

Corona Crisis: Hardship and Change of Circumstances

Implications for Commercial Contracts under International Law, French Law, English Law and German Law

With the coronavirus (“**COVID-19**”) having spread over 100 countries and infecting meanwhile over 300,000 plus people across the globe, it is set to alter commercial life as we know and anticipated it. The impact of the current crisis getting increasingly difficult to scope for parties involved in national and international trade and commerce.

Companies are likely to be faced with “Hardship” situations that may render discharging of contractual obligations difficult, i.e. more burdensome if not impossible.

In addition, one of the primary considerations of the current COVID-19 crisis are Force Majeure clauses in international contracts. However, in the prevalent regime of international contracts, the opportunity to rely on Force Majeure (*FM*) clauses may be limited considering the target specific drafting of Force Majeure clauses and the strict requirements contained in the applicable law.

[Force Majeure in the context of COVID-19 has been dealt with in great detail in our previous publication dated 17 March 2020. Available at:

https://www.alexander-partner.com/fileadmin/downloads/legal_update-force_majeure-and-the-corona-crisis-17-03-2020-oliver-alexander-and-dr.-philippe-stompfe-alexander-partner.pdf]

Hardship within the context of *rebus sic stantibus* is generally interpreted and applied that contracts are binding only so long as and to the extent that matters remain the same as they were at the time of the contract coming into force..

This publication sets out the key features, main functions and legal consequences of Hardship. In this regard, reference to the legal systems of France, England and Germany is made. Furthermore, a comparison between the legal institute of Force Majeure and Hardship is provided.

Force Majeure and Hardship: A Comparison

Force Majeure (“**FM**”) happens to be a legal institute that seeks to explicitly excuse a party from some or all of its contractual obligations in the light of an event that is **beyond the control of the parties** and that prevents, impedes or delays the performance therein. It is also a requirement of the jurisprudence that the concerned impediment to the performance of the contract **should not have been able to be taken into account at the time of conclusion of the contract**.

Furthermore, the FM event must render the performance of the relevant contractual obligation ***impossible***.

Hardship typically exists to combat situations of ***unforeseen events that make the performance of the contract more burdensome, though not impossible, than initially predicted***.

The salient features of “Hardship” clauses as understood uniformly in international commercial legalities are:

1. Occurrence of Hardship events must have ***fundamentally altered the equilibrium*** of the contract.
2. Occurrence of Hardship events must have occurred or ***become known to the disadvantaged party after the conclusion of the contract***.
3. The events constituting the Hardship ***could not have been taken into account at the time of conclusion of the contract***.
4. The events constituting Hardship are ***beyond the control of the parties*** and reasonably unforeseeable.
5. Affords a ***contractual right*** to the disadvantaged party to ***request renegotiations***.
6. ***Does not entitle*** the party relying on the Hardship clause ***to withhold performance***.
7. Hardship clauses may provide an ***opportunity for the court to intervene*** in directing terms of new contract (to restore equilibrium) or terminate the contract on specific date and terms.

In search of a testament to the international understanding of Hardship clauses, one might refer to the principles of international commercial contracts, in particular Articles 6.2.2 and 6.2.3 of the UNIDROIT Principles.

The genesis of legal complexity that arises in the event of a contractual dispute is due to the similarities between FM and Hardship clauses. Both the clauses seek to address unforeseeable and unavoidable events, which are further considered as grounds for being excused from contractual obligations. The scope of both these clauses are also largely dependent on their specific wordings and may have reference to the “*limit of sacrifice*”, referring to situations where the performance ***has not become impossible but extremely burdensome***.

In view of the possible interpretation of Hardship clauses (and FM clauses) there may be factual situations which can at the same time be considered as cases of Hardship and of FM. If this is the case, it is for the party affected by these events to decide which remedy to pursue. If it invokes FM, it is with a view to its non-performance being excused. If, on the other hand, a party invokes Hardship, this is in the first instance for the purpose of renegotiating the terms of the contract so as to allow the contract to be kept alive although on revised terms.

In this regard, it shall be emphasized, that situations amounting to Hardship in pandemics and epidemics, may range from direct factors like absence of workers owing to quarantine or illness to indirect factors like inability to access credit/funds due to an economic meltdown or interest rate swaps.

Factors to Consider: Impact Points of Hardship Clauses

1. ***Substantial Change in Economic Circumstance***: Apart from the current pandemic being unforeseeable at the time of the contract, it is usually the case that Hardship clauses in a contract shall require establishment of changes in economic circumstances in order to be invoked.

2. **Obligation to Alleviate:** Most of the Hardship clauses come with an obligation on the invoking party to engage in “best efforts” to alleviate the Hardship causing circumstances. The extent of such obligations largely dependent on the specific wordings.
3. **Renegotiation Mechanism and Time Limits:** In well drafted international contracts there has been an evolving trend of a detailed prescribed mechanism of renegotiations and time limits within which it shall be completed. The scope of what can be renegotiated can be heavily governed by such ancillary clauses, in addition to the situations under which the right of termination is evident or permissible.
4. **Renegotiations by Choice:** Hardship clauses like most adversity clauses in international contracts do not necessarily follow a standard form, and in some of such clauses the obligation to renegotiate certain terms may be subject to the choice of either party or vide unanimous consent. In such event, the wordings of the clause yet again come of paramount importance.
5. **Non-recognition of Change of Circumstances:** Certain jurisdictions, e.g. like France, are strictly traditional in their approach of understanding “change of circumstances”, and does not excuse a party from its obligations therein for anything short of impossibility to perform such contract (FM). However if a public contract is hampered, delayed or even paralyzed because of changed economic circumstances and may create calamities for a substantial number of citizens, administrative courts are more willing to apply the doctrine of *imprévision*.
6. **Validity of Renegotiation Obligation:** Every jurisdiction in the world has an evolved stature of contractual jurisprudence, and in some of them even if the Hardship clause is afforded validity, a contractual obligation to renegotiate is not necessary the clearly supported reaction of the law.. In the latter case, intervention must be run by expert legal professionals owing to the delicacy of the matter.
7. **Limited resort to International Conventions:** It is the case that several international conventions which are applicable by default do not regulate change of circumstances at all” such as in particular the United Nations Convention on the Contracts for the International Sales of Goods (CISG).
8. **Variable Legal approach in Judicial Intervention:** Different jurisdictions provide for variable scope of intervention by the court in re-writing the terms of the contract, or filling the gaps thereof. The subject matter of the contract may be interpreted within the meaning of public policy, and legal principles warranting changes hence read into it.
9. **Conflict with FM:** In the likely event that both FM and Hardship clauses had been incorporated in long term international contracts, the latter shall be applied primarily before entering the more adverse FM clause.

Relevant Legal Positions in National Laws

1. France

The French Civil Code does not provide for any specific rules or guidance in situations where performance of a contract becomes more difficult because of change of circumstances. The French courts are known for their “stringent attitude” in applying “*pacta sunt servanda*”. A party stands to be exonerated from the performance of a contract only in the cases of a superior force (FM), an accidental event (*cas fortuit*), or an external cause (*cause étrangère*). In legal doctrine, these three concepts are used interchangeably in order to encompass situations where the performance of a contract is

impossible owing to objective circumstances. However, the French administrative court of last resort (*Conseil d'Etat*) has developed a more flexible approach as compared to the traditional French approach, and has allowed for judicial intervention in contracts whose subject matter was of greater public importance.

2. England

English Contract Law recognizes the “*doctrine of frustration*” which has now evolved to include the situations of frustration of the purposes of the contract. The doctrine though evinces the English approach to be more flexible than the French *force majeure*, the former retains a relatively strict attitude towards the understanding of changed circumstances. Hardship, and financial loss or other inconvenience involved in performing the contract or delay which is within the commercial risk undertaken by the parties, has been treated by English courts as insufficient to frustrate particular contracts.

It is relevant to consider the words of Lord Radcliffe in the *Davis Contractors Ltd. v. Fareham Urban District Council* case, “*There must be as well such a change in the significance of the obligation that the thing undertaken would, if performed, be a different thing from that contracted for*”.

English courts however do not exercise rights to change the terms of the contract often, as such is left for the parties to agree upon.

3. Germany

The German legal doctrine of *Störung / Wegfall der Geschäftsgrundlage* enumerates that the party's expectations with respect to the contract's performance and related circumstances must coincide with the other party's expectations.

Section 313 of the German Civil Code (BGB) stipulates that if circumstances which became the basis of a contract have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change, adaptation of the contract may be demanded to the extent that, taking account of all the circumstances of the specific case, in particular the contractual or statutory distribution of risk, one of the parties cannot reasonably be expected to uphold the contract without alteration. In this regard, it is equivalent to a change of circumstances if material conceptions that have become the basis of the contract are found to be incorrect.

Furthermore, if adaptation of the contract is not possible or one party cannot reasonably be expected to accept it, the disadvantaged party may revoke the contract. In the case of continuing obligations, the right to terminate takes the place of the right to revoke.

Practical Suggestions

1. **Review clauses addressing adversity in contracts.** As expressly mentioned earlier, the kinds of clauses and their wordings shall primarily govern the trajectory of possible legal remedies. Whether the FM or Hardship clause will apply at a given case is not a matter of generic legal analysis, but depends on each individual case and the drafting of the relevant contractual clause.
2. **Review special adaptation clauses that allow for contract modification,** if any. For example, contracts may include indexation clauses based on inflation or stock exchange indexes which allow for automatic recalculation of the contract price when the index fluctuates to a certain degree.

3. **Review the applicable law to the contract.** Various jurisdictions treat obligations under the contract, especially adversity clauses (like FM and Hardship) differently. Thus, making a deeper analysis of the applicable law to the contract essential.
4. **Heed government restrictions in relation to the Pandemic.** Any deviation from such directives or orders may warrant contractual liabilities due to lack of “best efforts” or due to “contributory/gross negligence”.
5. **Choose Renegotiation over Termination.** Almost every long-term contract has gone through multiple expensive rounds of negotiations, and termination would stand to affect all parties significantly. Most importantly, renegotiations can be done at any point during the time of sustenance of the relevant contract at the choice of the parties.
6. **Review Dispute Resolution Mechanism under the contract.** The mode of dispute resolution or the competent jurisdiction as provided for in the contract may be resorted to in the event that the renegotiations fail or undue termination is forced. Thus, an in-depth risk analysis is warranted.

Remedies

The possible remedies on successfully invoking a Hardship clause may be:

- Modification/Alteration of contractual terms by means of Judicial Intervention/Renegotiation
- Enforcement of re-negotiation obligation, if any
- Absolute or Partial exoneration from contractual obligations
- Termination of contract, and obligations thereof.

Conclusion

With the shift of the epicenter of the pandemic from China to Europe and possibly Africa, the impacts thereof are increasing by the day. **The parties to international contracts hence stand at the brink of a consequent economic adversity that calls for specific reviewing and expert analysis of the concerned contracts to best protect their interests.**

For more information about this topic please contact us

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