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COVID-19's Impact on Contracts and Relation with Force Majeure

The following statements are intended to help clarify the current legal situation caused by COVID-19 in terms of contracts and are valid for contractual relations subject to Turkish law. If contracting parties choose a law other than Turkish law as the law to be applied to the contract, the following statements may not apply. In such cases, the matter would have to be interpreted according to the law under which the contractual relationship is governed.

1. What is Force Majeure and Hardship?

Most of the contracts concluded today include a clause called "force majeure". These clauses generally state the events that constitute force majeure and then explain the actions that the parties may take if these events occur and the legal consequences thereof. Although it is a commonly used concept in practice, the definition and conditions of force majeure are not stipulated in the Turkish legislation. We determine the scope of the implementation of this concept in Turkish law within the framework of doctrine and the precedents of the Court of Appeals. Accordingly, the conditions for an event to be considered as force majeure can be listed as follows:

- The event that constitutes force majeure should take place outside the control areas of the parties,
- It should not be possible to foresee the event at the date of commencement of the legal relationship or to predict that the concrete effect of the event should be so great even if the event is foreseen,
- The party should fail to prevent force majeure from making the performance of the contract impossible despite all measures being taken, and
- In the contract, it should not be determined that the relevant event will not be accepted as force majeure.

In addition to these fundamental criteria, the Court of Appeals also considers criteria such as whether the alleged force majeure event is effective throughout

the country on similar legal relationships and whether the parties are merchants.

Force majeure, which is defined within the scope of the above elements and criteria, makes it impossible for the debtor to perform its debt. The impossibility of performance can occur as permanent impossibility or temporary impossibility. The permanent impossibility of performance occurs when it is not possible to eliminate the obstacle that leads to the inability to perform the debt. For example, the destruction of a work of art committed to deliver due to fire is evaluated in this context. In the case of temporary impossibility of performance, since the obstacle to the performance of the debt is not permanent, the debt may be fulfilled after this obstacle is eliminated. The inability to perform the delivery of an item due to the closing of the roads because of heavy snowfall can be given as an example of the temporary impossibility of performance. However, in cases where there is no interest of the creditor in performance of the debt afterwards, or where the time at which the impossibility will be eliminated is beyond the time that the creditor can be expected to be bound by the contract, temporary impossibility of performance may be considered as permanent impossibility of performance.

On the other hand, hardship, which may bear a resemblance to force majeure from time to time, is stipulated in article 138 of the Turkish Code of Obligations ("TCO"). For hardship, the following conditions must be met together:

- An extraordinary event which was not anticipated or could not have been anticipated when the contract was concluded should have occurred,
- The party (claiming hardship) should not have caused the extraordinary event,
- The extraordinary event should have changed the circumstances to such an extent that requesting performance of the contract would violate the good-faith principle, and

- The party (claiming hardship) should not yet have performed its obligation or has performed it by reserving his rights arising from hardship.

In summary, the main difference between these two concepts is that while the performance of the debt in force majeure becomes impossible, the performance of the debt in hardship does not become impossible, but it becomes quite difficult due to the significant change of circumstances.

2. Does the COVID-19 Outbreak Constitute Force Majeure or Hardship?

As of the date of this article, there is no Court of Appeals precedent ruling that COVID-19 may constitute force majeure. However, considering the precedents of the Court of Appeals regarding previous epidemics and other extraordinary events, we can see that the Court of Appeals has rendered its decisions on the force majeure claims on a concrete event basis, taking into account the circumstances of the event and the provisions of the contract. For this reason, it is not possible to give a single answer to this question for all contracts. While COVID-19 will be considered as force majeure for some contracts, it may be possible that it does not even constitute hardship for some contracts. Moreover, the rate of spread of the disease, the expected second wave of the pandemic and the nature and extent of the measures already taken and will be taken require very frequent updates on the comments.

If the continuation of spread of the disease in our country and a possible second wave makes it objectively impossible to perform the debt under the contract, the party may base its force majeure arguments upon "epidemic disease" mentioned in force majeure clause. After examining the provisions of the contract and the circumstances of the event, it is necessary to determine whether the impossibility of the performance is permanent or temporary after it is determined that COVID-19 makes the performance of the debt impossible. The disease, in most contractual relationships, may not have the same effect as the destruction of a work of art in a fire which is given as an example of permanent impossibility of performance. In some relationships, it can be argued that the debts of the parties may be postponed until the effect of the

disease is eliminated, so the impossibility in question is temporary. However, in some cases, the contractual relationship may become extremely intolerable for the parties due to the indefinite duration of the disease (in other words tolerance period to the contract has expired). Such situations may be accepted as permanent impossibility of performance.

On the other hand, in cases where the performance of the debt in the contract does no become impossible due to the effect of the disease but it becomes too difficult to expect from debtor to bear it, hardship may be discussed. You can find our explanations on hardship in the following sections of our article.

The impossibility of performance may be due to factual or legal reasons. For this reason, while examining the results of the pandemic, the administrative measures taken for fighting against the disease should be followed closely and their effects should be evaluated. As of June,, as a result of the positive effect of the decisions to ban the import of various products from the People's Republic of China, to stop the activities of over 150,000 entertainment centers such as cafes, restaurants, bars, to cancel flights to 68 countries in total as of March 21 and to impose curfew and travel bans as of March; falling case numbers accompanied the normalization process and the measures taken were largely removed. However, in the current situation, the rapid increase in the number of cases as a result of both the bending of the administrative measures with the normalization process and the more imprudent behavior of the public during summer, has led to the re-introduction of administrative measures in relation to entertainment centers and wedding ceremonies. When these developments and the rhetoric about the start of the second wave are evaluated together, it can be said that the pandemic and administrative measures to be taken against the pandemic have become foreseeable, and therefore the assertion of impossibility of performance has become difficult, especially with regard to merchants.

Furthermore, the fact that enterprises operating in various sectors can benefit from force majeure conditions within the scope of economic support packages announced by the Presidency and the Ministry of Treasury and Finance shall not mean that they can rely on force majeure provisions in all their contracts.

The contracts made by those enterprises also need to be evaluated according to the terms of the contract and circumstances of the concrete events.

3. How Can the Clause Be Interpreted If the Contract Does Not List Epidemics as Force Majeure?

In accordance with the principle of freedom of contract, the parties may determine which events will constitute force majeure in the contract.

Where no force majeure clause is included in the contract, existence of force majeure can be accepted if it is proven that COVID-19 outbreak or the measures taken within the scope of the outbreak cause impossibility of performance.

Although there is a force majeure clause in the contract, if epidemic disease is not included in the clause, it will be important whether the clause counts the events that constitute force majeure numerus clausus. For example, where there is a clause on force majeure in the contract stating that "it has been decided by the parties that the events that constitutes force majeure shall be limited to the following situations", the assertion of force majeure may not be accepted unless an epidemic disease or an administrative decision given for that reason is among the examples in that clause. In such cases, the Court of Appeals tends to accept that the risk that occurs is on the party whose performance is impossible, especially in case of an event that is not considered force majeure in contracts between merchants, who are expected to be prudent in all cases.

On the other hand, where events that constitutes force majeure are determined by a phrase such as "events that constitutes force majeure are as follows, including but not limited to the following examples", it is possible to assert by interpretation that conditions of force majeure are established, even if the contract does not include the expression of epidemics or administrative decisions.

4. What Are the Consequences of Force Majeure?

If an event that can be considered as force majeure occurs, it must be determined whether the event in question leads to permanent or temporary impossibility of performance. If it is accepted that the disease leads to permanent impossibility of performance of the contract, article 136 and 137 of the TCO regarding the impossibility of the performance in whole or in part for which the debtor cannot be held responsible will be applied. The debt that becomes impossible (or part of the debt as a result of partial impossibility) under those articles will be terminated. In return, the debtor who is released from performing its debt will be obliged to return the performance that received from the other party.

On the other hand, it is argued that in the case of temporary impossibility, which is not regulated in our legislation and accepted in accordance with the precedents of the Court of Appeals and the doctrine, the contract shall maintain for a reasonable period (the period of tolerance as stated in the precedents of the Court of Appeals) to be determined by taking into account the purpose of the parties in making that contract, but the performance of debt cannot be requested. In the event that the period of tolerance is exceeded and the uncertainty arising from the event of temporary impossibility of performance becomes unbearable for one of the parties, the contract shall be terminated automatically in accordance with the provisions of the permanent impossibility of performance.

Since the above-mentioned results are not imperative, the parties may regulate the reasonable period in question and the results of force majeure in accordance with the principle of freedom of contract. Therefore, the consequences of force majeure in terms of the performance of the contract should be evaluated by carefully examining the provisions of the contract and characteristics of each concrete case. For example, if there are provisions in the contract that the parties will bear this risk at different rates even in the event of force majeure, the financial consequences of force majeure shall be determined in accordance with clauses of that contract.

It must also be noted that in contracts that introduce unilateral provisions for the sharing of risks by the parties in case of force majeure and contain

provisions as standardized terms in accordance with Article 20 et seq. of the TCO, force majeure provisions introduced in favor of one party may be deemed invalid.

5. What Should the Party Who Wants to Rely On Force Majeure Clause Do?

In contracts with force majeure clause, there is generally a provision that, in the event of a force majeure, the party affected by it must notify the other party. This provision is intended to enable the creditor to take measures. As a matter of fact, Article 136 of the TCO provides that the debtor should inform the other party without delay that the performance has become impossible and take the necessary measures to prevent further damage.

On the other hand, as we stated in the answer of question 4, the notification term and form requirements agreed in the contract must be taken into consideration as the said article of the TCO is not imperative. For example, if there is a contract provision that the event considered as force majeure shall be notified to the other party by notary public, together with documents proving the effect thereof on the performance, within 24 hours as of its occurrence, such event shall be notified in accordance with that provision. Otherwise, loss of rights may occur.

6. If There is a Waiting Period Specified in the Contract For Force Majeure, Can One of the Parties Unilaterally Extend This Period? How Long Can They Extend It?

The waiting period in contracts for the occurrence of force majeure is particularly important where the contract may be suspended instead of termination, especially in cases where there is a temporary impossibility of performance based on force majeure. In this case, the parties do not perform their debts during this period, but they do not terminate the contract and show willingness to maintain their contractual relations after the end of the impossibility of performance.

As stated in the answers to our above questions, the parties may determine the waiting period as long as they wish in their contracts, as the provisions regarding the impossibility of performance of the TCO are not imperative. However, of course, this period should not be contrary to the principle of good faith by taking into account the characteristics of the concrete event. Nevertheless, for example, when there is a provision in a contract stating that in the event of force majeure, the parties may suspend their debts for 30 days and one of the parties affected by force majeure unilaterally declares that he/she has suspended its debts for more than 30 days or for an indefinite period of time, even if the declared period is not contrary to the principle of good-faith, it may cause problems in terms of contractual relationship. Therefore, if the waiting period determined in the contract is found not long enough after force majeure has occurred, it will be healthier to negotiate with the other party and extend this period if necessary.

Even if no waiting period is determined in the contract, it is accepted that the contract is suspended for a reasonable period of time during which the temporary impossibility of performance persists. However, if the period of non-performance of the contract due to impossibility of performance exceeds the period of tolerance to the contract, it must be acknowledged that each party may terminate the contract on the basis of force majeure in accordance with the principle of good-faith.

7. How Can the Contract be Terminated Based on Force Majeure Clause?

Article 136 of the TCO stipulates that if the performance of the debt is permanently impossible due to reasons that the debtor cannot be held responsible, the debt will be terminated without any further processing. However, as mentioned in the previous questions, since the said article is not imperative, it is necessary to comply with the conditions and procedures under which the contract will be terminated in case of force majeure, if these are agreed in the contract. For example, it may have been agreed that there would be a 30-day waiting period after the debtor duly notified the other party that force majeure had occurred and if force majeure continues at the end of this period, the contract shall end automatically or with a termination notice of

either party. In such a case, the parties are required to take into account the relevant provisions of the contract when terminating it on the basis of force majeure.

In addition, if the performance is temporarily impossible, where the parties did not agree otherwise in the contract, after the period of tolerance to the contract ends the contract may be terminated in accordance with the procedure stipulated therein on the grounds that the situation in question constitutes permanent impossibility of performance as we explained in the question 4.

8. In the Event that Force Majeure Cannot Be Relied upon in accordance with the Contract, Can the Provisions of Hardship Be Applied?

Yes, although the boundary between the impossibility of performance due to force majeure and the hardship may be not be clear in some cases, these are concepts that essentially mutually excluding each other.

While force majeure leads to temporary or permanent impossibility of the performance, in the event of hardship it is still possible to perform the debt, even if the performance is quite difficult. In this context although the situation is not heavy enough to make it impossible for one of the parties to perform its debt under the contract, Article 138 of the TCO relating to hardship may be applied on the grounds that the balance between the debts disrupted against that party and requesting performance of the contract would violate the good-faith principle.

9. What Would Be the Consequences If the Failure of One of the Contracting Parties to Perform the Debt Because of the COVID-19 Outbreak is Deemed Hardship?

If COVID-19 outbreak causes hardship pursuant to Article 138 of the TCO under the terms described above, the debtor has the right to ask the judge to adapt the contract to new conditions or to terminate the contract if adaptation is not possible.

In case of request for adaptation of the contract, the judge shall adapt the debts of the parties to the extent that he/she shall relief debtor by fairly distributing the risks arising from the contract. As we see from the Court of Appeals precedents regarding adaptation, the content of the adaptation clause, if any, in the contract and the characteristics of the concrete case are given great importance. In cases where ithe court determines that it is not possible to restore the balance between the debts of the parties, it will be possible for the debtor to terminate instantaneous performance contracts and to renege on continuous performance contracts.

On the other hand, if the debtor does not perform the debt arising from the contract and is found to be wrong in the lawsuit filed with the request for adaptation, the debtor will be deemed to have defaulted due to the failure to perform the debt in the term specified in the contract and may face the default interest request of the other party. In order to prevent this, it would be safer in legal terms for the debtor, who relies on hardship, to perform its debt by attaching reservation for the period in which hardship claim is asserted.

In addition to the above we would like to emphasize that although filing an adaption lawsuit in case of hardship is a solution, it will be more beneficial to resolve the dispute through amicable negotiations before going to court in order to alleviate the burden of courts and to resolve the dispute faster.

10. What Happens If Hardship is Accepted as a Force Majeure Event in the Contract?

As explained above, force majeure and hardship are essentially concepts that exclude each other, even though they are raised for similar situations. However, sometimes it is observed that these concepts can be used interchangeably in contracts, or that the provisions concerning hardship or adaptability of the contract are regulated under the title of force majeure.

Concerning this issue, the doctrine states that it is not how the parties characterize the provisions in the contract, but rather their will, which actually matches, is important. In this context, although the parties may include a

situation in which they describe as hardship or a sanction which may be in question in hardship under the title of force majeure, these provisions should be evaluated in accordance with the provisions of hardship.

11. Can Impossibility of Performance or Hardship in Loan Contracts be on the Agenda?

In accordance with the principle of genus non perit as one of the most fundamental principles of the law of obligations, it is accepted that the performance of pecuniary debts cannot be impossible. In other words, as a rule, the defense of force majeure and therefore impossibility of performance will not be accepted for debts related to payment of a certain amount of money. However, for debts relating to payment of a certain amount of money, in the event that its requirements are met, defense of hardship pursuant to the Article 138 of the TCO may be considered since in loan contracts, the debtor, who is performing its debt that is generally spread over certain maturities, becomes the party of a loan contract by performing risk analysis within the framework of economic conditions. All of the predictions of the borrower based on which he/she thought that he/she can repay the debt may have been wasted due to a global pandemic such as COVID-19.

Although theoretically, the hardship may be claimed for loan contracts in the way we described above, the Court of Appeals, even in the similar economic crises our country has experienced before, rejected adaptation of the loan contracts between merchants, based on the fact that merchants must foresee those situations in advance. In the current situation, while the effects of the COVID-19 outbreak and administrative measures taken against the outbreak have been experienced, in light of current precedents, it does not seem possible to assert hardship, especially on the grounds that predictions were wasted in terms of loans received after the outbreak of the pandemic. On the other hand, it is not possible to make a clear comment at this time on whether the Court of Appeals will make a different interpretation for adaptation requests arising from COVID-19, which affects the entire world economy. In addition, packages of financial measures announced by the Presidency must be followed.

12. What About Lease Agreements?

One of the issues frequently raised within the scope of COVID-19 was the difficulty experienced by tenants in paying the rental costs of their workplaces. Pursuant to provisional Article 2 of the Law No. 7226, which was passed in Parliament on 25 March 2020, it is provided that between 01.03.2020 and 30.06.2020, the lease contracts cannot be terminated and the tenant cannot be evicted due to the non-payment of the rental costs of the workplaces. With the normalization process that began in June, commercial life began to return to normal, albeit slowly. However, given the rising number of cases and forecasts for the second wave, similar regulations may be on the agenda again. If such regulation is not regulated again in the case of a possible second wave, requests for adaptation in accordance with the provisions of the TCO or requests for reductions in rental prices may be raised.

On the other hand, at the time when the pandemic began to spread in Turkey, although the public authorities did not take any decision regarding the closure of shopping malls, we saw that retailers other than grocery stores and pharmacies ceased their activities voluntarily in many shopping malls. In the statements made by the Association of Shopping Malls and Investors and the Federation of Shopping Centers and Retailers of Turkey, where entities in the sector come together, it was declared that no lease will be taken from the businesses that are closed under COVID-19 measures. If shopping malls, which have started to operate gradually with the normalization process, cease their activities again due to a possible second wave, similar actions can be expected to be taken in terms of lease in order to protect commercial relations. However, it is still possible for tenants to bear side/common expenses such as security, cleaning due to not closing the shopping malls entirely. In this case, it would be appropriate for the tenant firms who own the workplaces to negotiate with the management of the mall and demand that the common expense contribution share to be recalculated by considering the density in the mall.

13. What Should be Considered in Contracts to be Entered Into In the Upcoming Period?

As the effects of COVID-19 pandemic currently have been seen in the whole world and various administrative measures have been taken to combat the disease, the possibility that COVID-19 will be accepted as force majeure on the grounds of unpredictability in terms of contracts to be made thereafter is weakening. Especially for merchants, it can be said that the impacts of the possible second wave are predictable, and that the economic and social impacts of COVID-19 should be carefully analyzed in the contracts to be made. In such a case, if the performance of the debtor, who can predict the consequences of the pandemic, is subsequently impossible due to the disease, the debtor can be held responsible for the impossibility of performance due to fault of the debtor under Article 112 of the TCO. However, if the consequences of the disease, which are not expected to occur even on the date of the contract, occur and make the performance of the contract impossible, force majeure defense may come back on the agenda.

Nonetheless, it is possible for the parties to include clauses for adaptation to the contracts to be made thereafter and to arrange principles according to which the actions in the contract will be adapted if unforeseen effects of the disease occur or persist for too long. In case of a subsequent dispute regarding adaptation, the court shall decide in accordance with the provisions of the contract, if the parties have included adaptation clause therein. Therefore, in these days of uncertainty, we recommend that the parties at least state that they have agreed on the debts anticipating how long the impact of the disease will last, and arrange what the terms of the renegotiation will be if this period is exceeded.