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CRISIS PRACTICE

Coronavirus

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COVID-19: Impacts on Commercial Contracts Under French Law

Since the outbreak of a new coronavirus, the Covid-19, in China in December 2019, the virus has gradually spread around the world. The World Health Organization (WHO) declared on 30 January 2020 that this new coronavirus is a public health emergency of international concern (PHEIC). France has not been spared, and, since 14 March 2020, has moved to stage 3 of epidemic management, with the emergency announcement of exceptional containment measures, which are likely to evolve and lead to further restrictions.

The Covid-19 epidemic affects companies' commercial activities, either because they are themselves unable to fulfill their contractual obligations, or because they have to deal with counterparties that are in breach of their contractual obligations. In order to mitigate the economic impact of this exceptional situation, businesses may consider implementing certain legal mechanisms, that are briefly described below.

1. In the event of the impossibility to fulfill one's own contractual obligations

If a party is unable to fulfill its own contractual obligations, it will first have to establish, depending on the economic impact, whether it wishes:

(i) to suspend/terminate the contract, in which case the possibility of invoking ***force majeure*** will have to be analyzed; or

(ii) to renegotiate the terms of the contract, by invoking **unforeseen circumstances** ("*imprévision*").

⇒⇒***Action:*** *identify the company's intention as to the future of the contract (suspension, termination or renegotiation) and take a coherent approach.*

1.1. *Force majeure* - Suspension or termination of the contract

1.1.1. Objective

The affected party could suspend or terminate the contract and be exonerated from its liability (it will be released from its obligations, partly or wholly depending on the nature of the impediment, and the other party will not be able to claim damages for non-performance of the contract), if the affected party establishes that the impossibility to perform its obligations results from a *force majeure* event.

1.1.2. Definition of a *force majeure* event

The first question to consider is whether the contract contains a definition of *force majeure* and/or provisions governing the termination of the contract.

> ⇒⇒***Action:*** *verify the existence or not of a force majeure clause in the contract, whether the definition of force majeure refers to epidemics or government restrictive measures, identify the conditions for implementing the force majeure clause (the existence or not of a notification obligation, mandatory deadlines for implementation, etc.), and identify the consequences provided for in the contract in the event of a force majeure event (suspension, termination of the contract, etc.).*

In the absence of a contractual definition, reference should be made to the definition contained in Article 1218 of the French Civil Code, which provides that "*in contractual matters, there is force majeure when an event beyond the control of the debtor, which could not have been reasonably foreseen at the time of conclusion of the contract and whose effects could not be avoided by appropriate measures, prevents performance of its obligation by the debtor. If the impediment is temporary, performance of the obligation is suspended unless the resulting delay warrants termination of the contract. If the impediment is permanent, the contract shall automatically terminate, and the parties shall be released from their obligations in accordance with the terms and conditions provided under articles 1351 and 1351-1.*"

Therefore, *force majeure* is characterized under French law cumulatively by:

(i) *an event beyond the debtor's control (externality)* – An event is considered to be external to the parties when it is not caused by and does not depend on them. The Covid-19 epidemic would indeed be considered as an event which is beyond the control of the parties and is independent of the parties' will. More importantly, the measures taken by government as a result of Covid-19 such as the interruption of international flights decided by certain countries, for example, would also be considered as beyond the parties' control. However, it is unlikely that the externality test would be met if the impossibility to perform the contract stems from the company's employees exercising their withdrawal right ("*droit de retrait"*) because of the risk of contagion. Conversely, if the virus were to cause an infection of such a nature as to deprive the employer of its employees, independently of any actions from the employees themselves, then the condition of externality would be met;

(ii) *an event which could not have been reasonably foreseen at the time of the entry into the contract (unforeseeability)* – If the contract was executed prior to 29 February 2020 (official declaration of the Covid-19 epidemic in France) or, for contracts entered into with foreign operators and in particular Chinese operators, before 30 January 2020 (declaration of PHEIC by the WHO), the legal *force majeure* would apply, without the need for the contract to expressly mention epidemics. However, if the contract was executed after 29 February 2020 (or 30 January 2020, at the global level), the Covid-19 epidemic would no longer be considered as unforeseeable as it could have been reasonably anticipated that governmental measures would be taken in the event of an aggravation of the epidemic and, consequently, the coronavirus would not be considered as a *force majeure* event exonerating the company from its contractual obligations, unless the parties had expressly provided for epidemics *per se* as a *force majeure* event in the contract; and

(iii) *an event whose effects cannot be overcome by appropriate measures (impossibility)* - The event must render performance of the contract practically impossible and not merely more expensive or more complicated. It is therefore necessary, in order to validly invoke *force majeure*, to demonstrate the existence of an absolute impediment. The criterion of the practical impossibility must be assessed on a case-by-case basis and the peculiarity in the case of an epidemic such as that of Covid-19 is that the assessment of the practical impossibility is likely to evolve over time, depending in particular on the degree of constraint imposed by the governmental restrictive measures which might be introduced in the days and weeks to come. Indeed, while the virus, as such, may not allow the condition of practical impossibility to be met, the various measures taken by some governments could however render the performance of the contract in effect impossible. This is the case of certain very strict containment measures enacted in China or Italy. The measures currently taken in France, for example, might not seem, at this stage, sufficient to render performance of a contract impossible since, on a simple sworn statement, it is possible to go to one's place of work when working remotely is impossible or when remote working has not been put in place by the employer. Similarly, travel restrictions and the suspension of many flights, or even the shutdown of some airports, may prevent the performance of certain obligations, particularly when these are carried out by incoming expatriates on a rotational basis. If the contract concerns, for example, the organization of an event which has become impossible because of the government measures prohibiting since 14 March 2020

certain establishments from receiving the public and prohibiting any gathering, meeting or activity involving more than 100 people simultaneously in a closed or open environment, it could be argued that the closures at the request of the government and the confinement are a "*Fait du Prince*", (*i.e.* an act of Government) resulting from a unilateral decision of the administration against which the organizer of the event cannot object.

In the past, French case law has ruled out the qualification of *force majeure* invoked on the grounds of an epidemic (i) because the Chikungunya epidemic could not have been considered unforeseeable and impossible to be overcome since this illness, relieved by analgesics, was generally curable and the contractor could have fulfilled its obligations during that period[1], (ii) because the Ebola virus did not render the performance of the obligations impossible[2], (iii) because the Dengue fever epidemic was of a recurrent and therefore predictable nature[3], (iv) because no causal link was characterized between the Ebola virus and the decline in the company's activity[4], and (v) because the existence of the H1N1 virus had been widely announced and foreseen even before the implementation of specific health regulations[5].

The burden will therefore be on the party invoking *force majeure* to prove that the criteria described above are met and, in particular, the impossibility of setting up alternative measures to enable performance of the obligations and the causal link between Covid-19 and the impossibility of performing one's obligations. As regards the criterion of unforeseeability, it should be considered to be met for contracts concluded before the official declaration of the epidemic in France (or at the global level). With regard to contracts entered into after these dates, the company could be faced with the argument that the condition of unforeseeability is not met.

One might attempt to use the concept of fortuitous occurrence ("*cas fortuit"*), which would have more flexible conditions than *force majeure* while benefiting from the same exonerating effect in accordance with the former Article 1148 of the French Civil Code, as this may have been used in the past. It should however be noted that this concept merely enabled an exemption from liability and not the suspension of the obligation. Moreover, the most recent trend in French case law is to consider *cas fortuit* as synonymous with *force majeure*. Moreover, this concept has not been included in the new Civil Code of 2016 as a ground to suspend an obligation and/or to exonerate the contractual liability for non-performance of the obligation.

⇒⇒***Action:*** *analyze the criteria of force majeure on a case-by-case basis, through an exhaustive review of the contracts.*

1.1.3. Identification of the economic impact of the Covid-19 epidemic on the contract

The party invoking the *force majeure* will have to identify the impact of the Covid-19 epidemic on the contract and to justify the fact that it prevents the performance of the contractual obligations. Therefore:

- *in the event of a partial impediment,* a party will only be released from the obligations affected by the *force majeure* event in the case of a partial impossibility to perform the contract (insofar as the said obligations are not material obligations under the contract);
- *in the event of a temporary impediment,* the obligations will be suspended, unless the delay and the consequences which may result from this suspension for the counterparty would justify the termination of the contract; and
- *in the event of a permanent impediment*, the contract will be automatically terminated, and the parties will be released from their respective obligations (with reciprocal restitutions).

Some elementary precautions must also be taken before declaring *force majeure*. Indeed, services suspended on grounds of *force majeure* will obviously no longer have to be paid for (save as expressly otherwise provided for in the contract). Suspending one's services therefore entails a loss of income that should be carefully anticipated, especially in the current situation which is likely to last for some length of time. In addition, a company can be both a service provider and a service recipient. A consistent approach with regard to the qualification of *force majeure* must be adopted, based on a detailed analysis of the company's contracts.

⇒⇒***Action:*** *verify the economic impact on the contract.*

1.1.4. Further considerations

- Notification / Communication - This will entail verifying whether the contract provides for specific provisions on the modalities and timing relating to the notification of a *force majeure* event, before reaching out to the counterparty to notify the impossibility of performing the contractual obligations, together with showing the causal

link between the delay or the impediment to meet the contractual obligations and the Covid-19 epidemic, and, if necessary, negotiating reasonable alternative measures in order to continue to perform the contract. The contractually agreed notification period is sometimes strict, and failure to comply with it may result - if expressly provided for in the contract- in the loss of the right to invoke *force majeure*.

- Good faith - Pursuant to Article 1104 of the French Civil Code, contracts must be performed in good faith and this provision is deemed a matter of public policy. The company must ensure that it complies with this good faith obligation, particularly with respect to the timing of the notification, the content of the information shared with the counterparty, the cooperation with the other party, etc.

⇒⇒***Action:*** *verify the opportunity / necessity to notify force majeure to the counterparty.*

1.2. Unforeseen circumstances ("*imprévision*") – Renegotiation of the contract

1.2.1. Objective

The party relying on this concept would be able to require a renegotiation (revision or adaptation of the contract) in order to reduce the financial impact (e.g., by renegotiating the late penalties) or the termination of the contract, provided that the contract was entered into after 1st October 2016. It should be noted that while *imprévision* may aim at maintaining the contractual relationship while adapting it, it may nevertheless lead to its termination. This is a risk to be taken into account.

1.2.2. Definition of unforeseen circumstances ("*imprévision*")

The theory of *imprévision* was introduced in Article 1195 of the new French Civil Code of 2016.

Before considering the conditions for implementing *imprévision*, it will be necessary to make sure that the contract does not contain a clause defining the unforeseen circumstances or excluding the application of Article 1195 of the Civil Code.

⇒⇒***Action :*** *verify that the contract does not rule out imprévision.*

Article 1195 of the French Civil Code provides that "*if a change of circumstances unforeseeable at the time of conclusion of the contract renders performance excessively onerous for a party who had not agreed to bear the risk, that party may request a renegotiation of the contract from the other contracting party. This party shall continue to perform its obligations during the renegotiation. In the event of refusal or failure of the renegotiation, the parties may agree to terminate the contract, on the date and under terms they determine, or request, by mutual agreement, the court to adapt the contract. If no agreement is reached within a reasonable period of time, the court may, at the request of one of the parties, revise or terminate the contract, on the date and under the conditions the court shall determine."*

In the event that the company sees its obligations impacted by the Covid-19 epidemic, but without wishing to invoke *force majeure*, it may possibly request the other contracting party to renegotiate the terms of the contract due to an unforeseen change of circumstances rendering the performance of its obligations excessively onerous. Here again, however, it will be necessary to be able to demonstrate the unforeseeable nature of the change of circumstances at the time of the entry into the contract.

Nevertheless, it should be noted that, in the absence of an agreement between the parties, the contract continues to apply unless the relevant court orders its termination. However, due to the current health crisis, the courts are functioning at a slower pace, rendering the possibility to lodge a claim for termination before a court theoretical, in the current situation.

⇒⇒***Action:*** *verify that the conditions for invoking "imprévision" are met on a case-by-case basis, identify the elements for renegotiation and reach out to the counterparty.*

2. In the event of non-performance by the counterparty

In the event that a party to a contract were to raise the issues it is facing as the result of the current situation, while not being in a position to validly invoke *force majeure* or *imprévision*, the other party could consider several options to reduce the impact of its contracting counterparty's failure to perform as a result of the Covid-19 epidemic, in particular:

- *specific performance*, by applying to courts for an order, with a daily non-compliance penalty payment ("*astreinte*", in French), on the counterparty to perform or have the contract performed by a third party at the counterparty's expense (however, this possibility is theoretical because of the current limited functioning of the courts, due to the health crisis);
- *request for a price adjustment* (for contracts entered into after 1st October 2016). If the counterparty eventually fulfills its obligations, the party could ask for a price reduction, for example, as a result of the delay in performance;
- *suspend the performance of its own obligations ("exception d'inexécution")*. A party to a contract would be allowed to suspend its own obligations as long as the counterparty does not perform its obligations under the contract; and
- *termination of the contract (in case of material breach) and claim for damages*, by implementing the termination clause in the contract, if there is one, or by applying to the court for termination of contracts entered into before 1st October 2016 and, for contracts concluded after that date, by notifying the termination to the c counterparty pursuant to Article 1226 of the French Civil Code, with a claim for damages (or even by invoking a liquidated damages clause, if the contract contains such a provision).

It will also be necessary, if the financial health of the counterparty appears to be fragile, to act quickly in particular to prevent the commencement of insolvency proceedings which could paralyze the legal mechanisms described above.

Finally, beyond the classical mechanisms mentioned above, an alternative approach, based on an adjustment of the performance of the obligation which could, for example, go as far as its postponement, could be explored. Whether under the new or the old French Civil Code, it is well established under French law that a contract obliges the contracting party not only to what is expressed therein, but also to all that the law, custom and fairness consider to be a consequence of the contractual obligation (former article 1135 of the Civil Code or new article 1194 since the 2016 changes). Furthermore, it is important to stress that the employer is required by law to take all necessary measures to ensure the safety and protect the physical and mental health of its employees (Article L. 4121-1 of the French Labor Code). This qualifies as an obligation to achieve a specific result under French law ("*obligation de résultat*")[6]. It could therefore be argued that the combined application of these provisions of the French Civil Code and the French Labor Code would allow the obligation to be adjusted or even deferred, given the health crisis which we are currently experiencing. This is an avenue worth exploring.

[1] French *Cour d'appel de Basse-Terre, 1ère Chambre civile, 17 Decembre 2018, Répertoire général n° 17/00739.*
[2] French *Cour d'appel de Paris, Pôle 1, Chambre 3, 29 March 2016, Répertoire général n° 15/05607.*
[3] French *Cour d'appel de Nancy, 1ère Chambre civile, 22 Novembre 2010, Répertoire général n° 09/00003.*
[4] French *Cour d'appel de Paris, Pôle 6, Chambre 12, 17 March 2016, Répertoire général n° 15/04263.*
[5] French *Cour d'appel de Besançon, 2ème Chambre commerciale, 8 January 2014, Répertoire général n° 12/02291.*
[6] *French Cour de cassation, chambre sociale, 22 February 2002, appeal No. 99-18389.*