DISPUTE RESOLUTION newsletter

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COVID19 impact on contractual obligations | Are "force majeure" clauses coming into play?

Restrictions or limitations to businesses as a result of the coronavirus outbreak could enable a contracting party to avoid its obligations by invoking a force majeure clause or to limit its liability for breach of contract, or may allow adjustment of the contract so as to reflect the new reality. As a rule of thumb, whether the pandemic or any other events related to it constitute an event of "force majeure" in specific contract and whether there is indeed a material change in the circumstances is a question of fact to be answered in relation to that particular contract. For this reason and as the threshold of success of any claim related to the above is high and it is important that parties seek careful advice before pursuing either one.

1. May customers and other contracting parties rely on force majeure as reason for non-performance or delay?

1.1 Force majeure provisions in contracts

Typically, most commercial contracts include provisions that allow parties to be excused from their contractual obligations in the event of critical and unpredictable circumstances beyond their control which may delay or make performance impossible for one or both parties. Even in contracts where there is no relevant provision, force majeure may still be invoked to exonerate the non-performing party from liability.

There is a list of factors that need to be taken into consideration in order to determine whether the coronavirus outbreak can be considered as an event that triggers a contract's "force majeure" clause allowing the parties to invoke it in order to escape their contractual obligations.

First, most "force majeure" clauses provide expressly for the events that trigger them. The coronavirus outbreak may be covered by terms such as "epidemic", "disease", or "pandemic". If the clause is loosely framed and includes no such terms, the coronavirus pandemic may still be covered by more open-ended phrases like act of god, or events beyond the reasonable control of the parties. "Force majeure" clauses may also be triggered by the events that took place in response to the viral outbreak, such as government action or change of law in a way which hinders or prevents performance of either party's contractual obligations. For example governmental measures such as the ones already taken by the Greek government aiming to prevent further spread of the virus by ordering closure of businesses, closure of bordure or minimising trading activity and supply chain restrictions could fall in the latter category.

Second, the time when the contract was concluded could also play a role. Arguably, for contracts entered into after the coronavirus outbreak, Covid-19 would in most cases with great difficulty excuse

non-performance or contractual breach. Nonetheless, this does not prevent a party from arguing for another trigger of the "force majeure" clause, such as for example the implementation measures taken by governments to halt the spread of the virus, or the inability of workers to fulfill their duties due to illness or quarantine. This is true, provided that it can be proven that such events remained unforeseeable even after the outbreak has begun.

Third, the occurrence of the "force majeure" event itself does not suffice to excuse a party from fulfilling its contractual obligations. It is necessary to establish that the event invoked has an actual impact on the party's performance and that there is a causal link between the event and the party's failure to perform its obligations. Depending on how the clause is framed, the party invoking force majeure may need to prove that performance of his contractual obligations was either hindered or delayed or outright made impossible. In practice Greek courts will most likely interpret the impact requirements strictly if the parties have not expressly set out the degree of interruption sufficient for triggering the "force majeure" clause.

Finally, a party who wants to rely on a "force majeure" clause must strictly follow the notice requirements set out in the contract. If there is no specific reference to such requirements, still the principle of good faith is relevant. Under such principle the counterparty needs to be informed promptly of the reasons and particulars of the delay or non-performance and –to the extent possible- be offered with alternatives so that the impact of such non-performance is mitigated.

Depending on what the parties have agreed upon in their contract, successful invocation of a "force majeure" clause may indicatively have the effect of suspending a party's performance of a contractual obligation for the duration of the "force majeure" event, partially excusing non-performance of contractual obligations during the event, altering the degree of the parties' obligations, or allowing termination for cause should the event not subside after a certain period of time.

1.2 Limitation of civil liability for damages for breach of contract under the Greek Civil Code

Article 300 of the Greek Civil Code (GCC) provides that in the event of breach of contract, the party who is at default is liable to compensate its counterparty only if the breach is attributable to default (intentional or negligent breach). Greek law excludes liability for damages for breach of contract due to events that escape the defaulting party's sphere of influence. Within these events are also included "force majeure" events.

Greek courts understand as "force majeure" only exceptional events that are humanly impossible to predict and cannot be avoided even if the defaulting party had demonstrated all reasonable care. Normally, the coronavirus pandemic would be considered as such an event. However, Greek courts will consider all circumstances surrounding the default before accepting to limit a claim for damages for a breach as due to the viral outbreak.

Also, it should be noted that the parties may however have agreed to extend liability for damages to include specific events that would otherwise be considered as "force majeure" events under article 300 GCC. For example, specific pharmaceutical contracts may have taken into consideration and extended liability for breach of contract attributable to viral outbreaks.

2. Can the situation caused in the wake of the coronavirus outbreak qualify as material adverse effect and what would its consequences be?

2.1 MAC and MAE contractual clauses

Another type of clauses that are commonly included in commercial contracts and may be triggered by Covid-19's impact is MAC (Material Adverse Change) or MAE (Material Adverse Effect) clauses. MAC and MAE are clauses which may allow adjustment of the parties' contractual obligations or termination of the contract when there is a material adverse change or material adverse effect on the value of the performance due to reasonably expected changes that affect a party's performance under the contract. Usually contracts do not specify the events that may constitute a material change. Instead, they broadly describe the type of impact that justifies the affected party seeking relief.

The case law on article 388 GCC which covers the material change of circumstances shows that Greek courts will primarily consider as material those factors which if were known to the party in advance, said party would not have entered the contract.

Whether the impact of the viral outbreak would constitute a material change of events capable of triggering the relevant contractual clauses is highly dependent on how each specific contract addresses the parties' allocation of risk for material changes. Some contracts may have been updated following the SARS outbreak a few years ago, but most contracts will not include specific reference to the situations created by viral outbreaks. Thus, the party invoking the clause will have to prove the objective materiality of the situation. Whether a viral outbreak and its impact suffices to trigger the clause depends, among other things, on whether the party invoking it can prove that there is no possibility of the parties meeting the burden imposed on them by newly founded situation, i.e. for example that the viral outbreak has a substantial adverse effect on either party's financial condition and that the harm caused will persist for a significant period. In turn, the court will have to assess whether a MAC clause has been triggered on a case by case basis. How the relevant clause is phrased and the actual impact on the company's business will be considered.

Due to the uncertainty related to the triggering of such clauses it is more common for the parties to invoke such terms in order to re-negotiate the contractual terms rather than outright terminate the contract.

2.2 Change of circumstances as legal grounds for adjustment of contractual obligations

Article 388 GCC provides for the effects of material change of circumstances in contracts. In particular, it provides that Greek courts may terminate or adjust a contract in the event of material change of the circumstances which, in good faith and in accordance with fair business practices, serve as the foundation of the contract. Should the contract be terminated by the court, each party shall have to return anything they may have received from the other party under the provisions of unjust enrichment. Article 388 GCC applies in practice where an unforeseen event for which none of the parties is liable renders performance of the contract radically different from what the parties had bargained for. In addition, the GCC contains a general reference to good faith in fulfilling an obligation in article 288. According to this article, a debtor shall be bound to fulfil their obligations in accordance with the requirements of good faith taking also into consideration fair business practices.

The threshold for application of article 388 GCC for adjustment of contractual obligations is very high and has been widely criticised in legal theory as it allows the court to intervene to the contractual relationship and replace the will of the parties with its own judgement in spite of the principle of contractual freedom enshrined in article 361 GCC. In the past, this provision has only been used in the context of 2009 financial crisis in order to adjust the amount paid by virtue of property lease contracts so as to properly reflect changes in the economy brought about by the crisis. If the impact of the coronavirus drastically changes the character of contractual obligations, in such a way so as to nullify the principle purpose or root of the contract it is possible for the courts to decide in favour of a claim for adjustment or termination of the contract. It is possible that the government-imposed restrictions on travel or trade and the economic effects of the compulsory business closure will allow application of article 388 GCC but this will have to be examined on a case by cases basis.

3. What measures need to be taken by a company when there are unforeseen payment problems or failure to meet contractual or other regulatory obligations?

In a situation such as the one we are all currently called to face, communication among business actors is of outmost importance. Companies should evaluate the impact of the coronavirus epidemic and the global measures for halting the spread of the desease on its business, assess the risks related to contract failure and from an early point begin discussions in good faith with its contractual partners explaining the situation and negotiating ways to resolve critical failures and delays.

When the circumstances allow it, proactive thinking may be the best practice. Invoking "force majeure" or seeking adjustment or termination of a contract should be the last resort and may only be invoked once the parties have exhausted all other viable options available that would permit continuation of performance of their contractual obligations. When it is not possible to avoid a breach of contractual obligations, the defaulting party needs to explain to the other party the reasons behind the factual or legal impossibility of its performance, present evidence of the circumstances it relies on and of the measures it is able to take to mitigate damages and resume performance when possible. If the incurrence of losses is unavoidable, the parties shall make every effort to mitigate damages, and resume fulfilment of their obligations the soonest possible.

In the meantime, the parties may also negotiate alternatives that allow even partial performance of their contract. All negotiations should take place in good faith and all efforts to defuse the situation created in the market should take place in accordance with best business practices.

The parties should also remain compliant to any regulatory obligations and communicate to each other the possibility of their failure to meet their regulatory obligations in advance. At the same time all disclosures and communication related to the impact of the outbreak on a company's operations should also comply with applicable law and for this reason it is important for companies to seek advice and coordinate from an early point with their legal teams. This will also allow companies to be prepared for future changes in the market and its regulatory framework.

During these difficult times, Zepos & Yannopoulos Dispute Resolution practice remains available to help you navigate the challenges you may faced.

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