light of relevant case-law. However, for present purposes, a number of broadly comparable common features can be noted. First, the event or impediment must have arisen after the contract had been concluded. Second, the event must at least have been unforeseen at the time of conclusion or even not reasonably foreseeable. There is some variation in what precisely is required in this regard – to say that the event/impediment was not foreseen sets the bar lower than to say that the event/impediment was not reasonably foreseeable – something can be foreseeable without having been foreseen. Third, there must be no provision in the contract in respect of the event/impediment or its consequences, i.e., no *force majeure* and/or hardship clause, nor specific contractual risk allocation of the consequences of the event/impediment. If the contract does make such provision, then the parties can no longer rely on whatever background provisions for unforeseen events there might be under the governing law.

In the context of the COVID-19 pandemic, these three aspects raise particular issues. The pandemic was declared by the World Health Organisation on 11 March 2020, although the effects of the spread of the Sars-Cov-2 virus could be felt long before then. In respect of many contracts concluded from mid-to-late February onwards, it may be difficult to argue that the event/impediment only occurred after such contracts were concluded. That said, it may be arguable that the stringent social distancing measures and increasing restrictions of commercial activities could be treated as separate events/impediments which could not be relied on in respect of any contracts concluded after such measures had been announced but might be

²⁶ Similar provisions can also be found in the *Principles of European Contract Law*, Art. 6:111 (change of circumstances) and Art.8:108 (excuse due to an impediment).

relevant impediments in respect of contracts concluded earlier. However, the rapid pace of developments from the emergence of the virus to a full-blown pandemic would make such distinctions of limited relevance in practice.

Secondly, the question of whether the pandemic and its consequences were foreseen, or reasonably foreseeable, will matter. Indeed, clarity about whether the requirement is that it was foreseen or reasonably foreseeable will be crucial: a party seeking to rely on frustration, *force majeure*, or hardship will be able to do so more readily if it can show that the event/impediment was not foreseen even if it was reasonably foreseeable. Of course, if an event/impediment was reasonably foreseeable, arguing successfully that it was not foreseen would mean having to overcome a high evidentiary threshold. The fact that something was reasonably foreseeable will effectively raise a rebuttable presumption that it was foreseen. But clarity on what the relevant standard is will be important.

Furthermore, it will be essential to determine what precisely must have been reasonably foreseeable: would it suffice that there was a possibility that there might be a pandemic which could be seriously disruptive or would it be necessary that a pandemic caused by a novel type of coronavirus spreading rapidly around the globe was reasonably foreseeable? In respect of any contracts concluded before December 2019, the COVID-19 pandemic was certainly not foreseen, nor was it reasonably foreseeable that there would be a COVID-19 pandemic let alone its severe and immediate impact on ordinary activities. However, it is less obvious that the possibility of a pandemic was not foreseeable. Only 11 years ago, the Swine Flu (H1N1 influenza) pandemic affected many countries around the world. In the intervening years, there were outbreaks of SARS and MERS which were contained. In that sense, the possibility that a pandemic, whether from an influenza virus or coronavirus, might occur at some point was not unforeseeable. However, the question would have to be whether any kind of pandemic during the contract period was not only foreseeable but whether it was *reasonably* foreseeable by the parties. The point here is that the question of whether the event/impediment was foreseeable may depend on the degree of precision that is required to identify the event/impediment. A low standard of

precision would mean that the law would rarely be of assistance whereas too high a degree of precision might, in contrast, make it too easy to invoke frustration or hardship. So while a relatively high degree of precision would be justified, it should not be too high.²⁷ Consequently, the question should be whether the rapid development of a pandemic which would necessitate measures causing serious disruption was reasonably foreseeable. The answer to this is almost certainly going to be that it was not.

This leaves the third question, whether the risk of serious disruption as a result of the pandemic were assumed by either party under the terms of the contract. What matters here is whether there was an assumption of risk regarding the consequences of the pandemic, e.g., with regard to the possibility to continue normal business operations, suspension of activities etc. If the contract makes provision for this, then the contractual risk allocation will govern the situation and frustration/hardship no longer apply.

In short, for many contracts concluded before December 2019, there is a reasonable prospect that rules on frustration, hardship, or something similar will be of assistance. The difficulty may lie in respect of the legal consequences arising from the application of these rules. The consequence of frustration in English law is that the contract is terminated by operation of law and the rather complex adjustments under the Law Reform (Frustrated Contracts) Act 1943 might come into play for financial adjustments. There is no scope for suspending performance, liability for breach, or to provide an opportunity for renegotiation. Under Art.79 (5) CISG, a party unable to perform is exempt from liability in damages for breach of contract. In contrast, under Art. 6.2.3 UPICC, in the case of hardship, renegotiation would be the first step, and if that failed, a court could either bring the contract to an end on terms or amend the contract “with a view to restoring its equilibrium”.²⁸ If the situation falls under the force majeure provision of Art. 7.1.7 UPICC, non-performance is excused, although the other party may terminate the contract for a fundamental

²⁷ Note Marcus Smith J’s observations that “There will, no doubt, be many cases where something can be foreseen as a theoretical possibility, but where neither party can be criticised for failing to take it into account. The court must also beware of framing questions of foreseeability too closely to the exact, specific, nature of the supervening event that ultimately occurred.” (*Canary Wharf v European Medicines Agency* [2019] EWHC 335, paras [211]-[212].

²⁸ Art. 6.2.3(4)(b) UPICC.

non-performance. Whether immediate termination is preferable to renegotiation or contract variation by court order will depend on the circumstances of each contract and its wider economic context.

Is a different approach needed for the COVID-19 pandemic?

In responding to novel circumstances, the instinctive reaction of lawyers is to delve into their legal toolbox to see which tools they can use to solve the legal problems which have arisen. However, for some problems, the tools they have may not be sufficient and new tools may have to be created. The brief discussion above reveals that when contracts are considered individually, reliance on appropriately drafted *force majeure* clauses and the background rules of the applicable law for post-formation unforeseen events will cover many contracts affected by the impact of the Covid-19 pandemic and might also provide an appropriate solution for many of those contracts. However, the impact of the COVID-19 pandemic is such that the number of contracts affected will be enormous. Moreover, it is not just a selected category of contracts which is affected but a wide-range of contracts across the economy. This will include many contracts which are part of contractual networks or supply chains. With so much commercial activity slowing down or grinding to a halt altogether, this will be an instance where lawyers and law-makers will have to be creative and think beyond the current law to develop new legal solutions. Such solutions could be limited in scope to the current COVID-19 epidemic, but they could also be of a more general nature, i.e., the pandemic could be the impetus to strengthen contract law now in case of any future severe-impact global disruption. The COVID-19 pandemic might feel unique to us but chances are this will not be the last global disruption on this scale.

An immediate solution that might be appropriate in many instances would be to enable the suspension of obligations under a contract for a period of time without penalty/liability. In other words, performance could effectively be frozen until it becomes possible to relax restrictions and allow commercial activity to resume again. One example of a specific COVID-19 response along these lines are the temporary changes made to German law permitting consumers and small enterprises to withhold performance on defined economic grounds until 30 June 2020 in respect

of contracts entered into before 8 March 2020.²⁹ This right to withhold performance is only available if the other contracting party's economic situation would not be unduly affected as a result.³⁰ Any related litigation would provide some indication of how this kind of approach would work practically. It is, however, a fairly cautious approach, and, for now, limited to a brief period – although on current projections, a longer period might be needed.

Conclusion

The key message of this note is that there are Contract Law mechanisms available to deal with the impact of the COVID-19 pandemic on many contracts. Whether these solutions are suitable in light of the economic context resulting from the measures taken by governments around the world to stem the spread of the virus remains to be seen. The crisis may provide the impetus for a review of how contract law regimes deal with the impact of major unforeseeable events on existing contracts. Short-term responses will be most appropriate for now, but they would not obviate the need for a more thorough look at this issue with a view to reviewing national rules on unforeseen post-formation circumstances.

²⁹ Introductory Law to the Civil Code, Art.240, §1(1) and (2). For a brief analysis (in German), see M. Schmidt-Kessel and C. Möllnitz, "Coronavertragsrecht – Sonderregeln für Verbraucher und Kleinunternehmen" (2020) *NJW* 1103.

³⁰ Introductory Law to the Civil Code, Art.240, §1(3).

