



July 16, 2020

8. COVID-19 and *Force Majeure* under Japanese New Contract law

On May 25, 2020, the Japanese government lifted the COVID-19 state of emergency for the entire country. However, the impact of COVID-19 is continuing to cause various legal issues throughout the world, including in Japan. This newsletter discusses whether the COVID-19 outbreak constitutes a “force majeure” event and whether a business operator who fails to perform a contractual obligation due to the impact of COVID-19 is exempted from liability under Japanese law. It should also be noted that Civil Code of Japan has been recently amended and in effect since April 1, 2020. However, default liability of contract is governed by the amended Civil Code only if the contract was entered into on or after April 1, 2020. As many contracts affected by COVID-19 are considered to have been concluded before April 1, 2020, unless otherwise noted, this newsletter is written based on the provisions of the Civil Code before amendment.

This article is written based on the information as of July 16, 2020

1. "Force Majeure" under the Civil Code of Japan

(1) General Rules on exemption of liabilities on the grounds of “force majeure”

Force majeure is generally construed as “an event or circumstance caused by an external cause beyond the parties’ control that cannot be prevented even with due care to prevent it.”¹

Under the Civil Code of Japan, the term “force majeure is not defined. Nor does Civil Code stipulate general rules on the exemption of liabilities on the ground of “force majeure”. However, in order to claim for damages and/or to terminate a contract based on default, the default must be “attributable to the obligor” (Article 415, Article 541 and 543 of the Civil Code). As commonly understood, default caused by force majeure cannot be “attributable to the obligor”; therefore, general rule is that the obligor is released from its liabilities for damages and the obligee cannot terminate the contract.²

In this respect, under Japanese law, “force majeure”

should be considered as sub-category of the event which is not “attributable to the obligor”³. Force majeure is not provided as an independent ground for exemption from contractual liability.⁴

(2) Amended Civil Code

Under Article 415, paragraph 1 of the amended Civil Code, there is no change in the requirement that default must be “attributable to the obligor” for the obligor to become liable for compensation for damages. However, under amended Article 541, the obligor’s negligence is no longer required to terminate a contract when the obligor is in default.

Therefore, even if the default is caused by force majeure, the obligee may still terminate the contracts that have been entered into on or after April 1, 2020.

(3) Special Provisions for Monetary Obligation

Article 419 paragraph 3 of the Civil Code is a special provision on the discharge of monetary obligations due to force majeure. Article 419 paragraph 3 of the Civil Code provides that “The obligor may not raise the

¹ Zentaro Kitagawa Zentaro and Yoshio Shiomi Yoshio. “§415 Compensation for damage due to default (Article 415).” Japanese Civil Law Annotated Vol.10II2nd Edition, edited by Okuda Masamichi Okuda, Kabushikikaisha Yuhikaku, 2011, pp172

² *Id* at pp.160-170

³ *Id* at pp.172

⁴ Although there are some other cases in which force majeure is relevant such as in tort liability, we will not discuss here because those cases are beyond the scope of this newsletter.

defense of force majeure with respect to the damages” for failure to perform any obligation for the delivery of any money. Monetary obligations include not only loan debt but also rent debt,⁵ and purchase price payment obligations⁶. Force majeure does not exempt these monetary obligations.

(4) Force Majeure Clause in Contract

Articles of Civil Code referred to in (1) to (3) above are discretionary provisions and the agreement of the parties take precedence over rules under those articles. Thus, if parties agree on exemption of liabilities based on force majeure event, the application and consequence of the force majeure will be determined based on the agreement.

However, even in this case, the court would carefully determine whether the default was caused by force majeure in the similar manner as it does in case where there is no force majeure clause as explained in Section 2 below.

2. Court cases on Force Majeure and Exemption of Liability

As of today, there is no published case on the judgment on default caused by or related to COVID-19. However, there are several cases on exemption of liabilities due to natural disasters as follows. These cases are helpful in determining whether the liabilities for default arising from the impact of COVID-19 can be exempted or not. Particularly, since earthquakes frequently happen in Japan, there are several court cases regarding force majeure and earthquakes.

a. Tokyo District Court Judgement April 7, 2016 Westlaw2016 WLJPCA04078002

In this case, a contractor was sued for compensation for damages due to delay of construction of a building after the Great East Japan Earthquake. There were provisions in the contract which stipulated that the contractor may request for an extension in the construction if there is a justifiable reason such as force majeure, etc.

The court found as follows: (1) a justifiable reason means an obstacle in the construction or other reasons that cannot be attributed to the contractor and could not be foreseen at the time of concluding the contract, and (2) force majeure constitutes such justifiable reason

including natural disasters or an abnormal change in economic conditions such as an unforeseeable shortage of goods wherein it is impossible to undertake alternative measures.

Specifically, the court found that the suspension of construction on the day of the earthquake and the next day and the suspension of shipment of building materials due to radioactive contamination can be deemed as force majeure. On the other hand, the court found that the delay in delivery of tiles from a tile manufacturer cannot be a justifiable reason because the contractor could have procured tiles from other tile manufacturers.

b. Tokyo District Court Judgement August 26, 2015 Westlaw 2015 WLJPCA08268002

The plaintiff purchased a land with a right to utilize hot spring water and entered into a contract with the defendant wherein the defendant agreed to supply a certain amount of hot spring water. However, after the Great East Japan Earthquake, the amount of the spring water decreased, and the defendant was not able to supply the amount of hot spring water as stipulated in the contract. Therefore, the plaintiff claimed for compensation for damages.

The court dismissed the claim stating that it is difficult to eliminate the possibility that there was a problem with the water pipe installed by the plaintiff and the deterioration of the spring water output was attributable to the plaintiff. In addition, the court also stated that the change in the amount of spring water due to the earthquake constitutes force majeure.

c. Takamatsu High Court Judgement October 24, 1960, *Shimomin*, vol.11-10 pp.2286

A contractor who was obligated to construct a fishing boat failed to perform its duty due to the escalating price of raw materials and labor cost or damage to construction site caused by earthquake and tsunami. The court found that considering such sudden change of circumstances caused by an unexpected natural disaster, forcing the contractor to perform the original duty under the contract would be extremely cruel to the contractor and violates the principle of good faith. In conclusion, the court denied the contractor’s liability for default.

⁵ Supreme Court Judgement November 13, 1941 *Minshu* vol. 21, pp. 995

⁶ Supreme Court Judgement December 11, 1912 *Minroku* vol.18, pp.1025

3 Possible outcome of Default related to COVID-19

Based on the above-mentioned provision of the Civil Code and court cases, it can be said that when considering the possible outcome of default related to COVID-19, it should be considered: (i) whether the event was foreseeable and/or controllable by the obligor; (ii) whether the default was actually caused by the event or attributable to other causes; (iii) whether there was alternate measure to perform the obligation. Whether an obligor can be exempted from liability of default caused by or in relation to COVID-19 depends on the individual circumstances. 19 may include various cases. For example, we can think of four patterns of delays in typical manufacture and sales contract: Case (1) seller delayed delivery of manufactured goods because its factory suspended its operations due to a lockdown order by the government; Case (2) seller delayed supply of manufactured goods because it suspended the operations of a factory or reduced the number of workers at the factory in response to a self-restraint request by the government; Case (3) seller delayed supply of manufactured goods because the delivery of raw materials got delayed as the supplier of the raw materials suspended its operations; and Case (4) buyer delayed payment because the obligor's cash flow is deteriorating as a result of rapid downturn in business performance caused by COVID-19.

With regard to Case (1), it is highly likely that the seller will be exempted from default liability because COVID-19 spread, and lockdown is thought to be unforeseeable and uncontrollable by the obligor. In Case (2), there is some room to consider that the self-restraint request by the government is not a force majeure because the seller could have decided not to follow the request and continued operation of the factory. However, in light of the social expectation and pressure under the situation where the self-restraint request was issued, it is more likely than not that the seller is exempted from the liability.

On the other hand, whether Case (3) constitutes a force majeure event will depend on whether there were any possible alternative measures that could have been taken by the obligor such as procuring the necessary raw materials from other vendors.

In addition, in common with Case (1) to (3), even if it was actually difficult to take any alternative measures because of the COVID-19 crisis, considering importance of formulating Business Continuity Plan

(BCP) or Business Continuity Management (BCM), the exemption from liability may be determined depending on whether a company should have taken measures in advance to continue its business in anticipation of an emergency situation.

As for Case (4), as mentioned in Section 1 above, even if the event may constitute a force majeure event, in the case of a monetary obligation, Article 419 (3) of the Civil Code will apply and the obligor will not be exempted from the liabilities. However, if there is any special agreement between the parties, the agreement shall prevail.

4. Conclusion

Although COVID-19 is not the first world-wide virus spread in recorded history, it is the first time for the business to be affected on this magnitude by virus spread in the modern era of expanding globalization. As same as in other developed countries, Japanese companies have expanded its business overseas and there are many international transactions governed by Japanese law. Close attention should be paid to the court cases related to COVID-19 which will start to accumulate soon, as possibility cannot be denied that the court change its past position in exemption of liability based on force majeure event.

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