LITIGATION - LUXEMBOURG

Unforeseeability theory developments in aftermath of COVID-19 crisis

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Introduction

To counterbalance the negative economic impact that the COVID-19 lockdown measures have triggered, Luxembourg has introduced several regulatory and legislative measures to limit or at least mitigate the financial difficulties that many businesses may face in order to avoid bankruptcy.

In addition to these official measures, businesses may benefit from contractual legal means or case law to avoid payment default. For example, their contracts may include specific clauses or refer to the concept of *force majeure* or fortuitous events (for further details please see "Impact of COVID-19 on contractual obligations: *force majeure* and case law"). Whether the defaulting party to a contract could request its renegotiation by invoking the unforeseeability theory is an interesting question. This article highlights the unforeseeabilty theory, which has not been used much in previous case law, but could be useful in the context of the unfolding COVID-19 pandemic.

Force majeure and case law

With regard to *force majeure*, unless the concept has been otherwise defined by the parties in a contract, case law has identified three conditions which must be cumulatively fulfilled – namely:

- the debtor must not have caused the (external) event;
- the performance of the contractual obligation must be impossible (irresistible); and
- the event must not have been reasonably foreseeable (unforeseeable).

In the present COVID-19 situation, the third condition is subject to debate. While a pandemic is always foreseeable, COVID-19's scale and duration were not foreseeable by any economic or political entity, given that economies all over the world have been affected.

If it is true that the containment measures imposed in Luxembourg between March 2020 and June 2020 were unforeseeable with respect to contracts concluded before the arrival of the pandemic, this is less true with respect to contracts concluded after the lifting of the crisis measures. Given the media speculation regarding a second wave of general containment, businesses should take this risk into account in their contracts. Judges are likely to assess the unpredictability of the pandemic more severely for contracts concluded from the end of June 2020.

Some European decisions have already confirmed that the COVID-19 pandemic is a case of *force majeure* (eg, Colmar Court of Appeal, 12 March 2020, 20-01098). However, it is not the pandemic that is *force majeure*, but rather the pandemic combined with the government's restraining measures.

The question also arises as to whether a debtor can avoid fulfilling its obligations by arguing that the revision of its contract is necessary due to unforeseeable circumstances that render its performance excessively onerous but not impossible; this is the unforeseeability theory.

Unforeseeabilty theory

The unforeseeability theory is based on the principle of performing contracts in good faith. According to this theory, a judge could intervene in a contractual relationship at the request of the debtor to revise and renegotiate the contract simply because they are facing difficulties which make the performance of their obligations abnormally onerous and which were unforeseen at the time of

the conclusion of the contract.

While the principle of unforeseeability was established in the French Civil Code in 2016, the approach is different in Luxembourg. Apart from the fact that this theory is not established in the Luxembourg Civil Code, the Luxembourg courts have tended, until now, not to base their decisions on this theory.

Case law

On 31 October 2012 the Luxembourg Court of Appeal ruled on the unforeseeability theory, holding that "the fact that the price of a building plot increases over time is entirely foreseeable". However, the judges identified three criteria that must be met to adopt this theory – namely:

- there must be reciprocal obligations, one being the counterpart of the other;
- the obligations must continue to be exercised over time; and
- the economic changes that occurred during the performance of the contract must have been beyond the reasonable expectations and action of the parties.

On 24 October 2013 the Court of Cassation agreed with these criteria (Decision 64/13).

In the abovementioned case, the conditions required to apply the unforeseeability theory were not met because the sale contract was executed instantaneously and the land's price increase was foreseeable. Although the Court of Appeal and the Court of Cassation do not totally reject the unforeseeability theory, they did so in this case because the land's price increase was foreseeable between the signing of the contract and the day on which the sale contract was executed.

Consequently, if a debtor succeeds in demonstrating that there has been an abnormally onerous increase of its financial obligations due to facts relating to the lockdown measures (eg, delays in delivery or excessively onerous costs of machinery), a Luxembourg court may be more inclined to apply this theory.

Further, Luxembourg doctrine seems to align with neighbouring EU countries' rights (in particular, those of France, the United Kingdom (frustration doctrine) and Germany (*Wegfall der Geschaftsgrundlage*)) and be moving in the direction of recognition of the unforeseeability of contracts. However, some authors have specified that this hostility towards the unforeseeability theory in Luxembourg can be particularly explained by fear of arbitrariness on the judge's behalf or by the potential chain reactions that this could provoke. Legal doctrine believes that being able to modify a contract in the event of a change of circumstances should be exceptionally recognised by the courts in order to correspond as closely as possible to equity and economic efficiency.

The current exceptional situation demonstrates that a debtor should be granted such possibility, while allowing the courts, at the same time, to apply it on a case-by-case basis. The possibility of revising a contract should not be an absolute right, but rather a corrective measure in specific situations assessed by the courts.

Comment

It is in parties' best interest to amend their pre-existing contracts or conclude new ones to provide for the possibility of revising a contract due to the current situation which could generate excessive costs – the extent of which could be defined by the contract – for one of the parties. The contract could provide that in the event of disagreement between the parties, a renegotiation could take place or a judge or an expert could be consulted. Since the end of the crisis is not in sight, businesses should plan to execute contracts in good faith and accept that current events are difficult to understand and that the economic equilibrium of all entities must be ensured.

Undoubtedly, the Luxembourg courts will have to handle numerous claims involving defaulting debtors that will invoke the current health crisis in order to not fulfil their obligations. Like France, Luxembourg may adopt legislative measures to introduce the possibility of renegotiating contracts.

It will be necessary to see how the courts apply the *force majeure* and unforeseeability theories in various disputes; an evolution of their current position is expected.

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