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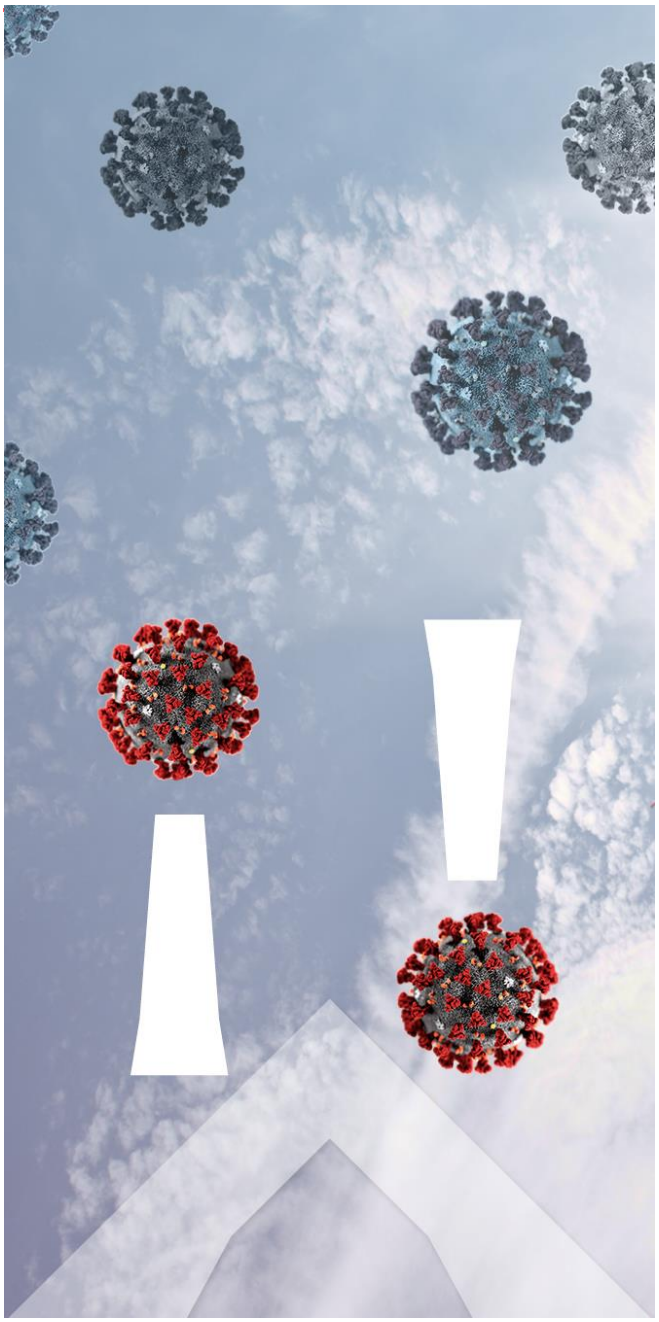
Contracts and coronavirus: initial considerations under Spanish law

Legal Flash from the Litigation and Arbitration Practice Area

February 2020



With the spread of the coronavirus (COVID-19) outbreak across borders, concern over the effects of the outbreak on commercial contracts has led to a growing sense of urgency and a spate of requests for legal advice.

The impact of the coronavirus on commercial relationships must be assessed case by case.

Two key concepts in Spanish law need to be taken into account: force majeure and *clausula rebus sic stantibus.*

Besides the effect of the coronavirus outbreak on private law relationships, possible repercussion on labor relationships and public law also need to be considered in light of the legislation and case law specific to those domains.

Concern over the impact of the coronavirus outbreak in China (the COVID-19 or *Wuhan coronavirus*) on commercial contracts has been steadily rising since news of the disease broke in late December of last year. With the crossborder spread of the virus, the number of cases has greatly increased in countries around us, such as Italy, and the economic impact of the outbreak has been felt in the cancellation or postponement of public events (such as the Mobile World Congress in Barcelona, the Shanghai Fashion Week, and the Art Basel contemporary art fair in Hong Kong), resulting in a growing sense of urgency and a spate of requests for legal advice.

The effect of the coronavirus on commercial relationships is unquestioned. What is not so clear, perhaps, is the appropriate legal response to instances of frustration of commercial relationships stemming from the outbreak. Though each case needs to be considered individually, Spanish contract law does contain certain key concepts to bear in mind.

Inevitability of an event culminating in contractual frustration is known as force majeure in Spanish law (as in most Western legal systems). Article 1105 of the Spanish Civil Code provides:

> "*Outside the cases expressly mentioned in the law, and those in which the obligation should require it, no one shall be liable for events which cannot be foreseen or which, being foreseen, should be inevitable.*"

Similarly, force majeure as grounds for exoneration of liability in international sales of goods is regulated under article 79.1 of the Vienna Convention of 1980 (ratified by Spain), which states:

> *"A party is not liable for the failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it, or its consequences."*

Once perfected, contracts are binding on the parties, who are therefore obligated to perform them (article 1258 of the Spanish Civil Code). Though not at any price, because no one can perform what is impossible to perform, e.g., in the circumstances of force majeure. Thus, force majeure is ordinarily defined as an objectively irresistible event that falls outside the norm for the parties to the contract and originated outside the obligor's company or milieu. In other words, force majeure is any event that, though foreseeable, is unavoidable or irresistible for the parties to the contract and results in frustration (even if only temporary) of the obligational relationship. Depending on the case, force majeure will excuse the obligor from liability for breach, will discharge it from performing its obligations, or will suspend performance of the obligation if the effects of force majeure are only temporary.

As a rule, the traditional case law handed down by the Spanish Supreme Court (e.g., judgment of the Supreme Court, civil division, of December 1, 1954) has held epidemics to be force majeure events. Indeed, there is a body of decisions by the Provincial Courts of Appeal ruling on cases involving frustration of contracts due to the effects of outbreaks of disease in the recent past (i.e., cancellation of flights or frustration of vacation plans due to Type A influenza in Mexico – Barcelona Provincial Court of Appeal, 14th Chamber, June 8, 2012; Seville Provincial Court of Appeal, 5th Chamber, July 6, 2011 – or to SARS in Toronto – Madrid Provincial Court of Appeal, 28th Chamber, November 2, 2006) that has considered whether force majeure provided relief from liability.

Whether the recent coronavirus outbreak constitutes force majeure capable of discharging contractual liability, releasing from having to perform a contractual obligation, or allowing performance to be postponed is a question that will have to be decided based on examining the specific nature of the obligational relationship, the wording of the contract, the circumstances existing at the time of frustration (including the state of knowledge concerning the outbreak, the measures taken or recommendations followed, and the location), and in particular the degree to which the event was foreseeable or unavoidable by the parties in each individual case.

Where the individual circumstances of the case do not allow the event to be classed as force majeure, the parties could still consider whether other provisions laid down by civil law in Spain, in particular *clausula rebus sic stantibus*, might be relied on. Generally speaking, this rule holds that contracts may be revised or terminated where supervening changes in the circumstances extant at the time they were signed upset the balance between the contracting parties, making performance by one to the other unduly burdensome. The case law has interpreted this rule restrictively.

According to case law handed down by the Supreme Court, for this rule to be applicable: (i) there must have been an exceptional alteration in the circumstances in effect when it comes time to perform the contract as compared to those in effect at the time the contract was signed; (ii) the performance obligations of the contracting parties must have become inordinately disproportionate for reasons that could not be envisaged, and the disproportion must invalidate the contract by upsetting the balance between the obligations; (iii) the circumstances in question must have been wholly unforeseeable; and (iv) no other remedy for repairing the harm is available to the parties.

Lastly, in addition to the effect of the coronavirus outbreak on private law relationships, possible repercussions on labor relationships and public law will also need to be considered in light of the legislation and the case law specific to those domains.

Conclusions and recommendations

The feasibility of relying on either of the remedies discussed above in cases of breach or expected breach of contract will depend on the nature of the contract and its contractual clauses, the impact of the outbreak on performance, and the specific measures taken, all in the context of location and the economic sector concerned.

In view of the wide range of scenarios that could arise, we would recommend taking the following steps without further delay:

- Conducting an internal review of any potential or prospective disruption that might affect performance of contractual obligations, separately by contract and by each individual obligation. In this respect, a fundamental aspect will be to consider whether the parties have stipulated any specific terms applicable to events of this kind and, if so, what obligations were established and what were the (contractual) expectations of each party.

- Considering the advisability of notifying the contracting parties of any outbreak-related contingency that could potentially prevent performance of the contractual obligations. The wording of notices of this kind will play an essential role in minimizing losses and potential consequences, and we would therefore recommend obtaining specialized advice when notices are being drafted.
- Gathering as much supporting evidence as possible attesting to the existence of the circumstances preventing performance of the contractual obligations and to the measures that have been taken to mitigate potential harm.

- Evaluating the impact of any potential or prospective disruption in the performance of the contractual obligations on labor and public law relationships, which need to be considered separately since they are governed by their own bodies of law and case law.

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