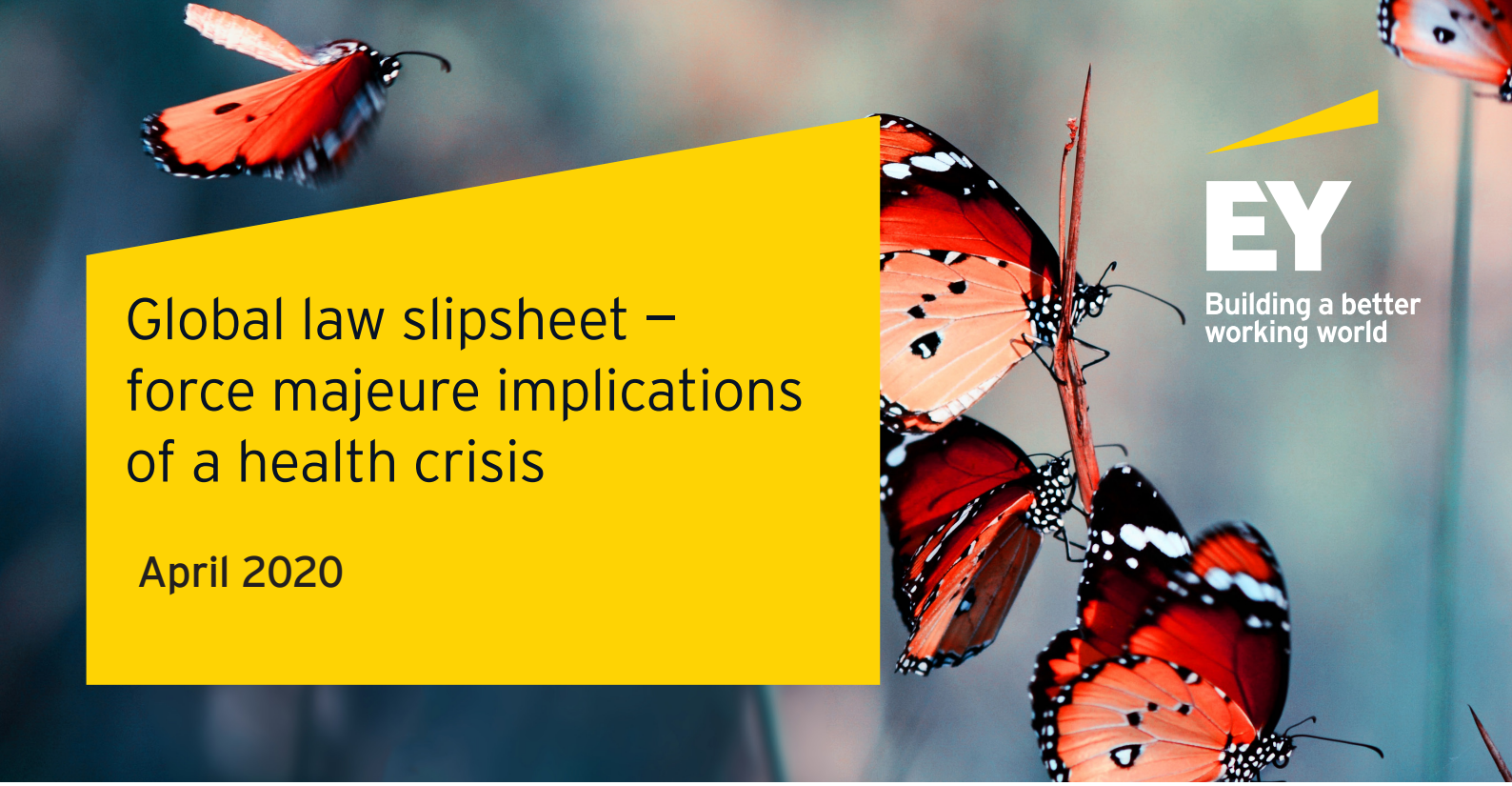

Global law slipsheet – force majeure implications of a health crisis

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EY
Building a better working world

Force majeure, hardship clauses and managing the contract risk burden: key questions and answers

- Does a health crisis constitute a force majeure event?
  - Do not assume this is the case. The situation depends on the wording of the relevant clause and position in the parties' jurisdictions. While we understand some countries are providing legislative guidance and issuing certificates confirming a force majeure event, we suggest that when it comes to commercial contracts, organizations need to verify the legal position in the contract's governing jurisdiction.
- Is there a difference in interpretation if my organization's contracts and operations are in a civil law jurisdiction as opposed to a common law jurisdiction?
  - While in the absence of any reference to a pandemic event into a contract, in most civil law jurisdictions, relying on the statutory provisions of force majeure is possible – in common law countries, it is always the contract that primarily determines whether force majeure applies.
- If a party seeks to rely on force majeure, how should it proceed?
  - Organizations should ensure that formal notification obligations are met. In addition, it may be prudent to demonstrate that all reasonable alternatives have been evaluated and are unavailable to the organization.
- What remedies do parties have in force majeure situations?
  - Successfully claiming a force majeure event may mean, according contractual wording, that the parties' contract is terminated and/or suspended. However, it is prudent to discuss your suppliers' situation and how they may be intending to handle a challenging time, such as a global health crisis.

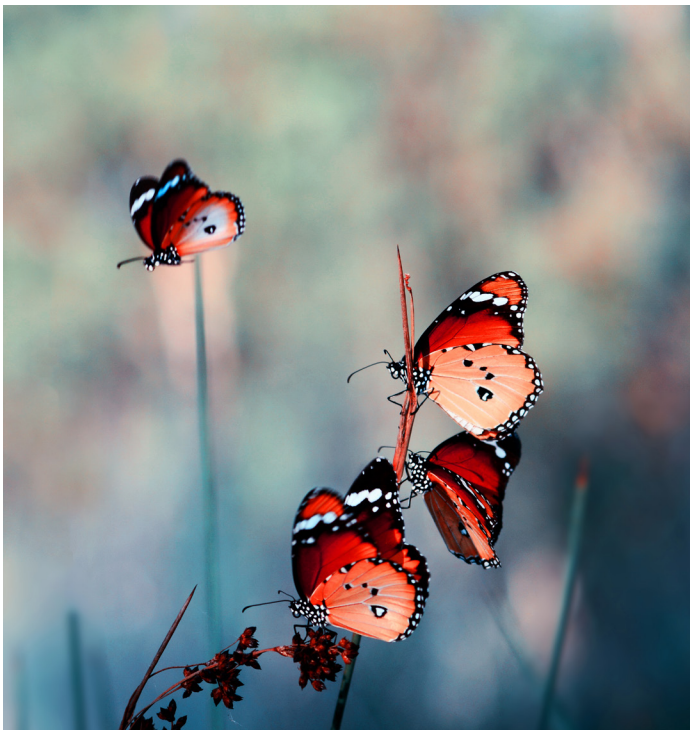
EY Law teams can provide assistance with the following relevant matters:

- **Contract review**
  Accurately evaluate your legal risk exposure, including the application of your organization's force majeure and hardship clauses during a health crisis.
- **Dealing with counterparties**
  Communicate, explore options and solutions, including options for high-volume responses.
- **Remedies/dispute resolution**
  Offer guidance from experienced lawyers for timely, practical advice on available remedies.
- **Implications for next steps**
  Assess implications for restructuring, refinancing and insolvency situations.

EY provides legal services delivered by lawyers in more than 80 jurisdictions. Along with our high quality lawyers, our teams include contract review professionals across eight delivery centers, working with a suite of technology tools to provide a seamless, efficient service for our clients.

On 11 March 2020, the World Health Organization (WHO) declared the COVID-19 outbreak as a pandemic event. The gravity of the outbreak, together with the impact of responsive measures implemented by governments around the world, has posed challenges for supply chains and other commercial relationships.

Legal teams are contemplating the option of applying the principles of force majeure to assess suspension or termination of their organization's contracts. This slipsheet assesses legal positions on force majeure across the world and how it affects parties who are unable, or may be unable, to perform their contractual obligations due to COVID-19 and the associated responsive measures.



Does this health crisis constitute a force majeure event?

Following the WHO classification, parties should review the key provisions of relevant contracts to determine whether the organization's standard force majeure clause contemplates a pandemic event as constituting force majeure.

Commercial contracts usually provide for a force majeure or Material Adverse Change clause. In many cases, contracts don't define a pandemic as an event constituting force majeure. Where contracts do include pandemics as a force majeure event, the clause typically also defines "pandemic." This may refer to definitions provided by external organizations, such as the WHO or, as we saw following the SARS outbreak in 2002, it may refer to a specific health crisis.

While in most cases there will not be any automatic presumption that a pandemic constitutes a force majeure event, organizations are advised to consider the wording of their force majeure clauses, particularly in key supplier contracts. While previously it was difficult for legal departments to precisely evaluate contract risk, legal teams and their advisers are now able to utilize technology and low-cost resources to quickly analyze their contract estate with accuracy and completeness.

What about relying on the force majeure doctrine in law? Does the position differ in civil law or common law jurisdictions?

- **Civil law perspective**

Legal systems utilizing civil law are typically found in continental Europe, South America and parts of Africa and Japan. EY research suggests that it may be possible to rely on the force majeure doctrine in civil law countries.

The force majeure doctrine will not automatically apply in civil law countries. Where the contract clause provides that epidemics or pandemics are force majeure events, "pandemic" must be defined to include an event such as COVID-19. In such instances, it is likely that the party facing the obligation will argue that COVID-19 is a force majeure event. If the contracting parties did not include a contract clause dealing with the impossibility of, or delay in, performance due to force majeure, the relevant local statutory provisions will apply in civil law jurisdictions.

To assess whether COVID-19 may be considered as a force majeure event, the courts will have to determine if the disease constitutes a foreseeable contingency for which reasonable measures could have been taken by the affected party. In this respect, the courts will have to perform a complete case-by-case analysis, since pandemics may be analyzed as force majeure events in some cases, whereas they will not be considered as such in other cases depending on the circumstances.

The event hindering the performance of the contract should be:

- External (i.e., outside the contracting parties' control).
- Unforeseeable at the time the contract was agreed upon.
- Unpreventable or unavoidable (through the exercise of reasonable diligence by the contracting party).

While most South American jurisdictions follow the same approach by having introduced a definition of force majeure into their respective legislation, other countries, such as Portugal and Poland, adopt a broader approach, referring to the impossibility to perform contractual obligations for "reasons not attributable to the debtor," rather than relying on force majeure per se.

Common law perspective

For common law jurisdictions, there is no single definition of force majeure. The application of the doctrine is decided on a case-by-case basis.

When the contract is governed by a common law system, the courts will generally start from the presumption that parties are free to agree on all matters, which includes the freedom to agree to widen or narrow relief in force majeure situations. Generally, force majeure provisions are interpreted by focusing on the actual language used, with the result that each case rests on its own contractual language and set of facts.

Understanding the contractual wording in common law jurisdictions becomes critical for organizations trying to understand their risk exposure, mitigating factors and potential remedies. If the contract states that a force majeure event must "prevent" performance, and the matter reaches the court, the affected party must generally demonstrate evidence that its performance has become legally or physically impossible, not merely more difficult or more expensive. It's also useful to remember that the legal position in each country may differ should the matter go before the courts.

Will legislation or local regulatory activity confirm a force majeure event?

As stated above, the legal position on force majeure varies in law, whether in a civil or common law country. In civil law countries, it is possible that government legislation could confirm that a pandemic will be treated as a force majeure event. While not automatically confirming that all contracts would then be deemed terminated and/or suspended, the presumption would favor the affected party.

In most jurisdictions, whether civil or common law, the answer to the above question is negative. Once again, the terms of the contract will be the primary determining factor in deciding whether a pandemic qualifies as a force majeure event. While some governments such as China have moved to support businesses facing contractual challenges — including the provision of "force majeure certificates" to suppliers — we would still suggest that an impartial court would disregard government intervention.

Available remedies in cases of force majeure

Civil law perspective

Most civil law jurisdictions distinguish between temporary and final force majeure: if the impediment is temporary, the performance of the obligation is suspended unless the resulting delay justifies termination of the contract. If the impediment is final, the contract is automatically terminated, and the parties are released from their obligations.

Based on the above, the COVID19 outbreak, although hopefully likely to last for a limited period, may constitute either a temporary force majeure event or a final force majeure event for contracts where time is of the essence, which may be consequently terminated.

As a result of a suspension and/or termination of contracts caused by the outbreak, if force majeure has been successfully claimed, the non-performing party would not be liable for any breaches or delays resulting from this event.

Common law perspective

In common law jurisdictions, the question of whether a valid force majeure event exists is a matter of drafting, and needs to be sufficiently defined and detailed to be enforceable. Typically the affected party is excused from relevant non-performance while the force majeure event (or its effects) persists.

If non-performance caused by the force majeure event is extended (or becomes permanent), then the provision must state the financial consequences thereof for the parties. Where such termination right is mutual, the affected party may need to consider carefully whether to invoke force majeure at all, especially if preserving the economic benefit of the contract is more valuable than losing the contract.

In addition to the above, a party may have alternate remedies, depending on the governing law of the contract.

- For common law jurisdictions, a party might claim relief under the doctrine of frustration, which results in the contract automatically coming to an end. While frustration tends to have limited application and is even more difficult to establish than when a contract contains force majeure provisions, this could be a potential solution when emergency measures have made the supply permanently unavailable due to travel restrictions.
- Countries such as France, Portugal and Italy recognize the concept of hardship and provide a right to renegotiate the contract in cases of a change of circumstances.

Conclusion

As discussed above, certain types of commercial contracts contain a force majeure clause, setting out the events that qualify as force majeure and its consequences. Contracts often do not expressly mention disease, epidemic or pandemic as force majeure events. As a result, there are no specific rules on the characterization of non-performance due to the COVID-19 as an event of force majeure.

To rely on a force majeure clause, a party will usually have to notify the counterparty that an event of force majeure has occurred, which has prevented, hindered or delayed the performance of its contractual obligations. Force majeure clauses often require the party asserting force majeure to produce evidence and set out notice requirements.

EY Law recommendations

In light of the above, EY Law recommendations include:

- Review your existing contract estate in order to determine:
  - Do all your contracts contain a standard force majeure clause, or are a proportion concluded on the counterparty's standard terms?
  - When force majeure clauses are not mentioned, are there other similar "hardship" clauses or wording on non-performance that should be considered?
  - Does the scope of the force majeure clause expressly exclude any events, such as a health crisis?
  - If your organization wishes to claim that force majeure applies, are there any procedural requirements, such as notification protocols, that must be followed?
- Identify possibilities to avoid or mitigate non-performance of the contract:
  - For instance, a party seeking to rely on force majeure may be subject to a duty to show that it has used all reasonable endeavors to avoid the effect of the outbreak.
  - Have you assessed the actual cost of the alternatives to non-performance?
  - What are other parties in your sector or geography doing in relation to non-performance during the current health crisis?

If you would like to discuss any of the issues raised here, please do not hesitate to contact us.

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