



## **The Coronavirus Crisis - Force Majeure and the Prevention of Future Litigation: Essential Preparation for 'The Day After'**

Dear Clients,

The global economy has been shaken by the coronavirus pandemic. Although it is too early to determine the extent of its impact, the effect of the coronavirus pandemic is already being felt around the world. As they deal with factors beyond their control such as border closures, government-mandated quarantines, closings of businesses and restrictions on movement, and notices of non-performance, delay or termination from contractual counter-parties, many businesses are subject to uncertainty as to their cash-flow and long-term prospects for survival. In the midst of all of this they must contend with complex legal situations, some of which have no clear-cut solutions at this stage. In the present reality, it may be impossible to perform certain contracts, while others may be worthless to a particular party to the contract, at least for the time being. This situation is likely to result in future litigation which will likely address the question of whether a global pandemic constitutes an event of force majeure or contractual frustration under Israeli law.

### **Force Majeure Clauses and the Doctrine of Frustration**

Some contracts include a force majeure clause that relieves a party of obligations under the contract until the force majeure event has ceased or that provides grounds for termination of the contract. The purpose of the clause is to mitigate damages caused by circumstances beyond the control of the parties to the contract which the parties could not foresee when they entered into the contract. Such clauses often present a list (sometimes exhaustive) of force majeure events.

Section 18 of the Contracts Law (Remedies for Breach of Contract), 1970 (the “**Remedies Law**”) provides potential relief to parties in such a situation when their contract does not contain a force majeure clause, by excusing the party in breach of the contract from enforcement and payment of damages (though it does not excuse the breaching party from restitution and payment of reliance damages).<sup>1</sup> In addition, Israeli jurisprudence has applied the doctrine of “approximate performance”

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<sup>1</sup> Section 18 of the Remedies Law States:

- (a) Where the breach of contract is the result of circumstances which at the time of making the contract the person in breach did not know of or foresee and need not have known of or foreseen, and which he could not have avoided, and performance of the contract under these circumstances is impossible or fundamentally different from what was agreed between the parties, the breach shall not constitute grounds for enforcement of the contract or for compensation.
- (b) In the cases referred to in subsection (a), the Court may, whether or not the contract has been rescinded, require each party to restore to the other party what he has received under the contract or, at his choice as provided in section 9, to pay him the value thereof, and require the person in breach to indemnify the injured party for expenses reasonably incurred and liabilities reasonably contracted by him for the performance of the contract, all if and in so far as the Court deems it just to do so in the circumstances of the case.



whereby when circumstances render it impossible for the breaching party to perform the original contract, the injured party is entitled to performance that best approximates the original contract.

Over the years, Israeli courts have enforced force majeure clauses as drafted and have taken a restrictive approach in their application of Section 18 of the Remedies Law, focusing primarily on reasonable expectation of the parties. Israeli courts have previously held that death, serious natural hazards in agriculture and wars are predictable or may be expected and therefore do not excuse the breaching party from sanctions. For example, despite the obvious fact that the 1973 Yom Kippur War was a complete surprise to the government of Israel and to the Israel Defense Forces and caused material harm to the Israeli economy, Israeli courts held that the outbreak of the war did not relieve parties of their contractual obligations.

### **Will Israeli Courts Recognize the Coronavirus as an Event of Force Majeure or Frustration?**

On March 11, 2020, the World Health Organization declared the coronavirus a global pandemic, but based on past rulings, it appears that Israeli courts will not rush to uphold terminations or excuse breaches of contract across the board due to the pandemic. The courts are likely to examine the parties' behavior and their real-time attempts to maintain the contract by adopting amendments, deadline extensions, quantity reductions and so on instead of terminating the contract outright. In addition, the courts will likely address the individual circumstances of each case brought before them.

### **What Immediate Steps Should be Taken?**

Any party who has sustained damage or anticipates damage from the coronavirus pandemic should take action now to address immediate issues while also planning ahead for the day after, when the reasonableness and proportionality of real-time actions will likely be examined post-facto by the courts. The following steps should be considered:

1. **Loss mitigation** - attempt proactively to mitigate losses for oneself, for one's contractual counter-parties and for third parties: (a) consider which governmental Corona relief programs may be relevant and which governmental authorities may be in a position to provide special dispensations and record all enquiries made and actions taken in this respect; (b) at the same time, review existing contracts, particularly jurisdiction and applicable law clauses, as well as termination and force majeure clauses and the potential applicability of force majeure certificates issued by some countries such as the People's Republic of China; and (c) examine existing insurance cover vis-a-vis losses incurred due to sickness, epidemics, force majeure etc. and provide any mandatory notices to insurers.
1. **Dialogue** - consider which steps may be taken on a commercial level - such as revising delivery and payment schedules, reducing quantities or modifying the scope of work - and communicate clearly with contractual counter-parties in this respect. Clear, properly documented communications that contain good faith attempts to agree on joint measures for loss mitigation may prevent a crisis in commercial relations and thereby avoid litigation. They are also vital as proof of attempted loss mitigation in the event that litigation ensues.
2. **Record, record, record** - although most work is now being performed remotely and orderly record-keeping may not be a priority, it is vital to reiterate to employees the importance of documenting all conversations and actions taken in the course of ordinary operations and in



connection with Corona disruptions in particular. Procedures should be put in place to ensure consistent and accurate daily reporting of discussions with counter-parties and of actions taken.

3. **Ongoing legal input** - ensure that employees dealing with Corona disruption issues have access to in-house or external legal counsel and that they are properly translating legal advice received into practical day-to-day conduct. The importance of accurate record keeping for potential future Corona-related litigation cannot be emphasized enough. Cases may be won or lost in the future based on the quality of records kept during the crisis.
4. **Crisis work procedures** - putting in place procedures now for all employees and management to mitigate damages and to ensure work continuity will enable a judge or arbitrator to understand the rationale of the organization's decisions in future litigation.
5. **Cash flow assessment and actions required in order to avoid insolvency** - periodic assessment of cash-flow changes followed by management decisions supported by legal counsel to prevent insolvency are vital to long-term survival of the organization and in extreme cases will serve as necessary preparation for insolvency proceedings.
6. **Adjusting Existing and Future Contracts** - in light of the legal ambiguity regarding non-performance or termination based on the Corona pandemic and given that its economic impact will likely remain for months to come, it may be appropriate to change the wording of future contracts and to seek to amend existing contracts. Parties drafting a contract (or renegotiating an existing contract) should consider explicitly stating whether pandemics **do or do not** constitute grounds for termination or for temporary suspension of performance, whether this be in a separate clause or an explicit reference in a "force majeure" clause in the contract.

As always, we are at your service, even in these challenging times.

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