

ARBITRATING COVID-19 CONTRACT DISPUTES: KEY ISSUES AND STRATEGIES

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OVERVIEW

I. Potential Common Law Defenses Based on COVID-19

- Force Majeure
 - ✓ What is the Triggering Event?
 - ✓ Causation
 - ✓ Notice
- Frustration/Impossibility

II. Potential Civil Law Defenses Based on COVID-19

- Material Adverse Change
- Hardship

III. Conclusion

COVID-19 CONTRACT DISPUTES

FOUR SCENARIOS

1. A U.S. buyer backs out of a contract to buy a global retail chain after the seller closes multiple stores world-wide due to COVID -19
2. A Chinese company purchasing natural gas from a French energy supplier tries to suspend its contractual obligations due to the sharp decline in demand following COVID-19.

COVID-19 CONTRACT DISPUTES

FOUR SCENARIOS

3. A German supplier fails to deliver the required product to a Brazilian purchaser because a sub-contractor defaulted following a loss of business due to COVID-19.
4. A conference organizer terminates a contract to schedule a June event in London after a U.K. order restricts gatherings of more than 100 people to slow the spread of the virus.



Part I

POTENTIAL COMMON LAW
DEFENSES BASED ON
COVID-19

POTENTIAL COVID-19 DEFENSES

KEY COMMON LAW DEFENSES

- **Force Majeure**
- **Impossibility or Frustration of Purpose**

POTENTIAL COVID-19 DEFENSES

FORCE MAJEURE (CONTRACT)

- An (i) unforeseeable event that (ii) is beyond the party's control and (iii) prevents or impedes performance.
 - Example: “natural disaster, acts of government, or other acts beyond a party's control”
- **Typical Remedies**
 - No liability for **duration of FM event**.
 - Some contracts may authorize **termination**

POTENTIAL COVID-19 DEFENSES

FORCE MAJEURE: SPECIAL ISSUES

- **Economic Hardship**
 - Generally will not qualify as a FM event, even when it is a direct result of a FM event.
- **Sub-Contractor Default**
 - Generally will not qualify as a FM event unless both the Contractor and the Sub-contractor meet the FM requirements.

POTENTIAL COVID-19 DEFENSES

FORCE MAJEURE: ECONOMIC EFFECTS

- **U.S. Court Decision**

- A conference organizer reserved 500 hotel rooms for an event to occur in October 2001.
- After the 9/11 attacks, attendance plummeted and the organizer cancelled the reservations
- The court held that the FM clause did not apply to economic hardship, even though the hardship resulted from the FM event.
- 266 F. Supp. 2d 1214 (D. Hawaii 2003)

KEY ISSUES IN FORCE MAJEURE

THREE KEY ISSUES

1. Defining the Triggering Event

2. Causation

- a. Direct Causal link
- b. Could the effects have been avoided?
- c. Could the effects have been overcome?

3. Notice

KEY ISSUES IN FORCE MAJEURE

ISSUE 1: THE TRIGGERING EVENT

- In COVID-19 cases, the non-performing party will likely define the triggering event as either:
 - The pandemic itself;
 - A government shutdown or other restriction;
 - A combination of both;
 - Some other direct effect of the pandemic

KEY ISSUES IN FORCE MAJEURE

ISSUE 1: THE TRIGGERING EVENT

- **Key Issues in COVID-19 Cases**
 - **Unforeseeability** will likely be disputed in contracts formed after the virus emerged.
 - Internal documents and third parties' experience will be relevant
 - **Duration of event** will also be disputed.
 - "Duration" may include the "after-effects" of the event if such effects prevent performance.

KEY ISSUES IN FORCE MAJEURE

ISSUE 1: THE TRIGGERING EVENT

- **English Court of Appeal**
- Supplier claimed FM based on both a general strike (which closed ports) and the resulting congestion after the strike ended.
- The court agreed that the FM event included both the strike and its direct “after-effects.”
- **Principle:** A triggering event may include after-effects if they prevent or delay performance

Carboex SA v. Louis Dreyfus Comm. Suisse SA

KEY ISSUES IN FORCE MAJEURE

ISSUE 2: CAUSATION

DID COVID-19 CAUSE NONPERFORMANCE?

Major Elements

- Can a direct causal link be shown between COVID-19 and nonperformance?
- Could the effects have been avoided?
- Could the effects have been overcome?

KEY ISSUES IN FORCE MAJEURE

ISSUE 2(a): CAUSATION—THE CAUSAL LINK

- Event must directly cause nonperformance
- The necessary proof will depend on whether the contract
 - specifies that the event “prevent” or merely “delay” performance
 - requires that the event be the sole cause of nonperformance

KEY ISSUES IN FORCE MAJEURE

ISSUE 2(a): CAUSATION—THE CAUSAL LINK

- **ICC Case No. 19566 (2014)**
- Supplier claimed FM based on a drought, even though supplier also had other problems that were a separate cause of non-performance.
- Tribunal held that the FM event “trumped” the other causes and excused non-performance.
- **Principle:** A triggering event may not have to be the sole cause of nonperformance unless the contract requires it.
 - *Global Tungsten v. Largo Resources, Ltd.*

KEY ISSUES IN FORCE MAJEURE

ISSUE 2(b): CAUSATION—COULD THE EFFECTS HAVE BEEN AVOIDED?

- The non-performing party must also show that it could not have been avoided the effects of the event through due diligence.
 - **Example:** A flood may not excuse a supplier's failure to deliver goods destroyed by the flood if the supplier could have avoided the water damage by packaging the goods in industry-standard ways.

KEY ISSUES IN FORCE MAJEURE

ISSUE 2(b): CAUSATION—COULD THE EFFECTS HAVE BEEN AVOIDED?

- **Key Issues for COVID-19 Cases**
 - Could the non-performing party have avoided the effects of the pandemic through the exercise of due diligence?
 - Expert testimony and the experience of similarly-situated third-parties will be relevant

KEY ISSUES IN FORCE MAJEURE

ISSUE 2(c): CAUSATION—COULD THE EFFECTS HAVE BEEN OVERCOME?

- The non-performing party must also show that it could not overcome the effects of COVID-19.
 - If the non-performing party could implement a “**commercially reasonable substitute**,” but fails to do so, its non-performance will not be excused.

KEY ISSUES IN FORCE MAJEURE

ISSUE 2(c): CAUSATION—COULD THE EFFECTS HAVE BEEN OVERCOME?

- **ICC Case No. 4462**
- Company claimed that a U.S. government order banning travel to Libya prevented it from constructing a Libyan plant because the scheduled US workers could not come to Libya.
- The Tribunal rejected the claim because the company could have used non-US workers.

National Oil Co. of Libya v. Libyan Sun Oil. Co.

KEY ISSUES IN FORCE MAJEURE

ISSUE 2(c): CAUSATION—COULD THE EFFECTS HAVE BEEN OVERCOME?

- **Key Issues for COVID-19 Cases**
- Did the non-performing party have **alternative methods** of performing the contract?
- If so, were such alternative methods “**commercially reasonable**”?
 - Expert testimony and the experience of similarly-situated third-parties will be relevant

KEY ISSUES IN FORCE MAJEURE

ISSUE 3: NOTICE

- Will failure to give timely notice preclude any defense based on COVID-19?
 - **Clear language** required for notice to be a **condition precedent**.
 - Otherwise, simply a contractual duty that if breached must cause harm.
- **Key Issue:**
 - Any **prejudice** to opposing party?
General Dynamics v. Libya, ICC Case No. 19222 (2016)

POTENTIAL COVID-19 DEFENSES

IMPOSSIBILITY/FRUSTRATION

- Many **common law jurisdictions** recognize an “impossibility of performance” or “frustration of contract” defense.
 - Requires an unforeseeable event that makes performance impossible or frustrates the contract’s major purpose.
 - Remedy is termination.



Part II

POTENTIAL CIVIL LAW
DEFENSES BASED ON
COVID-19

POTENTIAL COVID-19 DEFENSES

KEY CIVIL LAW DEFENSES

- **Force Majeure** (codified in civil codes – not just contractual remedy)
- **Hardship / change of circumstances**

POTENTIAL COVID-19 DEFENSES

FORCE MAJEURE

- **Civil jurisdictions** often provide FM relief even when not specified in the contract
 - **France** (Art. 1218 of FCC)
 - **Brazil** (Art. 393 of BCC)
 - **China** (Art. 117 of PRC Contract Law)
- Each of these statutes require the event to be unforeseeable, beyond the party's control, and prevent or impede performance.

POTENTIAL COVID-19 DEFENSES

HARDSHIP (CHANGE OF CIRCUMSTANCES)

- Some **civil jurisdictions** also provide that an unforeseeable event rendering performance excessively “onerous” can qualify as a defense.
 - **France** (Art. 1195 of the Civil Code)
 - **Brazil** (Arts. 317 and 478 of the Civil Code)
- **International Instruments**
 - Unidroit Principles (Art. 6.2.3)
 - European Principles of Contracts (Art. 6:111)

POTENTIAL COVID-19 DEFENSES

ECONOMIC HARDSHIP (cont'd.)

- In these jurisdictions, if a party establishes an unforeseeable economic hardship
 - The parties must re-negotiate the contract; and
 - If unsuccessful, the dispute is referred to a judge or arbitrator to revise or terminate the contract.
- **Issues**
 - Obligation to negotiate
 - Jurisdiction of courts and arbitrators



Part III

CONCLUSION: TAKEAWAYS

POTENTIAL COVID-19 DEFENSES

| DEFENSE | COMMON LAW/CIVIL LAW | ELEMENTS | ECONOMIC HARDSHIP QUALIFY? | RESULT |
|----------------------------------|---|--|----------------------------|--|
| FORCE MAJEURE | Contractual remedy in common law jurisdictions; codified into civil codes of many civil law jurisdictions | Unforeseeable event beyond party's control | No | No liability for duration of event In civil law systems, if impossibility is permanent, contract is terminated |
| HARDSHIP | Civil law | Unforeseeable event beyond party's control | Yes | Contract Review or Termination |
| IMPOSSIBILITY/FRUSTRATION | Common law doctrine | Unforeseeable event beyond party's control | No | Termination of contract |

CONCLUSION

KEY TAKEAWAYS

- In both civil and common law jurisdictions, COVID-19 contract disputes will likely involve pandemic-based defenses that require a showing of **unforeseeability**.
- “Economic hardship” may provide grounds for a defense in civil law jurisdictions, but generally not in common law jurisdictions
- Civil law remedies potentially include renegotiation or referral to a court or an arbitrator.

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