PESTALOZZI

ATTORNEYS AT LAW

COVID-19: Impact on supply and distribution agreements

19.03.2020

In the following, we outline the parties' potential remedies or the legal course of action in cases where the COVID-19 outbreak affects the performance of an agreement. Parties should first examine the contract for possible remedies (e.g. force majeure clauses). Under Swiss default law, it is important to distinguish between situations where performance is delayed, impossible or has become significantly more onerous (hardship).

Our recommendations at a glance

- **Immediately inform counterparties of any event that puts performance at risk**
- **Consider alternative ways to perform the contract and take all reasonable measures to mitigate damages**
- **Keep detailed records of the event impeding performance, measures taken and communication between the parties**
- **Review the contract for force majeure clauses or other remedies that could apply in the circumstances**
- **Consider Swiss law remedies depending on whether performance has become delayed, impossible or substantially more onerous**
- **For future contracts, consider how epidemics, pandemics and other unforeseen events can be more adequately addressed and consider arbitration clauses in cross-border contracts**

Pestalozzi Rechtsanwälte AG
Feldeggstrasse 4
CH-8008 Zürich
T +41 44 217 91 11
zrh@pestalozzilaw.com

Pestalozzi Avocats SA
Cours de Rive 13
CH-1204 Genève
T +41 22 999 96 00
gva@pestalozzilaw.com

pestalozzilaw.com

Introduction

The World Health Organization (WHO) declared an international health emergency due to the outbreak of COVID-19 in late January 2020. Since then, governments around the world have imposed severe sanctions including quarantine measures, travel bans and export or import embargos to prevent or limit the spread of COVID-19. The Swiss government has already taken strict measures including the ban of private and public events with more than 100 people, the closure of schools, increased border controls, and an aid package of 10 billion Swiss francs for struggling businesses.

The COVID-19 outbreak has a significant effect on global production and trading activities. Companies have slowed down production capacities, supply chains are interrupted and deliveries are delayed or cancelled with severe economic consequences for the contracting parties.

This raises a number of question under Swiss contract law, for example, in relation to (long-term) supply or distribution agreements or sale and purchase contracts generally which are governed by Swiss law. The non-performing party may want to be released from the existing contractual obligations and exonerate itself from further performance and liability. The purchaser/customer may insist on delivery or wish to enter a substitute transaction against compensation of damages resulting therefrom from the non-performing party.

As a general principle under Swiss law, the contracting parties must continue to fulfil their obligations, even if the outbreak of the epidemic makes performance of the agreement more difficult (pacta sunt servanda). Only under exceptional circumstances may parties be released from their duties to perform and/or be exonerated from liability.

Contract clauses allowing the suspension or termination of the agreement (force majeure or hardship clauses)

Parties whose agreement is affected by the COVID-19 outbreak are advised to consult their contract for possible remedies. Some contracts contain express provisions for situations where performance is impeded for reasons beyond the parties' control (known as force majeure clauses). Force majeure clauses typically excuse the non-performing party from liability.

Whether a force majeure clause applies in the individual case depends on its wording (i.e. whether it explicitly covers such cases or leaves sufficient scope for interpretation) and the specific circumstances of the case. Force majeure clauses often include a (non-exhaustive) list of possible force majeure events. Some force majeure clauses expressly refer to "government actions" or "national emergency" or, less frequently in practice, to specific situations like an "epidemic" or "pandemic". Some clauses might impose additional requirements, such as the obligation to notify the counterparty within a fixed period of time or a duty to mitigate damages.

It is recommended to examine such clauses at an early stage and to assess from a legal perspective whether an event could qualify as force majeure to ensure compliance with the relevant contractual requirements.

Remedies if performance is delayed

Most measures that have been implemented (such as export bans or quarantines) are of a temporary nature. In many cases where supply and distribution agreements are affected by COVID-19, delivery may be delayed, but not impossible. In case of a delay, the performing party may choose to continue with the contractual fulfillment, or (after an additional period to perform) waive performance and terminate the contract.

Termination typically leads to a rescission (so-called termination ex tunc) of the entire contract (goods already delivered are returned, payments are refunded), with the exception of long-term supply and distribution agreements, where the termination only has effect from the time of the default (so-called termination ex nunc). The non-performing party is liable for damages unless it can show that is not at fault. It is more likely that a non-performing party can exonerate itself from liability if the delay was caused by governmental action compared to if the disruption was caused by other reasons (e.g. the non-performing party had to put its workforce on quarantine due to a COVID-19 incident).

Remedies if performance is impossible

If performance due the COVID-19 breakout has become permanently impossible by circumstances for which the non-performing party is not responsible, the parties may be released from their obligations to perform and the non-performing party is exempted from liability for damages. Impossibility is generally defined as an extraordinary, unforeseeable, unavoidable event that could not be prevented with due care and therefore makes the fulfillment of the contract objectively impossible. Whether the spread of COVID-19 merely delayed performance or made performance objectively impossible must be assessed on a case-by-case basis. If governmental actions – such as import restrictions – prevented performance for which a fixed date was agreed, it is more likely that performance could be viewed as being impossible. Economic hardship (for instance if performance has become substantially more expensive due to the COVID-19 outbreak) does not constitute an impossibility under Swiss law, but may entitle the parties to renegotiate the contract (see next chapter).

Remedies if performance is substantially more onerous (economic hardship)

In cases, where contract performance is still possible, but has become substantially more onerous due to the COVID-19 outbreak, parties may resort to the Swiss doctrine of clausula rebus sic stantibus. The clausula doctrine exceptionally allows the equitable modification of an agreement if an unforeseeable change of circumstances led to a serious disproportion between the parties' obligations without fault of the parties. The clausula principle is an exceptional remedy that is available in very limited situations where the counterparty’s insistence on pacta sunt servanda would practically amount to bad faith.

If the COVID-19 outbreak made performance of the contract substantially more onerous (but not impossible), the modification of agreements based on the clausula doctrine might be an additional option to consider and to further evaluate in light of the specific circumstances.

Further considerations

The responsible party must immediately notify the other party of any event that may impede performance of the contract. Furthermore, the parties are required to take all reasonable measures to mitigate damages (e.g. substitute sale of perishable goods to a third party) as they otherwise risk losing their right to claim damages for their losses.

The party claiming one of the above remedies must prove that the respective legal requirements are met. In particular, the party wishing to be released from its obligations to perform or requesting a modification of the contract must prove that the COVID-19 outbreak caused the delay or impediment to perform.

In future contracts, it is advisable to consider how epidemics, pandemics and other unforeseen events can be adequately addressed. For cross-border contracts, we advise considering the inclusion of arbitration clauses to ensure that the dispute can be settled at a neutral venue (instead of local courts at the supplier's or the customer's place of business).

Contributors: Franz Schubiger (Partner), Lukas Rusch (Senior Associate), Céline Spahn (Junior Associate)

No legal or tax advice

This legal update provides a high-level overview and does not claim to be comprehensive. It does not represent legal or tax advice. If you have any questions relating to this legal update or would like to have advice concerning your particular circumstances, please get in touch with your contact at Pestalozzi Attorneys at Law Ltd. or one of the contact persons mentioned in this Legal Update.

© 2020 Pestalozzi Attorneys at Law Ltd. All rights reserved.

Franz Schubiger

Partner
Attorney at law, LL.M.
Co-Head Life Sciences

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 49
franz.schubiger@pestalozzilaw.com



Michael Kramer



Partner
Attorney at law, LL.M.

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 32
michael.kramer@pestalozzilaw.com