

LES Benelux

Termination and Force Majeure

17. November 2021

Overview

1. What is Force Majeure and how does it affect license agreements?
2. How do parties address Force Majeure in contract drafting?
3. Legal background: What if the agreement is silent on Force Majeure?
4. Key take aways for contract drafting

1. What is Force Majeure and how does it affect license agreements?

What is Force Majeure?

1. Force Majeure is what the **parties define** to be Force Majeure.
2. In the absence of a definition:

Force Majeure usually means circumstances/events, which are

- unforeseeable,
- extraordinary,
- outside the **control** of the parties (**or**: which are not in the **risk sphere** of either party), and
- which cannot be **avoided** even if the parties act diligently and implement the customary measures to be prepared for such events.

Sphere of Licensor

(Depending on agreement)

- Due registration of IPR/payment of fees
- Sole control over IPR
- No conflicting contracts with third parties
- Suitable transfer of know-how
- Etc.

Force Majeure

- War,
- Riots,
- Embargo
- Natural disasters
- Pandemic
- Fire
- Strike and lock-out
- Breakdowns of energy supply or internet
- Cyber attacks
- New laws and regulations
- Inflation?

Sphere of Licensee

- Money
- Staff
- Other resources to exploit the licensed IPR
- Etc.

- In many agreements, most of these events are defined as *per se* Force Majeure events
- While the criteria of **unforeseeability**, **extraordinary dimension** and **unavoidability** are not reflected

Effects of (potential) Force Majeure events on license agreements: Direct

- A new export control law renders a technology **license illegal**.
- A new law **prohibits to practice** the licensed invention.
- The employees of Licensor who have to train the employees of Licensee for the technology transfer are subject to a travel ban because of a **pandemic**.

Effects of (potential) Force Majeure events on license agreements: Indirect

- The holder of a license to exploit a movie in cinemas cannot exploit the licence since the government orders the closure of all cinemas during a **pandemic**.
 - The closure of a port due to strikes delays the supply of products which makes it **impossible** for a licensee to **achieve a milestone** under a patent license agreement.
 - A pandemic has the effect that sales of luxury perfumes drop by 70%; as a consequence, the **annual minimum royalties and mandatory advertising budget** in a trademark license agreement for a luxury perfume brand are much higher than the income generated through the license.
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- Keep in mind to cover **indirect** consequences of Force Majeure
 - Distinguish impossibility **to perform an obligation** and impossibility to **exploit a right**
 - Distinguish **impossibility** and **hardship**
 - Distinguish **permanent** and **temporary** consequences

2. How do parties address Force Majeure in contract drafting?

Contract clauses addressing Force Majeure

- **Force Majeure clauses**
- Hardship clauses
- Material adverse change clauses (MACS)
- Preventive measures:
 - Provisions requesting **business contingency** plans, **disaster recovery** plans and/or **redundant systems**
 - Right to have 2nd source
- Specific termination rights

Force Majeure Clause – Example – Short

Force Majeure. Neither Party shall be held liable or responsible to the other Party nor be deemed to have defaulted under or breached this Agreement for **failure or delay in fulfilling or performing** any term of this Agreement other than an obligation to make a **payment**, when such failure or delay is caused by or results from fire, floods, embargoes, government regulations, prohibitions or interventions, war, acts of war (whether war be declared or not), insurrections, riots, civil commotions, strikes, lockouts, acts of God, or **any other cause beyond the reasonable control** of the affected Party.

Force Majeure Clause – Example – Medium

- 12.1 Force Majeure shall mean any circumstances beyond the control of the Party affected thereby including, but not limited to, Acts of God, peril of the sea, earthquakes, flood, fire, explosion, storms, civil commotion, declared or undeclared war, restrictions or directions from any government or governmental body or authority, impossibility to obtain energy, breakdowns of equipments, strikes, labour disturbances or any other causes whatsoever similar to or with similar effects to those stated above, which prevent the affected Party to execute its obligations under this Agreement partly or as a whole.
- 12.2 Neither Party shall be liable to the other Party for any failure or delay of performance if such failure or delay is due to an event of Force Majeure, provided that such affected Party shall **inform** the other Party by written notice of the existence, expected extent, duration and consequences of the event of Force Majeure as soon as reasonably possible.
- 12.3 During the duration of the Force Majeure, but for no longer period, the obligations of the affected Party shall be **suspended** to the extent as prevented by such Force Majeure. The **obligations of the other Party shall be suspended in proportion** to such extent and for the same period of time. The Parties shall **endeavour to mitigate** the consequences of the Force Majeure event.
- 12.4 Should the Force Majeure event continue for more than thirty (30) days after notice is given thereof and the Party affected by such Force Majeure event is not able by the end of such thirty (30) day period to reasonably fix the date on which it expects in good faith to be able to perform its obligation hereunder, the Party which is not affected by such Force Majeure event **shall be entitled to terminate this Agreement** with immediate effect upon the sending of a written notification to the affected Party.

Force Majeure Clause – Example – Long

1. For the purpose of this Agreement, “**Force Majeure**” shall mean any event that impedes a Party **from performing an obligation** under this Agreement or **that prevents Licensee from exploiting the License**, if and to the extent that the affected party proves that
 - a) such event is **beyond its reasonable control**;
 - b) such event could not reasonably have been **foreseen** at the time of the conclusion of the Agreement;
 - c) the effects of such event could not have been **avoided** by preventive measures customary in the industry of the affected party; and
 - d) the effects of such event could not reasonably have been **overcome** by the affected party.

The following events shall **be deemed to fulfill** conditions (a) and (b): war, riots, rebellion, acts of terrorism, embargo, natural disasters, fire, epidemic, break-down of energy supply or internet (outside the premises of the Parties), strike and lock-out.

Non-performance or default by a **subcontractor** of a Party shall only be considered Force Majeure if the Party can prove conditions (a)-(d) in respect of the subcontractor and, in addition, conditions (c) and (d) in respect of itself.

For the avoidance of doubt, bankruptcy, other insolvency events or **insufficient funds** to make a payment under the Agreement do not constitute Force Majeure.

2. The affected Party is under an obligation to take all reasonable measures to limit and **mitigate** the effects of the event.
3. A Party who desires to invoke Force Majeure has to **inform** the other Party by written notice of the existence, expected extent, duration and consequences of the event of Force Majeure as soon as reasonably possible after the occurrence of the event.
4. **Neither Party shall be liable** to the other Party for any failure or delay of **performance of an obligation** if such failure or delay is caused **directly or indirectly** by Force Majeure. The obligations of the affected Party shall be deemed **suspended**. Where the effects of the Force Majeure are **temporary**, the suspension applies for the duration of the effects. The obligations of the other Party shall be **suspended in proportion** for the same period of time. If the Force Majeure directly or indirectly affects **core obligations** of the Parties (like, e.g., the obligation to grant the License, the obligation to pay the License Fees, the obligation to perform the technology transfer), **the suspension affects all obligations**. If the Force Majeure affects non-core obligations, the suspension shall be limited to such obligations.

4. The Parties agree that each Party {or: the non-affected Party} may terminate the agreement with 1 month' prior written notice if the effects of Force Majeure exceed the **duration of 120 days**.
5. If Force Majeure has the direct or indirect effect of preventing Licensee from **exploiting the License** for more than ... months, **each party** {or, depending on the license fee model: the Licensee or Licensor} is entitled to terminate this Agreement by giving one month's prior written notice. Licensor has the right to prevent such termination if it offers to suspend all payment obligations of Licensee during the Force Majeure.

Hardship Clause

Each Party shall be bound to perform its obligations under this Agreement even if events have rendered performance more onerous than could reasonably have been anticipated at the time of the conclusion of the Agreement. Notwithstanding the foregoing, if a Party proves that the continued performance of its obligations or the exploitation of the License has become **excessively onerous and disproportionate** due to a **change of the circumstances beyond its reasonable control** which it **could not reasonably have been expected** at the time of the conclusion of the agreement and that cannot reasonably be **avoided or overcome**, the Parties are, upon request of the affected Party, obliged to **negotiate in good faith** an adjustment of the Agreement. If the Parties are unable to agree on an adjustment within ... weeks from the request of the affected Party, the affected Party is entitled to request a sole arbitrator according to Clause ... to adjust the agreement in accelerated proceedings {in the alternative: to terminate the Agreement}. By way of example, an event shall be deemed to entitle the affected Party to request an adjustment of the Agreement, if {**add specific examples to set the standard and to help interpret the clause**}.

3. Legal background: What if the agreement is silent on the topic of Force Majeure?

Swiss law - Basics

- Under the Swiss Private International Law Act (SPILA), termination and invalidity of a contract are subject to the **law applicable to the contract** (*lex causae*; Art. 148 SPILA). This also applies for the restitution based on unjust enrichment (Art. 128 para. 1 SPILA).
- The Swiss Code of Obligations (**CO**) includes **general rules** for all agreements (and specific rules for certain types of agreements, but not for license agreements).
- These general rules only apply to the extent that the parties have not agreed on other terms (subject to mandatory provisions which are, however, irrelevant here).
- The general rules of the CO do not mention Force Majeure, but they provide for several rules where it is decisive whether or not a party is responsible for non-performance or not.

Swiss law: No obligation to pay damages without fault (in principle)

In Swiss law, a non-performing party does (in principle) **not** have to pay **damages** if it can show that non-performance was not its **fault** («faute», «Verschulden»; Art. 97, 106 and 109 CO)

- Under Swiss law, non-performance of an obligation in a license agreement due to Force Majeure does not lead to an obligation to pay damages (unless a Party had contractually assumed **strict liability** [e.g. in a rep or warranty] or the law provides for strict liability [**e.g. if a party is in default**]).

Swiss law: Impossibility to perform an obligation (Subsequent impossibility)

- Art. 119 CO:
 - An obligation is deemed **extinguished** if its performance is made **impossible** by circumstances for which the **obligor is not responsible**.
 - The obligor has to refund the consideration already received pursuant to the provisions of **unjust enrichment**.
 - This does not apply to cases in which, by law or agreement, the risk passes to the obligee prior to performance.
- Art. 119 CO was drafted for “one-off agreements”. For **continuous agreements** like licensing agreements “automatic voidness” is not adequate. Legal doctrine suggests **termination ex nunc**.
- Does the impossibility of the performance of an obligation affect the **entire** agreement? Depends on whether the parties had entered into the agreement without the impossible terms (hypothetic will of the parties)
- Art. 119 CO only applies to **permanent** impossibility; **temporary** impossibility is treated like **default** which (in case of impossibility which is not the fault of the obligor) in essence may ultimately lead to a termination right of the obligee (Art. 107-109 CO; Art. 97 CO).
- **Payment obligations** cannot be impossible (from a legal perspective).

Swiss law: Hardship / impossibility to exploit a right

- In principle, changing circumstances are in the risk sphere of each party and contracts have to be fulfilled (*pacta sunt servanda*).
- Exemption: *Clausula rebus sic stantibus* («things such standing»); high standard
- A party can request **termination** or **adjustment** of an agreement if
 - The **circumstances have changed fundamentally** since the conclusion of the agreement;
 - The change of circumstances was **not foreseeable**;
 - The change causes such **hardship** on the side of one party that it would contravene the principle of **good faith** if the other party refused to change/terminate the agreement (obligations entirely **out of balance**); and
 - The change or the consequences thereof could not have been **avoided** by customary preventive measures.
- Consequences: The agreement has to be modified in the way which the parties would have agreed if they had been aware of the change. This may also lead to termination of the agreement.

Examples from the (rare and old) cases of the Swiss Federal Supreme Court re Clausula rebus sic stantibus

Change	Year of decision	Termination/adjustment allowed or rejected?
Due to the financial crisis 2008 a pension fund did not have sufficient funds to pay-out pensions	2012	Rejected; changes in the stock markets like in 2008 have happened before
15 years' lease of a restaurant; the worldwide economic crises led to a significant drop of income during two years	1933	Rejected; major economic fluctuations are not unforeseeable in an agreement with a 15 years term
Lease of a restaurant on a ship; during World War I, passenger numbers fell by 44%.	1922	Adjustment allowed
Contract to build four houses; during World War I the cost for salaries and materials increased by 60% in 1.5 years	1924	Adjustment allowed

Three scenarios – Four laws

Scenario	Likely legal consequences (if the agreement is silent) (all answers are, of course, subject to an assessment of all relevant facts and details on a case-by-case basis and subject to a certain discretion of the courts)			
	Belgium	Netherlands	US federal or state law	Switzerland
Scenario 1: Due to a pandemic it becomes impossible for the licensor to complete the technology transfer within the timeline agreed under the license agreement.	<p>Check: impossibility non imputable to debtor? (was it unforeseeable? E.g. would not be the case if the pandemic already existed at the time of entering into the license)</p> <p>If unforeseeable: force majeure</p> <p>Principle: temporary impossibility leads to suspension of the agreement.</p> <p>But if the temporary impossibility has as effect that the execution of the agreement definitively loses its interest, then termination right of licensee. No damage payment by licensor, as no fault.</p>	<p>Force majeure; no damage payment as no fault. Potentially termination right of licensee and, depending on the license fee model, of licensor.</p>		<p>Impossibility; not permanent; default; no damage payment as no fault, but may lead to a termination right of licensee</p>

Three scenarios – Four laws

Scenario	Likely legal consequences (if the agreement is silent) (all answers are, of course, subject to an assessment of all relevant facts and details on a case-by-case basis and subject to a certain discretion of the courts)			
	Belgium	Netherlands	US federal or state law	Switzerland
<p>Scenario 2: License agreement with 5 years fixed term. Due to a pandemic it is impossible to obtain supply of raw materials for six months and, as a consequence, licensee cannot exploit the licensed technology during that period.</p>	<p>Idem above: check whether pandemic and subsequent impossibility to obtain raw materials was foreseeable. If unforeseeable: force majeure.</p> <p>Principle: temporary impossibility leads to suspension of the obligation. (no extension of agreement after 5 years)</p> <p>If agreement contains obligation for licensee to exploit the technology (cf. fee model): suspension of that obligation and correlated obligations.</p> <p>However: never an impossibility to pay license fees (genera non pereunt) if minimum royalty agreed upon in license agreement.</p> <p>+ Under Belgian law, no recognition of the clausula rebus sic stantibus (hardship) yet. Only possible remedy: abuse of right. (high threshold). Negotiate decrease of royalties.</p>	<p>Force Majeure; no license fees or reduced license fees during that period</p>		<p>Clausula rebus sic stantibus may apply (uncertain); depending on the license fee model, right to adjust agreement</p>

Three scenarios – Four laws

Scenario	Likely legal consequences (if the agreement is silent) (all answers are, of course, subject to an assessment of all relevant facts and details on a case-by-case basis and subject to a certain discretion of the courts)			
	Belgium	Netherlands	US federal or state law	Switzerland
Scenario 3: 2 years license agreement; after six months the demand for the licensed technology (a software for virtual reality on board entertainment in planes) drops by 85% during 1 year due to a pandemic with unforeseeable dimensions.	<p>Belgian law does not (yet) recognize the <i>clausula rebus sic stantibus</i> (hardship).</p> <p>If there is no impossibility to execute the obligation, then there is no force majeure. No termination right.</p> <p>However, always possibility to argue that execution of agreement “as is” would lead to abuse of right à negotiate decrease of royalties, etc.</p>	<p>Unforeseen circumstances; termination right of licensee, depending on license fee model also termination right of licensor.</p> <p>Alternatively, duty to renegotiate on the basis of the principle of reasonableness and fairness.</p>		<p><i>Clausula rebus sic stantibus</i> likely applies; depending on license fee model, right to adjust or even terminate agreement</p>

4. Key take-aways for contract drafting

Key take-aways

- Take dimension, foreseeability and unavailability of events into account when drafting Force Majeure clauses
- Take into account the scenario that Force Majeure does not make performance impossible, but may make performance too onerous; if possible, define specific examples which the parties would consider as hardship
- Take into account that Force Majeure may prevent the licensee from exploiting the license, achieving a milestone etc.
- Depending on the type of license, provide for rules regarding preventive measures to be implemented by the parties