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Observing Contracts in the Corona Days

The Corona epidemic and the measures implemented by the government to deal with it, such as emergency regulations, orders, guidelines and various recommendations, affect our lives in many ways. One of the potential effects relates to agreements to which we are parties, on a personal or business level. Sometimes we cannot, or have difficulty fulfilling the agreement, and sometimes the other party will experience these difficulties. Below, we will briefly review the challenges that Corona presents us with respect to the execution of contracts and suggest ways to deal with them.

What should I look for in my contracts?

- | In many **commercial contracts**, there is an explicit provision that addresses extreme situations and sets forth the rights of the parties in such situations. Often the caption or title to the section is "force majeure", but this may vary.
- | **Mergers and acquisitions agreements** often have a clause that relates to materially adverse changes (a MAC - Material Adverse Change or MAE - Material Adverse Event clause) and allows one or both of the parties to withdraw from the transaction in such circumstances.
- | **Commercial financing agreements** with financial entities may have a number of relevant provisions for this time, such as clauses that include undertakings that the borrower must meet at all times (sometimes referred to as the borrower's covenants), including in relation to its financial condition and the continuity of its commercial activities. It is also possible that there are clauses that provide relief for the lender in circumstances of a material adverse change in the credit market.
 - Please note that applicable provisions in commercial financing agreements will generally work to the lender's benefit.
- | **In all agreements**, please pay attention to general representations and undertakings. For example, if you have represented or warranted that you have the manpower and other resources required to fulfill your obligations, you may be in breach of these clauses in the current situation.

I found a force majeure clause in the contract. What protection does it give me?

- | The answer to this question depends on the way the clause is formulated and the law applicable to the agreement, and the options are different and varied. **It is important to check on a case-by-case basis.** However, there are certain aspects that characterize force majeure arrangement and appear throughout *force majeure* clauses in many contracts.

In many cases the event will be defined through a list of instances and examples, with or without a general description of the concept.

- Check if the definition includes an explicit reference to epidemic, pandemic or government action. The term “Act of God” may also be relevant.
- In many cases, the event **will freeze or cancel the contractual obligation affected by it, without it causing a breach of contract** and without giving the other party the right to terminate the contract.
- Some contracts allow for the contract to be canceled, if the event is very extreme or lasts for a certain period of time.
- Some contracts allow for the contract to be suspended or partially suspended even if there is no contractual obligation that has been negatively affected by the event. For example, orders can be frozen as a result of a force majeure event even if there is no contractual obligation to place orders.
- Some contracts explicitly state that a force majeure event will in no case allow for the cancellation of a payment commitment.

In many cases, the contractual clause will require the party affected by a *force majeure* event to **meet several conditions** in order to claim relief, in particular:

- Obligation to notify about the event.
 - Pay attention to the timing of the notice and its content. A late or incomplete notice may adversely affect your ability to enjoy contractual protection.
 - The Corona event may make it difficult to address some of the issues that need to be expressed in the notice such as the expected duration of the event. It is important to be draft the notice carefully.
- Actions must be taken to mitigate the damage caused by the event, such as finding alternative ways to fulfill contractual obligations or reduce the delay in time schedules.
- Commitments that have been delayed must be observed (as far as possible) after the circumstances which constitute a *force majeure* event cease to exist.

I did not find a "force majeure" clause in the contract. What protections do I have?

For contracts that are governed by Israeli law, and which do not have a specific arrangement for the current circumstances, **general contract law** applies, which includes provisions that regulate extreme situations in which a contractual undertaking is impossible or fundamentally different from what was agreed between the parties. Such a general provision exists in **Section 18** to the Israeli Contracts Law (Remedies for Breach of Contract), 5731-1970.

Sometimes there are **specific provisions that apply to contracts of a certain type**, such as Section 15 of the Rent and Lending Law, 5731-1971, which applies to real estate leases.

- In light of a Supreme Court ruling, it is difficult to apply Section 15 of the Rent Law to the circumstances resulting from an event that has a broad impact, such as the Corona epidemic. It is important to evaluate each case and its specific circumstances independently.

Section 18 of the Remedies Law provides protection to a party to a contract if all of the following conditions are met:

- Circumstances exist under which the party could not, and was not required to, know or foresee in advance at the time the contract was signed;
- The contracting party could not prevent these circumstances;
- Due to these circumstances, the fulfillment of the contractual obligation is impossible or would be fundamentally different from what was agreed between the parties.

I Does the Corona epidemic meet the requirements of Section 18?

- In the past, the courts interpreted section 18 narrowly, stating that almost everything, including wars in Israel, for example, is foreseeable at the time that a contract is signed.
- Over the past twenty years, the courts have shown a more lenient approach to recognizing events as unforeseeable, and events such as a general strike in the economy and restrictions under the orders of government agencies have been recognized as events frustrating contractual obligations. Certain judges have also expressed their view that events such as wars, prolonged general closure or extraordinary weather conditions may be events that frustrate or make a contract impracticable.
- Given this more lenient approach, and considering the exceptional nature of the Corona epidemic and the measures which have been taken to deal with it, as well as its wider international recognition, it is quite possible that the Corona epidemic may be recognized as grounds for frustration contract in Israel under Section 18.
 - Both the epidemic itself and the related regulations and orders of the Israeli government may establish a claim that the contract has been frustrated. It is important to explore both possibilities - according to the circumstances of the contract.

I Which legal defenses does Section 18 offer?

- Section 18 only applies if a party cannot fulfil its contractual obligations or the execution of such obligations is fundamentally different from what was originally agreed upon. Generally, a lack of financial practicality will not meet this requirement. Therefore, if I have purchased commodities and currently I am unable to sell them because of the situation, I have purchased raw material and currently cannot manufacture my product because of the situation, or I have rented offices and currently most of them are empty because of the situation – it is uncertain that I will be entitled to the legal defense of frustration of contract, since the current situation does not prevent me from fulfilling my payment obligations.
 - Look for contractual obligations that you cannot observe due to the situation so that you may be entitled to the defense of Section 18.
- Section 18 provides protection against claims for enforcement of the contract or for compensation. The party whose commitment has been frustrated is still considered to be in breach of the contract, and the other party may terminate the contract or postpone fulfilling its own commitments (e.g. payments). The court is also authorized to order restitution and compensation of the other party for certain costs and expenses.
 - Note that the law only provides partial protection. If you do not want the contract to be terminated by the other party - you may not want to rely on this defense.
 - Note that the law does not allow the party claiming its contractual obligations were frustrated (the breaching party) to terminate the contract - this right is reserved for the other party to the contract.
- A claim under Section 18 is a defense claim providing certain relief to the party which does not fulfil its obligations and not a claim that can be made against the other party. Therefore, if we see that the other party to a contract is not fulfilling its obligations and we assume that this is due to *force majeure* circumstances, we cannot act immediately

to postpone our contractual obligations or terminate the agreement – first we must approach the other party regarding the breach in order to allow the other party to claim *force majeure*, and then we may act accordingly.

- While the process from a purely legal standpoint is as described above, the final outcome can be reached immediately through discussion between the parties.

I **What if Section 18 does not apply to me or does not give me sufficient protection?**

- Additional provisions of the law which may provide protection may be explored. Contact us for further details.

I **So, what is the difference between defenses under the law and contractual defenses?**

The main differences between the general protection of Israeli contract law and the typical protection of contractual force majeure clauses can be summarized as follows:

Subject	Section 18	A typical force majeure clause in a contract
How is the event defined?	General definition: the lack of an ability to predict circumstances, an inability to avoid them, existing contractual commitments becoming impossible or fundamentally different	May include specific instances or examples of <i>force majeure</i> events. Look especially for epidemic, pandemic, or government action. Act of God may also be relevant
Scope of protection	Protection against claims for enforcement or compensation for breach of contractual obligations. The contract is still considered as having been breached.	In some clauses - protection against a breach of a contractual obligation In other clauses - the right to freeze the contract or parts of it even in the absence of a breach
Can the contract be terminated?	Only the other party (not the one whose commitments have been frustrated) is entitled to terminate the contract	Generally, if the clause provides that lack of fulfilment due to <i>force majeure</i> circumstances does not constitute a breach then the contract cannot be terminated. In some cases, such as an extreme event or one that extends for a long period of time, either party may terminate the contract
Can payment obligations under the contract be frozen?	Generally no, but it is important to examine the specific circumstances of each case	In some contracts, all payments are frozen, while other contracts explicitly state that the obligation to pay remains valid even in circumstances of <i>force majeure</i>
What obligations apply to the party affected by the situation?	Section 18 does not make an explicit reference to any such obligations, but the obligation to give notice and the duty to mitigate the damage may apply under other provisions of the law	In many cases, there will be a duty to notify according to the timing and format determined by the agreement and to reduce the damage and take alternative measures to fulfill the contract

What is next?

Examine each case on the basis of its specific merits and circumstances – and find solutions. That's what we are here for.

For further information please contact:



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