The impact of the COVID-19 crisis and government measures in relation to the capacity of parties to perform their contractual obligations - force majeure, revision of contracts for unforeseen circumstances and MAC clauses

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In an unprecedented global crisis, the performance of contractual obligations has become very difficult, if not impossible, for many economic players who consequently are tempted to find a way to circumvent them. Pleading force majeure may suspend contractual obligations, but such solution should be used with great caution, given the strict requirements to qualify for force majeure and the complexity of its assessment. One may also consider to request the revision of the contract due to an unforeseen change of circumstances, provided that this option is given and its conditions are met. However, the effect of such option is not the same as force majeure, since the contract is not suspended during the time of the renegotiation. At last, if a material adverse change clause was included in the contract, it may be invoked by the party wishing to be relieved of its obligations, provided that its drafting permits it.

The crisis linked to the Covid-19 epidemic and the measures taken by governments to limit the propagation of the virus has resulted in a number of companies being unable to perform or having great difficulty in performing their contractual obligations. Can these companies invoke force majeure, a material adverse change or apply to have the contract revised due to unforeseen circumstances?

1. APPLICABLE LAW OF THE CONTRACT

First and foremost, the law applicable to the contract must be identified. The analysis of what amounts to force majeure, a material adverse change or unforeseen circumstances justifying a contract revision differs from one country to another.

In certain countries such as France these principles are defined by law (with the exception of a material adverse change); these definitions may therefore be invoked even in the absence of an express contractual provision. In other systems of law, they must be expressly provided for in the contract.

This memorandum sets out the rules applicable under French contract law.

2. FORCE MAJEURE

2.1 Legal definition of force majeure

Article 1218 of the Civil Code, codifying previous case law, defines force majeure and its legal regime as follows:

« *In contractual matters, there is force majeure where an event beyond the control of the debtor, which could not reasonably have been foreseen at the time of entering into the contract and whose effects could not be avoided by appropriate measures, prevents performance of his obligations by the debtor.*

If the prevention is temporary, performance of the obligation is suspended unless the resulting delay justifies termination of the contract. If the prevention is permanent, the contract is rescinded by law and the parties are discharged from their obligations under the conditions provided by articles 1351 and 1351-1 ».

Three cumulative conditions must be fulfilled for an event which prevents performance by one party of his contractual obligations qualifying as force majeure:

(a) the event must be independent of the will of the party who can no longer perform his obligations;

(b) the event must not have been reasonably foreseeable at the time of entering into the contract;

(c) the event must be unavoidable when performing the contract: performance must be impossible and not merely more onerous or more difficult.

The consequences resulting from the event will depend on the nature of the resulting prevention: if it is temporary, the performance of the obligation is suspended; if it is final the contract is rescinded.

2.2 Contractual arrangements

The definition of force majeure and its effects can be amended by contract. Accordingly:

- the definition of force majeure can be extended, restricted, or simply limited to a list of events defined in advance;

- the effects of force majeure can be amended or even deleted (unless the contractual clause creates material inequality between the rights and obligations of the respective parties to certain contracts); and

- the contract can set specific conditions for force majeure to apply, for example only after notification or expiry of a period of time.

Where a force majeure clause is included in a contract it should be examined to determine how it applies, how it is triggered and the consequences of its application.

Such examination is crucial since a force majeure clause may give the opportunity to invoke force majeure in a case where the legal definition alone would not allow it. For example, a court recognized the Covid-19 crisis as force majeure due to the existence of a force majeure clause amending the condition of unavoidability by referring to the impossibility of performing the obligations "under reasonable economic conditions" (Paris Commercial Court, Ord. of 20 May 2020).

2.3 Can one invoke force majeure in the present context?

The effects of the epidemic and exceptional government measures to deal with it clearly affect the ability of parties to perform their contractual obligations. However does this constitute force majeure?

Where there is a contractual force majeure clause it should be examined to identify events referred to in the clause and the terminology used (with a narrow or wide approach) to determine if it applies to the Covid-19 crisis and the government measures currently in force. In the absence of a specific clause in the contract, one would have to refer to the legal definition.

In any case, the existence of force majeure, and whether there is an event of a temporary or definitive nature preventing performance, is to be determined on a case-by-case basis. In this respect, the courts will have a wide discretion power.

Traditionally, case law does not accept that force majeure is a justification for not paying a sum of money (Cass. Com., 16 sept. 2014, n° 13-20.306).

The qualification of force majeure may also depend on which particular event is invoked to justify non performance of contractual obligations.

(a) Can one invoke the epidemic itself?

Case law is often reluctant to recognise force majeure where the parties invoke an epidemic or a disease in order to avoid having to perform their obligations.

For example judges have determined in the past:

- an event is not unforeseeable where the epidemic existed at the time of entering into the contract:

"*the epidemic of chikungunya began in January 2006 and cannot be considered an unforeseeable event justifying rescission in August of the contract after a hiring that took place on 4 June*" (Court of Appeal of Saint-Denis de la Réunion, Dec. 29 2009, no. 08/02114; see also Court of Appeal of Besançon, Jan. 8, 2014, no. 12/02291);

- an event is not unavoidable when the epidemic in question is known, endemic and not lethal:

"*the epidemic of chikungunya cannot be considered unforeseeable or, especially, unavoidable because in all cases this disease can be mitigated with analgesics and is generally curable, (as the claimants did not suggest that they had any particular medical vulnerability and as the hotel was able to fulfill its services during the period*". (Court of Appeal of Basse-Terre, Dec. 17 2018, no. 17/00739; see also about the dengue epidemic: Nancy Court of Appeal Nov 22, 2010 no. 09/00003)

In the case of Covid-19, the situation is without precedent due to the widespread nature and seriousness of the virus, therefore courts might consider in certain cases that the conditions of a force majeure event have been met. Apart from contractual matters, a few decisions have already

upheld the qualification of force majeure in connection with the Covid-19 epidemic, in particular to justify the absence of appearance (regarding the hearing of a foreigner placed in administrative custody: Court of Appeal of Colmar, 16 March 2020, No. 20/01142; regarding the hearing of a person involuntary hospitalized: Court of appeal of Bordeaux, 19 March 2020, No. 20/01415).

The first force majeure condition of an event independent of the will of the debtor is unlikely to be an issue in the context of this epidemic.

However, for such a claim to succeed, the other two conditions of force majeure should be verified, i.e.:

- unforeseeability: if the contract was entered into after the start of the epidemic it may be difficult to argue that it was unforeseeable; but if the contract was entered into before the epidemic, is that sufficient for courts to consider that it was unforeseeable? This is not self-evident: as major epidemics are infrequent but recurrent phenomena (plague, Spanish flu, SRAS, etc.), it could be argued that such an event is foreseeable; and

- unavoidability: the defaulting party needs to have taken all appropriate steps to try to perform the contract or to limit the effects of the epidemic; in addition, impossibility to perform the contract must have resulted directly from the epidemic (Court of Appeal of Toulouse, Oct. 3, 2019, no. 19/01579, Court of Appeal of Paris, March 17, 2016, no. 15/042363).

(b) Can the measures taken by governments to prevent the propagation of the epidemic be invoked?

The measures taken by many governments, border closure, closure of certain shops, confinement of the population or meeting prohibition result in performance of numerous contractual obligations being made impossible (organisation of events, transport of people, etc.).

These measures (rather than the epidemic itself) may constitute force majeure (they may qualify as a specific case of force majeure in the form of overriding executive government action ("le fait du prince") provided that they meet the contractual or, in the absence of such provision, the legal definition of force majeure.

In this regard, it will be necessary to verify whether the measures taken were foreseeable or not. If the contract was entered into tafter the start of the epidemic, it will be necessary to take into account any public announcements made by the authorities before entering into the contract, the progressive nature of the restrictions and their foreseeability having regard to the action taken by the first countries affected by the epidemic (China and Italy).

One also has to verify if the steps taken to perform the contract or limit the effect of government measures and the impossibility to perform result directly from these measures.

In addition, in contrast to the epidemic itself which is obviously independent of the will of the parties, it may be argued that the measures taken by governments to limit the spread of the epidemic do not comply with the requirement of being external to the debtor, for example if the debtor of the obligation is a State or an agency of the State, or if the measures were taken as a result of wrongful conduct on the part of the debtor.

In the end, the courts will use their discretion on a case-by-case basis to determine if the events constitute force majeure or not.

2.4 What action should be taken if one wants to invoke force majeure or if another contracting party invokes force majeure?

1. Check the applicable law.

2. Check if the contract includes a force majeure clause.

3. Check if the conditions required for force majeure, under the contract (if applicable) or by law, have been met:

    a. was the event independent of the will of the party invoking it?

    b. was the event reasonably unforeseeable when the contract was entered into: was the contract entered into before or after the beginning of the epidemic? Had the first public announcements on governmental measures been made?

    c. was the event unavoidable when the contract was being performed? Did the defaulting party take all necessary steps to try to perform the contract?

4. Analyse the terms on which the clause is to apply (as applicable).

5. Anticipate and weigh up the consequences of force majeure: suspension or rescission of the contract.

6. Collect evidence of the situation of force majeure, the steps taken to try to perform the contract and the communications with the other contracting party.

7. Prepare resumption of the contract if it is suspended.

3. REVISION DUE TO UNFORESEEABILITY

Where performance of the contract has not been made impossible but has been made more difficult or more onerous, it will not be possible to invoke force majeure. However the affected party may then consider requesting a revision of the contract due to unforeseeability.

3.1 Legal definition of revision due to unforeseeability

Since the reform of French contract law (this provision is only applicable to contracts concluded after 1 October 2016; contracts concluded before this date remain subject to previous applicable law, which did not provide for the possibility for the judge to revise the contract for unforeseen

reasons: for these contracts, the case law which refused judicial review for unforeseen reasons should therefore be maintained), revision due to unforeseeability is provided for in article 1195 of the Civil Code which provides:

> « *If a change of circumstances that was unforeseeable at the time of the conclusion of the contract makes performance of the contract excessively onerous for a party who had not accepted the risk of such a change, that party may ask the other contracting party to renegotiate the contract. The requesting party must continue to perform its obligations during the renegotiation. In the event of refusal or the failure of renegotiation, the parties may agree to rescind the contract, at a date and on terms which they may determine, or, by common agreement, they may ask a judge to adapt the contract. In the absence of an agreement within a reasonable period of time, the judge may at the request of one party revise or rescind the contract at a date and on terms which he will determine* ».

Accordingly there are three cumulative conditions which must be fulfilled in order to renegotiate the contract on this basis:

(a) an unforeseen change of circumstances when the contract was entered into;

(b) such change of circumstances must result in performance of the contract by one party being excessively onerous;

(c) that party must not have accepted the risk of this change.

Whilst this provision may allow renegotiation of the contract, or even its rescission, it does not allow the affected party to refrain from executing his contractual obligations; he must continue to perform whilst the negotiation is taking place.

It should be noted that this provision does not apply to contracts relating to securities and financial contracts (subject to these transactions were concluded after 1 October 2018) (article L. 211-40-1 of the Financial and Monetary Code). Therefore, contracts for transfers of securities issued by most limited companies cannot be revised on this basis.

3.2 Contractual arrangements

It is possible to derogate from the provisions of Article 1195 of the Civil Code, and even to exclude the possibility of a revision due to unforeseeability, subject to complying with the general law in relation to abusive clauses.

Clauses which provide for renegotiation or adaptation of a contract in the case of the occurrence of an unforeseeable event, are generally called hardship clauses, or revision, adaptation or renegotiation clauses.

Where such a clause is provided for in the contract, it should be analysed in order to determine its scope, the procedures for its implementation and the consequences of its application.

3.3 Could revision due to unforeseeability be invoked in the present case?

Where there is a hardship clause it needs to be analysed by reference to the events referred to in the clause and the terminology used (whether a wide or narrow approach) to determine if Covid-19 may be invoked in this connection. In the absence of such a clause the legal definition of unforeseeability shall apply.

In any case, the existence of an unforeseeable event and the need to revise or rescind the contract will need to be determined on a case-by-case basis. It is for this reason (for fear of uncertain results) that many contracts expressly exclude the applicability of revision due to unforeseeability and the contracts actually provide that the parties accept to assume the risk.

If such a clause excluding the provisions of Article 1195 does not appear in the contract, it is reasonable to consider whether the present circumstances may allow a request for a revision of the contract to be made.

Such revision request could apply if the epidemic of Covid-19 represents a change in circumstances that was unforeseeable at the time the contract was entered into (a), and if such change resulted in the performance of the contract being excessively onerous for one party (b).

(a) Does Covid-19 represent an unforeseeable change in circumstances?

Having regard to the importance of the epidemic, it could be argued that the pandemic itself or more specifically its consequences (restrictions on movement, border closure, prohibition of meetings, etc.) constitute a change in circumstances.

It may be difficult to demonstrate the unforeseeable nature of this change of circumstances. The foreseeability of the epidemic and its consequences are subject to the same analysis as to determine force majeure.

(b) Is performance of the contract made excessively onerous?

In the absence of contractual arrangements, the contracting party seeking to rely on revision due to unforeseeability will have to show that performance of the contract had been made excessively onerous by the pandemic or its consequences.

In the absence of case law on the subject, it is difficult to predict how courts would apply this criterion.

The debtor will clearly need to justify the fact that he was in an excessively difficult situation. It should be noted that the mere increase in the cost of a service or a reduction in the value of its counterpart, following a change in circumstances, is not in itself a cause for revision due to unforeseeability. The binding nature of a contract means that each party must bear the risk of normal fluctuations in values.

In addition, it will be necessary to show the causal link between, on the one hand, the epidemic and/or its consequences and, on the other hand, the excessive difficulties suffered by the debtor in the performance of his contractual obligations.

If a contracting party is able to fulfill these conditions he shall be entitled to request a revision of the contract due to the Covid-19 epidemic and the governmental measures currently in force.

However, this approach is not adapted to urgent situations: the implementation of the revision procedure takes a relatively long time and during this time the parties are required to continue to perform the contract.

3.4 What action should be taken in order to ask for a revision of the contract due to unforeseeability or if another contracting party make such a request?

1. Check the applicable law.

2. Check if the contract includes a hardship clause.

3. Check if the requirements under the contract or, failing which, by law, have been met:

    a. was the change in circumstances unforeseeable when the contract was entered into: was the contract entered into before or after the beginning of the epidemic? had the first public announcements on governmental measures been made?

    b. was performance of the contract made excessively onerous?

4. Identify the conditions of implementation of the clause (as applicable).

5. Anticipate and measure the consequences of implementing a revision due to unforeseeability; in the absence of agreement between the parties, there is a risk of revision of the contract by the judge or of judicial rescission.

6. Collect evidence of the situation of unforeseeability and of the communications with the other contracting party.

4. MATERIAL ADVERSE CHANGE CLAUSES

Material adverse change clauses (MAC clauses) allow a party to a contract to withdraw from a transaction or to renegotiate part of the contract where an event materially reducing the profitability of the transaction occurs after the signing of the initial commitment.

4.1 The regime of material adverse change clauses

The concept of material adverse change clauses is not defined under French law or case-law.

4.2 Each contractual MAC clause individually defines the adverse events likely to enable its implementation and the consequences of their occurrence. Can material adverse change clauses be invoked in the present case?

In order to determine whether the MAC clauses are applicable to the Covid-19 epidemic and/or to the governmental measures currently in force, it is necessary to analyse each clause's terms and definitions.

Material adverse changes may be defined by a general formula, such as "event that is beyond the parties' control and which substantially affects the economy of the contract" or "a significant adverse change within the company".

Having regard to the Covid-19 epidemic and its consequences, a number of MAC clauses drafted in such a way are likely to apply. However these clauses must be applied in good faith (for example one should not take advantage of the situation to apply clauses in certain contracts and not in others where the wording is similar). In the event of litigation, a judge will have a wide discretion in applying these clauses.

This wide discretion will be considerably reduced when the MAC clause lists in detail the events which may trigger its implementation. If one of these events applies to the current situation (reference to an epidemic, a pandemic, a break in supply chains, shortage of labour, etc.) the implementation of the MAC clause may hardly be challenged. Otherwise it will be necessary to determine if the list of events provided for in the clause is purely illustrative or exhaustive.

In addition, certain MAC clauses stipulate accounting and financial thresholds to determine whether a change is "material". In such a case the contracting party seeking to invoke the MAC clause needs to check if these thresholds are met.

In the absence of these provisions, the contracting party seeking to invoke such a clause will have a wider margin of manoeuvre. Nevertheless, he will have to demonstrate the impact of the adverse effect on the contract in question.

Moreover, it may be argued that, to be material, an adverse event cannot only be temporary. To our knowledge however, this point has not been the subject of French case-law.

If the MAC clause is applicable, its implementation requirements (notifications, notice periods, etc.) must be followed, bearing in mind that the date of occurrence of the event may be hard to determine in the present case. The other contracting party should therefore be notified as quickly as possible if the MAC clause is to be enforced.

4.3 What action should be taken to invoke a MAC clause or if the other contracting party wants to invoke it?

1. Check the applicable law.
2. Check if the contractual requirements have been met.
3. Identify how the clause applies.
4. Anticipate and measure the consequences of implementing the clause. Renegotiation, rescission of the contract or action for breach of warranty.
5. Collect evidence of the material adverse change and of the communications with the other contracting party.

5. THE RISK OF INVOKING FORCE MAJEURE, A MAC CLAUSE OR ASKING FOR REVISION DUE TO UNFORESEEABILITY

A MAC clause or force majeure implemented without good cause may result in the other contracting party seeking to have the contract enforced.

Such other contracting party may also claim damages on grounds of the contract being perfomed bad faith or of abuse of rights.

Therefore, we recommend exercising caution when these provisions are implemented since they can have significant consequences (for example triggering a MAC clause in a loan agreement can lead to the insolvency of the borrower).

A request for revision of the contract due to unforeseeability does not stop performance of the contract. The requesting party should not therefore be liable in that respect. The risk in this case is the uncertainty as to what the courts will decide in the absence of agreement between the contracting parties.

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