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Force Majeure Clauses During Covid–19 and Their Implications

Vis maior záradékok a Covid–19 során és a következményeik

MARIAH ROSSI

INSTITUTE FOR FOREIGN AFFAIRS AND TRADE

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Publisher:
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Reviewer:
Barnabás Szabó

Copyediting:
Réka Futász

Typesetting:
Andrea Tevelyné Kulcsár

Editorial office:
H-1016 Budapest, Bérc utca 13-15.
Tel.: + 36 1 279-5700
E-mail: info@ifat.hu
http://kki.hu

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Abstract: In the midst of the Covid–19 pandemic, economists, political scientists and lawyers are all speculating about its medium-to-long term repercussions. One issue that poses a common challenge for many scholars is Force Majeure clauses in contracts and their applicability during this crisis. Due to the "fact-specific" nature of Force Majeure clauses, Covid–19 cannot be unilaterally applied to all contracts, although the potential of mass contractual disputes and fallouts is high. The economic impact of stalled and cancelled international and domestic business contracts is staggering, and governments have to decide whether they will opt to legislate or have parties litigate in response to the virus. Scholars advocate for international collaboration and flexibility between parties to mitigate the contractional consequences of the novel coronavirus. Despite scholars' emphasis on collaboration, governments around the world have not coordinated efforts to address these legal ramifications. Instead, governments have implemented drastically different legal measures in addressing the virus, further complicating international business and international relations. To illustrate this point, this paper will look at France, Italy and China. The comparison between France and Italy will demonstrate the lack of consensus within the European Union with respect to Force Majeure clauses, while China's stance as a world trading power will have legal consequences for international business worldwide.

Összefoglaló: *A koronavírus-járvány okozta válság közepette közgazdászok, politológusok és jogászok egyaránt igyekeznek előrejelzéseket adni annak közép- és hosszú távú hatásairól. A szerződésjog olyan sajátos terület, amely számos tudományág szakértőit állítja kihívás elé a szerződésekre alkalmazható* vis maior *(elháríthatatlan külső ok,* force majeur*) klauzulák alkalmazhatóságának kérdése révén. A külső ok elháríthatatlansága,* vis maior *jellege esetenként külön vizsgálatot igényel, így a Covid–19 miatt sem alkalmazható automatikusan minden szerződésre. Ugyanakkor a járvány nagy valószínűséggel tömeges szerződéses vitákhoz és nem teljesítésekhez vezet. A nemzetközi, illetve a belföldi szerződések teljesítésének akadozása vagy felfüggesztése pedig jelentős károkat okozhat a gazdaságnak, így a kormányoknak el kell dönteniük, hogy az igazságszolgáltatáson keresztül vagy a helyzet által megkívánt különleges törvényalkotással próbálják enyhíteni azokat. A szakértők a nemzetközi együttműködés és a rugalmasság mellett érvelnek, az államok egyelőre mégsem koordinálták egymás között a koronavírusnak a szerződések teljesíthetőségére gyakorolt negatív hatásai kezelésére hivatott lépéseiket. Ehelyett egyes kormányok drasztikusan eltérő módszerekkel éltek a vírus miatti* vis maior *záradékok alkalmazhatóságát illetően, ami tovább bonyolítja a nemzetközi üzletmenetet. Ennek érzékeltetésére a jelen elemzés Franciaország, Olaszország és Kína megközelítését vizsgálja meg alaposabban. A francia–olasz összehasonlítás rámutat az Európai Unión belüli koordináció aggasztó hiányára, a Kína mint globális kereskedelmi hatalom által alkalmazott megközelítés pedig világszerte hatással lehet az üzleti életre.*

Introduction

In March 2020, Italians Christian Fracassi and Alessandro Romaioli from the company Isinnova aided an Italian hospital in short supply of oxygen valves for CPAP Hood Systems. The pair used their company's 3D printers to mass produce the necessary part. To do this, they bought the original valve from Intersurgical and reverse engineered it. There are reports that the pair was threatened with a lawsuit for the actions they took as a violation of Intersurgical's intellectual property, but the company released a statement saying that the company had not pursued legal action. Regardless of whether or not the pair was actually sued, this instance has brought up questions in the context of Covid–19. The legal ramifications of this global pandemic are staggering as both businesses and governments try to reconcile new legal restrictions aimed at combating the virus. It is reasonable to assume that a pair of Italian "vigilantes" who copied a patented design without the permission of its owner in circumstances outside a global pandemic would have faced a lawsuit. However, under the current conditions a different set of legal principles are being relied on to make exceptions for and mitigate the legal consequences brought about by Covid–19.

Force Majeure clauses account for extraordinary events in contracts to mitigate liability between the parties. *Force Majeure* clauses are designed to "remove liability" for "natural and unavoidable catastrophes that interrupt the expected course of events and prevent participants from fulfilling obligations". This paper will first explore the legal rules that guide *Force Majeure* clauses, then whether or not Covid–19 can be classified as *Force Majeure*. Upon the conclusion that Covid–19 has the potential to be but cannot universally be called *Force Majeure,* it will explore the different ways state and non-state actors are responding to the crisis.

Whether or Not Covid–19 Is a *Force Majeure* Situation

Covid–19 in layman's terms is an "extraordinary event"; however, in a legal sense these clauses cannot be applied to every contract in effect during Covid–19 (governmental action impacting these clauses will be addressed later in the paper). *Force Majeure* clauses are analysed on a fact-specific basis and generally must meet the following standards:

an event that is beyond the party's reasonable control;
which has prevented, hindered or delayed its performance;
with no fault or negligence of the affected party; and
that the affected party has taken reasonable measures to avoid or mitigate the event or its consequences.

Reasonably, Covid–19 is an event beyond a party's control, while the other aspects are more case specific and would have to be proven by factual analysis. The complexity in addressing whether or not Covid–19 is *Force Majeure* event does not end with these legal guidelines, as the event itself has both direct and indirect implications. Some industries may be suffering from a sick workforce and may be unable to fulfil contractual obligations directly due to the pandemic. Others are hindered by governments' emergency measures (*factum principis*) and regulations that hinder business transactions. Marco Torsello and Matteo Winkler address the concern that the economic slowdown may also lead to legal impossibility to fulfil contracts. However, they note that *Force Majeure* clauses would probably not cover long-term economic consequences. A blanket statement that Covid–19 is a *Force Majeure* event would be overbroad because it is difficult to address to what degree the novel coronavirus has affected businesses and made it impossible to fulfil contractual duties. The International Chamber of Commerce has declared that "it is not for ICC to pronounce whether any particular set of event(s) amounts to a force majeure event". Further, some international businesses have thrived despite the pandemic, which also dismisses a dogmatic application of *Force Majeure* principals. An event itself cannot be *Force Majeure*, rather it can have *Force Majeure* implications. The factual underpinnings of those implications become dispositive rather than the global impacts of the virus. Circumstances benefit some businesses (DocuSign and Zoom for example) but work to the obvious detriment of others (all travel-related businesses). Most of these implications can only be decided by a judge or agreed upon by the parties.

While not every international business is in a dire situation, many are facing challenges that make it impossible to perform contractual duties due to Covid–19. Due to the global nature of the pandemic, international businesses must brace for an unprecedented number of contractual disputes. David Baxter and Carter Casady argue that an "adjudication approach" to handling bellicose parties in contractual disputes that arise from Covid–19 would stall economic progress. They suggest that businesses accommodate for this by setting aside the contract and seeking alternative remedies, as Intersurgical did towards Fracassi and Romaioli. Both parties understood that they were in extraordinary circumstances and that it was necessary to adapt in order to produce a mutually desirable outcome, in this case saving lives. Dispute resolution platforms utilizing artificial intelligence, like eBay's system, may provide faster and cheaper results in these cases.

Due to the fact-specific nature of *Force Majeure* clauses and the Covid–19 global pandemic, states faced two options: "legislate or litigate". Both options have economic implications, the former could be seen to favour certain sectors or only domestic actors, the latter could result in further economic slowdown due to cumbersome litigation processes. Legal scholars advocate for an international resolution aimed at domestic and international businesses to balance risk and sustain current contractual relationships; however, this has not occurred. Rather, state actors have taken radically different stances that favour litigation and have immediate and long-term implications for international trade and business.

States and *Force Majeure* Legislation

The European Law Institute has issued its principles for the Covid–19 crisis. Of its fifteen principles, number thirteen is dedicated to "Force Majeure and Hardship". This principle emphasizes that "States should ensure that existing law on impossibility or force majeure applies in an effective way and provides reasonable solutions". The principle includes contractional failures due to the virus itself and breaches caused by state emergency measures. It also emphasizes the need for balanced allocation of risk between parties during the Covid–19 crisis. The principle ends with a section on solidarity between states. While the principle itself is very generic and does not suggest solutions, the fact that the ELI dedicated a section to *Force Majeure* clauses validates the clauses' impact in the context of the current crisis. The Institute predicts that these clauses will be brought to the forefront of legal challenges emerging from Covid–19. It encourages governments to address laws surrounding these clauses so that disputes are not mishandled during the crisis. It also touches on the international nature of these disputes and that states should act in solidarity, though it does not outright call for international collaboration.

Despite this call for solidarity, even the European Union has not issued guidelines or rules to direct EU Member States in handling this legal issue. Instead, EU member states have taken radically different stances in *Force Majeure* legislation. To illustrate the lack of consensus even within the European Union, this paper will compare France's and Italy's legislation. It is disconcerting that the EU has not tried to further coordinate member state efforts to combat this problem, as it will further complicate trade and business relations within the EU and with the rest of the world. If the EU, with its emphasis on economic cooperation, cannot act in solidarity, then there is little hope for the rest of the world. There is currently a lack of global consensus to mitigate *Force Majeure* fallout. To illustrate this point, this paper will look at China's response to *Force Majeure* clauses, for as a world trading leader the economic impact of its stance is monumental. Lastly, the paper will analyse the reaction of the International Chamber of Commerce to *Force Majeure* clauses: it too has little guidance on how to coordinate efforts and instead encourages parties to incorporate *Force Majeure* clauses into contracts to make them more adaptable during extraordinary events.

Italy

The Italian government implemented national requirements for factual analysis by issuing "[p]rovisions regarding delays or contractual breaches deriving from the implementation of containment measures and advance price on public contracts". Torsello and Winkler's interpretation is that "the respect of PMRs [pandemic-mitigation restrictions] has to be "always" considered when

assessing the exclusion of the debtor's liability for failure to perform, with particular regard to deadlines and penal clauses." This means that in judgements of *Force Majeure* claims restrictions imposed by the government must be considered and that their effects are not outside the scope of the clause. A court must then rule if the emergency measure made it impossible for a contractor to fulfil its obligations. The only restriction is that courts cannot say that governmental regulations are irrelevant. Restrictions therefore can be considered a direct causal link for impossibility to perform. This provision does not seem to encourage parties to set aside disputes or resolve them amicably, and mandating that courts consider governmental regulations will result in more litigation. The opening salvos are likely to argue that Italian law should not apply to the dispute whenever a "choice of law" argument is available.

Torsello and Winkler also address how this provision would have different implications for international business, as the provision itself is not universally applicable. While it set out to make *Force Majeure* claims more effective, it also complicated the landscape for international businesses in Italy. It should also be noted that "[a]lthough this provision is dictated only for public contracts, the *adem ratio* would require extending the principle to all contracts, regardless of the object and nature of the contractors". The provision is very domestically focused, which is reasonable because it was initially intended for public contracts. However, due to the *adem ratio* and the globalized nature of both businesses and the virus, it has complicated international business litigation.

France

In comparison, France has taken a different approach and ordained that "the resolutive clauses as well as the clauses providing for a forfeiture, when their purpose is to sanction the non-performance of an obligation within a specified period, are deemed not to have taken effect or to have effect, if this period has expired during the period defined in I of article 1". The legislation grants blanket immunity to contractual breaches during the emergency measure period. Therefore, if a party fails its contractual duty during 12 March through 23 June 2020, the other contracting party cannot sanction them for failure to perform. Similar to their concerns with the Italian provision, Torsello and Winkler address the effect of this ordinance on international business and contracts and conclude that it "may prove problematic vis-à-vis foreign parties".

Unlike the Italian provisions, the non-effect of non-performance does not encourage litigation, rather it legislates that non-performance cannot have occurred. The legislation is very specific to the domestic situation in France and may not be enforceable in other courts, complicating its effect on international businesses working within France. Skilful international litigators will pick and choose from this smorgasbord of provisions to locate the forum most favourable to their clients' interests, resulting in additional complexity in already complicated disputes.

China

While China has not issued regulations prompted by Covid–19 to deal with *Force Majeure* clauses, the Chinese government is anticipating that the coronavirus and the regulations intended to curtail its spread will wreak havoc on international businesses. To mitigate these legal challenges: "China's Council for the Promotion of International Trade (CCPIT), a quasi-governmental organization that promotes foreign trade has issued thousands of force majeure 'certificates' to Chinese companies, affirming that these businesses were affected by government policies to contain the COVID–19 epidemic. According to Arnold & Porter partner Anton Ware, who is based in Shanghai, the CCPIT has issued nearly 5,700 certificates, addressing international contracts worth about $73 billion."

These certificates are used to partially or completely excuse a party from its contractual duties. However, the certificate does not "lead to an assured legal outcome;" rather, it can only be used in conjunction with factual analysis. Frankel argues that these certificates will be used to prove *Force Majeure* in international litigation disputes and that some Chinese companies have abused them to take advantage of anticipated price drops. These certificates, like the other government policies discussed in this paper, are only applicable in China, but they could be used as factual evidence in international courts. The risk of the Chinese government issuing so many certificates is that their validity may be questioned, which has already occurred in Frankel's article, and more companies and parties may be willing to pursue litigation to prove the "non-occurrence" of a *Force Majeure* event, thereby making the certificates irrelevant or misleading to companies who believe they are no longer liable for failure to perform contractual duties.

Unlike Spain or Italy, the Chinese government is more willing to assert that Covid–19 is a *Force Majeure* event, issuing thousands of "get out of jail free cards" in the form of the certificates. Although it is more willing to make this assertion, it is also doing so on a case by case basis, highlighting a fundamental element of *Force Majeure* clauses that requires thorough factual analysis.

The International Chamber of Commerce

Although it is not a country, the International Chamber of Commerce under its "Competence-Competence" provision has jurisdiction over many international arbitration disputes. However, it has done very little reform to its own rules to address the changing legal environment of the coronavirus. On 7 April 2020 it released a guidance paper where it stated that "it must be stressed that no revision of ICC rules is currently proposed" in reaction Covid–19. Instead, its guidance was to seek solutions amicably to continue to facilitate international trade. While the ICC

does have several rules governing *Force Majeure,* it is not willing to change rules to account for the current pandemic. This means that the ICC is not declaring whether direct or indirect causes of Covid–19 are relevant to be used in *Force Majeure*. It too emphasizes the individual nature of *Force Majeure* clauses and the need for in-depth factual analysis in order to exempt parties from contractional duties.

Rather than changing its governing policies, the ICC has issued an updated *Force Majeure* clause that could be incorporated into contracts by parties or modified to fit the parties' specific desires. The update is from the 2003 version, and the ICC says it was updated "to help businesses large and small draft contracts adaptable to unforeseen events such as the Covid–19 outbreak". While the ICC did not state that it was issuing guidelines because of the virus, it suggests that these clauses could be used in future contracts to mitigate challenges "such as" Covid–19. However, as we are in the midst of the pandemic, it can no longer be classified as "unforeseen". Furthermore, neither the updated nor the 2003 version lists "pandemics" as a potential *Force Majeure* event, but "epidemics" are listed. The ICC also encourages parties to resolve disputes. It has provided updated clauses that make contracts as adaptable as possible to unforeseen circumstances and does not suggest relying on rule changes due to the virus.

Analysis of Different Coronavirus Responses

The general consensus among legal authors is that countries and companies should work together to agree upon amicable solutions. They do not encourage the use of *Force Majeure* clauses in hope of avoiding mass termination of contracts and international trade disruptions. However, as demonstrated earlier, there are varying responses to the crisis. One thing remains certain, that there is no likelihood of a universal declaration that Covid–19 is indisputably a *Force Majeure* event. If anything, the general consensus is that *Force Majeure* clauses can only be determined case by case through fact-specific analysis proving impossibility to perform a contract. Legal scholars' proposed solution to this is that parties should be more flexible in the wake of Covid–19 and open to negotiations, like Intersurgical in Italy. However, due to the nature of these clauses and disputes, it is imperative to ask if this is even an achievable goal, as it may not be in the best interest of all parties to do so.

If there continues to be no consensus among governments to curtail the possible fallout of international contracts, this inaction could lead to more economic slowdown. David Baxter and Carter Casady warn of its effect on public-private partnerships, saying: "Workouts of PPP deals involving the cooperation of multiple parties should thus be pursued in lieu of termination because restarting a terminated transaction will be much more difficult than resuscitating and restructuring a stalled project." Renegotiating entire transactions could result in cumbersome processes and is sometimes not even an option.

Due to Covid–19 supply chain disruptions and skyrocketing demand, medical suppliers like Intersurgical and governments have to be prepared to mitigate fallout from unmet demand. Intersurgical itself cited "medical production regulations" as a reason for its inability to meet demand. Although these regulations are not directly attributed to Covid–19, the company could not supply enough valves, and a third party produced Intersurgical's patented product. In this case it would have been possible for the government to alter regulations so that Intersurgical was less burdened, but instead the private sector handled the challenge. In a choice of legislation or litigation, the risk of litigation was chosen. This example displays the reality that governments are slow to act despite action being in their best and immediate interest. Casady and Baxter argue that there is hope for PPPs to be maintained; however it still goes to show just how complex and disastrous governments' slowness to act can be in the short term. In the long term, many PPPs will have to be renegotiated. There may also be reluctance to enter into PPPs during or after Covid–19 as government regulations or the virus itself could no longer be seen as unanticipated, and *Force Majeure* could not be used as an emergency fallback measure.

Conclusion

Force Majeure clauses pose a unique legal and economic challenge to businesses and government during the Covid–19 pandemic. Legal scholars encourage an international resolution that aids businesses in mitigating the challenges caused by the virus, so they are not forced to terminate existing business relationships, but there has been very little cohesion in this regard. The lack of a consensus has spurred states to independently decide to lean towards either legislation or litigation. France has opted to legislate; China and Italy have supported litigation, whether or not it was their original intent. The disparity between countries complicates international business transactions to such an extent that the ICC and other legal scholars encourage businesses to "be more flexible", even if it means putting their self-interest behind that of the global economy. The fact-specific nature of *Force Majeure* encourages companies to litigate, but governments can do more to step in and mitigate these challenges. In order to do so they must respect global commerce, evaluate the desired effect and actual outcome of the restrictions related to the virus, and legislate to discourage escalation of disputes. The reality is that the economic impact of Covid–19 has the potential to be much worse if there is a mass termination of business relationships for purely legal reasons. Equally daunting is the spectre of years of litigation slowing the restarting of the global economy. This fallout must first be anticipated and then mitigated by governments and if need be, by businesses themselves. Perhaps broad-based resolution mechanisms, like the special masters sometimes hired to resolve mass tort litigation in the United States, offer a path forward, but that conversation remains unfinished.