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Trade, Labor and EU Law Perspectives

# European contracts in the COVID-19 age: A need for adaptation and renegotiation

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**Introduction: The Hardship Clause**

The outbreak of the COVID-19 pandemic has had (and is still having) a major impact on long term contracts, both at national and supranational level. In Italy, for instance, the emergency has ignited a lively debate on the most appropriate remedy to restore fairness in a contractual relationship where one of the party's business was heavily struck by the emergency.[1]

At supranational level, attention was especially drawn to the topic of the force majeure clause,[2] yet hardship clauses could prove to be more fitting, in particular when it comes to long-term contracts. Indeed, whilst force majeure is invoked with a view to excuse the non-performance of the contract, hardship serves the purpose of renegotiating the terms of the contract, in an attempt to keep it alive.

In 2003 the International Chamber of Commerce (ICC) drafted a force majeure and a hardship clause, which were revised last March to face the COVID-19 pandemic.[3] The UNIDROIT Principles[4] and the Principles on European Contract Law (PECL) of the Lando Commission have also handled hardship clauses since their first drafting, and discipline them almost identically (at par. 6.2.1 – 6.2.3 and 6:111, respectively).

The main rules of these provisions are basically three. First of all, that a party remains bound to the contract even if its performance has become more onerous. Secondly, that this general rule can only be derogated when the difficulty amounts to hardship. This means that the supervening events are such as to fundamentally alter the equilibrium of the contract, provided that they have become known only after the conclusion of the contract, that they could not be foreseen, and that they are beyond control of the party. Furthermore, it is required that the risk of such events had not been assumed by the party. According to the third rule, when hardship occurs the parties have to initiate renegotiations of the contract. If these do not succeed, it is up to the judge or the arbitrator to decide whether to terminate the contract or to adapt it.

**Comparative law perspective**

From a comparative law perspective, European countries handle contractual contingencies very differently. In English common law, the principle of the sanctity of the contract is traditionally felt so strongly that no force majeure rule was ever codified, let alone a hardship one. Indeed, force

majeure only exists as a clause-model.[5] As a consequence, courts were urged to develop the notion of frustration of the contract, which allows for termination of an agreement when the circumstances are "in a fundamental respect different from those which were envisaged".[6] Frustration being the only way to dissolve a contract which has become unfair, no judge would ever feel authorised to amend the contract in a creative way. The situation is slightly different in the US, where the American Uniform Commercial Code (UCC) also espoused, in addition to frustration, the doctrine of impracticability. Such a doctrine serves other functions than simply as a defense for nonperformance, though it can never go so far as a proper adaptation of the contract.[7]

On the contrary, most European continental countries did codify some form of intervention on the contract in cases where contingencies have altered it significantly. In Italy, along with the exception provided for by Art. 1664 of the Italian Civil Code with regard to procurement contracts (Italian: *appalti*), the main provision on this topic is Art. 1467 of the Italian Civil Code. This provision favours, similarly to a force majeure rule, the termination of the contract, which, however, can be prevented by the creditor's *reductio ad aequitatem* offer. This consists in an offer made to the party whose performance has become excessively burdensome to restore the fairness of the contract, thus preventing its termination. The suitability of such an offer can also be evaluated in a judicial proceeding, although opinions differ with regard to the margins of the intervention of the judge. Indeed, while some scholars reckon that it should be limited to the appreciation of a detailed offer made by the creditor,[8] others believe that the judge may acknowledge the creditor's willingness to reduce the debtor's performance and actively intervene to quantify the reduction.[9] In any case, the creditor's willingness to revise the terms of the contract is always indispensable, whereas the termination of the contract remains the core of the disadvantaged party's protection.

Unlike Italy, other legal systems consider termination and adaptation of the contract as basically equivalent tools. In the Netherlands, for example, when a judge assesses that unexpected occurrences have undermined the fairness of the contract, he/she can decide whether to terminate or adapt it. It must be highlighted that both remedies are called upon by the law without one prevailing over the other.[10] Since the reform of Art. 1195 of the French Civil Code in 2016, a similar rule is in force also in France.

The discipline is slightly different in other countries that do show a preference for adaptation over termination. That is the case, for instance, in Greece (Art. 388 of the Greek Civil Code) where the judge can either adapt or terminate the contract, but termination is only an *extrema ratio*.[11] This means that the judge shall bear in mind that "whatever can be salvaged from the contract must be preserved".[12] In Austria, both remedies are viable through a combination of different provisions of the ABGB (Austrian Civil Code) and scholars tend to consider termination as a mere *extrema ratio*. Nonetheless, courts are still reluctant to intervene on the contract.[13]

The most advanced regulation of adaptation of the contract in Europe was drafted in Germany in 2002, with the new wording of Art. 313 of the BGB (German Civil Code). The provision indeed prescribes adaptation as the first and main remedy to a sudden and unexpected change of circumstances, which should push contractors to try the way of an extra-judicial renegotiation. On the contrary, termination can only be taken into consideration if adaptation turns out to be

impossible or *unzumutbar*, unacceptable.[14] Such an unacceptability shall be judicially proven through a balancing of interest's assessment, and can only be assessed if the survival of the contract would lead to a result which is intolerable an contrasting both with the law itself and with fairness.[15]

**Future harmonisation perspectives and private international law remedies**

The opening of several legal systems to a codified rule of judicial adaptation, together with the equalizing of the remedies (termination and adaptation) made by UNIDROIT Principles and the PECL, shows a clear trend towards the continuity of the contract. The trend is indeed so evident that it was suggested that an obligation to renegotiate contracts was likely to be introduced in the majority of the contemporary legal systems.[16]

It is quite curious, then, that the EU proposal for a Regulation on a Common European Sales Law[17] codified neither renegotiation, nor hardship and not even force majeure. The whole system of the draft is indeed based on the compensation of damages. The proposal embraces, therefore, the common law principle of the sanctity of the contract. The future will tell if, in the aftermath of the COVID-19 pandemic and of Brexit, this choice will be revised, and conservative remedies will make their appearance in the proposal.

As for now, without a harmonisation at EU level of the remedies to unexpected and unforeseeable interferences in the equilibrium of the contract, the resolution of a controversy in terms of termination or adaptation depends entirely on the law applicable to the contract. This also means that two identical contracts concluded between an Italian and a German party, one submitted to Italian law and the other to German law, will likely undergo very different destinies if extraordinary events make one of the performances excessively burdensome. That is not the case, of course, when the parties have explicitly regulated the occurrence with a material law clause.

So far so good. It might also occur, however, that the contract is disciplined by two laws simultaneously, Italian and German, that have been chosen to regulate different sections, as permitted by Art. 3, para. 1, Rome I Regulation.[18] On the one hand, this provision could be useful to submit a contract to (for instance) Italian law, at the same time allowing for the remedy of Art. 313 of the BGB to be applied – only and – when the contractual equilibrium is broken because of an external unforeseeable event. This way, the parties can somehow extrapolate a factual case that is disciplined by a material provision of another law, which appears to be more fitting. Such a material law choice is indeed considered admissible by scholars under the Rome I Regulation.[19]

On the other hand, however, troubles may arise when different laws are picked to regulate parts of the contract that are distinguished only by their abstract, legal qualification. This can be the case if, for example, the reasons for termination of the contract are submitted to Italian law, whereas the rest of it, including its modifications, is submitted to German law. In this case, shall an exceptional situation occur, just like the COVID-19 pandemic has, the qualification of Art. 313 of the BGB could prove to be tricky. In the eyes of the Italian interpreter, indeed, where one performance has become excessively burdensome, the contract shall be terminated according to Art. 1467 of the Italian Civil Code. Under the Italian perspective, in fact, the situation in point surely represents a cause for termination. To the German interpreter, however, the situation of hardship requires in the first place an adaptation of the contract to the new circumstances, namely its modification. Its

termination, on the contrary, remains a mere *ultima ratio* solution. This shows that the variety of regulations in the face of hardship situations also produces, as a side effect, qualification incidents, as well as possible *depeçage* situations.

These difficulties could be deleted at least at EU level if a common material rule on the handling of hardship was adopted. Since then, however, harmonisation could take a different, somehow easier, path. Whilst the sharp gaps and differences between legal systems might make it extremely hard to find a shared solution on a material prescription, in fact, EU member States might agree on a less impactful provision. It could be agreed that in a case where unforeseeable occurrences hit a contract in which two or more legal orders are implied, prevalence is given to the one which favours the continuity of the contract. It could be prescribed, for example, that the rules of a member State allowing the judge to impose adaptation over termination amount to overriding mandatory provisions. This way, private international law could help favour the application of the conservative remedies to face hardship, while waiting for a modernisation of national provisions or a harmonisation of EU private law in the direction of renegotiation and adaptation.

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References[+]