British Institute of International and Comparative Law

"Breathing space"

Concept Note 1 on the effect of the pandemic on commercial contracts

This concept note arises out of a meeting on 7 April 2020 hosted by the British Institute of International and Comparative Law, attended by Lord Phillips of Worth Matravers, Lord Neuberger of Abbotsbury, Sir David Edward, Sir William Blair, Professor Spyros Maniatis, Professor Malik Dahlan and Keith Ruddock.

In his comments on the crisis, Mario Draghi has described the risk of a "plethora of defaults" leaving irreversible damage[1]. The challenge is to prevent the recession morphing into a deep depression, and as the IMF's policy tracker shows, a large number of measures have been deployed internationally at the fiscal and monetary level[2]. This concept note concerns the response at the private law level, where the challenges are likely to be equally great.

Draghi was speaking from an economist's perspective, but from a legal perspective, it is easy to see how damage can happen as parties trigger default clauses, and counterparties maintain that they are excused from performance. It happens in many different ways under contracts with different governing laws, and may disrupt supply chains. It can be mitigated by agreement, or by mediation – both of which must be encouraged and will have a crucial role – but there is a risk of a deluge of litigation and arbitration placing a strain on the system of international dispute resolution, and reducing the prospect of more constructive solutions and increasing the prospect of uncertainty of outcome.

The common law and the civil law have their own approaches to force majeure, material adverse change, supervening illegality, and frustration/impossibility or its equivalent, and clauses bringing the contract to an end, with or without contractual termination payments.

The common law (which is widely used in international commerce) has traditionally taken a strict approach to such issues, and this has generally worked well so far. Within the principle of legal certainty, however, a discussion of the present crisis has to recognise that it does not have an easy analogy in past case law. In at least one jurisdiction, measures have been introduced to give a "breathing space", offering temporary relief to specified businesses and individuals unable to fulfil their contractual obligations because of COVID-19[3].

In times of uncertainty, the law must provide a solid, practical and predictable foundation for the resolution of disputes and the confidence necessary for an eventual recovery. Sometimes, and the case of business interruption insurance may be an example, there may be little alternative to resolution through the courts even if lengthy and expensive.

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[1] https://www.ft.com/content/c6d2de3a-6ec5-11ea-89df-41bea055720b

[2] https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19

[3] The COVID-19 (Temporary Measures) Act 2020 (No. 14 of 2020), Singapore. https://sso.agc.gov.sg/Acts-Supp/14- 2020/Published/20200407?DocDate=20200407

In other cases, arguably an outcome which leaves one party a winner, and the other a loser, will not take full account of the market/social contextualisation of the crisis. Is there is a case for adopting a more creative, graded, but nevertheless rigorous approach without prejudicing the underlying need for legal certainty? In many jurisdictions, procedural rules already encourage conciliation – can these be developed further to give a breathing space? The onus at least in the first instance would be for the continuance of a viable contract rather than bringing it to an immediate end.

A comparative approach will be fruitful. In the common law, as well as the scope of the doctrine of frustration[4], rules as to the implication of terms and the debate as to long-term relational contracts[5] may be relevant. Examples in the civil law would include the reformed section of the French Civil Code on the law of contract, and other national doctrines such as the German Störung der Geschäftsgrundlage, as well as international dimensions such as the work of Unidroit. Another approach would be through the doctrine of unjustified enrichment (enrichissement sans cause/ungerechtfertigte Bereicherung), the question being whether, without declaring their contract at an end, the relations of the parties can be equitably readjusted by the Court so that the one will not be unintentionally enriched at the expense of the other.

In the current emergency, which is a universal challenge, a debate should happen as a matter of priority on the necessary contribution of the law to safeguard commercial activity, minimise disruption to supply chains, and ameliorate the adverse effects of a "plethora of defaults", by encouraging a legal environment which is conducive to optimism and a global recovery.

[4] For the position in the aftermath of world war, see Journal of Comparative Legislation and International Law, Vol. 28 (1946), "Frustration of Contract".
[5] https://www.judiciary.uk/wp-content/uploads/2016/10/mr-justice-leggatt-lecture-contractual-dutiesoffaith.pdf

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