NEWSLETTER

December 2021

International Arbitration Practice Group

CONTACT

Sean (Sungwoo) LIM

T: +82.2.2191.3008
E: sean.lim@leeko.com

Robert WACHTER

T: +82.2.6386.6241
E: robert.wachter@leeko.com

Saemee KIM

T: +82.2.772.5902
E: saemee.kim@leeko.com

Court Allows Lessee to Terminate Commercial Lease as COVID-19 Force Majeure[1]

1. Introduction - the first reported court decision on Covid-19 force majeure

When the COVID-19 pandemic began two years ago, disrupting supply chains and shutting down international travel, some in the arbitration community expected a flood of force majeure cases to follow. The flood never came. New disputes have continued to arise, but the cases have not been as dominated by force majeure issues as much as one might have expected. The economic effects of the pandemic have been distributed unevenly. Some businesses have prospered. Many have failed. Many are still struggling.

Perhaps more cases would follow if there was clearer guidance from the national courts about how to interpret force majeure clauses in the context of the pandemic and the pandemic response in various jurisdictions. The last pandemic happened a century ago, so the pandemic precedents are all quite dated. Many arbitration practitioners have been waiting to see how modern courts would apply the principles of force majeure in the context of the events of the last two years.

We now have a recent lower level court case from Korea that answers some of these questions.[2] The court held in that case that a lessee under a commercial lease was entitled to terminate the lease based on the force majeure clause. The court also ruled that the lessee would have had the right to terminate the lease even if the lease did not contain a force majeure clause.

2. Case Background - 90% drop in sales of the lessee

The Plaintiff, a fashion jewellery merchant, and the Defendant, a company that managed a building in Seoul, executed a lease under which the Plaintiff agreed to lease the premises for three years, from June 2019 to May 2022. The premises were located in Myeongdong in the center of Seoul. Before the pandemic, Myeongdong was a popular shopping district for international tourists. Two years into the pandemic, many stores in Myeongdong have closed, and many of the shops remain vacant.

The Plaintiff established through evidence that its sales dropped by more than 90% due to the COVID-19 outbreak and the government measures that followed. As a result, the Plaintiff failed to pay the rent due for March 2020, and eventually closed down the business in May 2020. In early June 2020, the Plaintiff notified the Defendant that it was terminating the lease due to COVID-19, a force majeure event. The lease agreement did not specifically mention 'epidemic' or 'pandemic' as a ground for force majeure, but more generally provided (emphasis added):

- Article 13 (Termination or Cancellation)

  (4) A party is entitled to cancel or terminate this agreement if that party is prevented from operating its business for 90 days or more due to the event of force majeure, including but not limited to change in law, abolition of law, urban planning, fire, floods or riots, by giving 30-day prior notice in writing to the other.

The Defendant argued that the representative examples of force majeure listed in the clause, especially the reference to 'fire, floods or riots', indicated that the parties did not intend the clause to apply to the COVID-19 pandemic, but instead only considered events that might preclude the lessee from occupying the premises. The Defendant also argued that COVID-19 was qualitatively different because the lessee was still able to use the premises for the intended purpose, even if its business prospects had deteriorated. The parties failed to reach a mutually agreeable compromise, so the Plaintiff commenced litigation in October 2020 asking for a declaration that the lease agreement was validly terminated, either (i) based on the force majeure clause, or (ii) pursuant to the doctrine of change in circumstances.

3. The Judgment - termination on grounds for force majeure or, alternatively, change in circumstances

The Seoul Central District Court agreed that the Plaintiff had the right to terminate the lease. The primary basis for the holding was the force majeure clause. Even though the clause did not specifically refer to 'pandemic' or 'epidemic' as a ground of force majeure, the key words in the clause were 'prevented from operating its business.' The court broadly interpreted this provision in favour of the Plaintiff, even though no regulations were imposed that required the Plaintiff to shut down the business. The court was persuaded that a 90% decrease in sales due to the COVID-19 outbreak, together with the effects of government measures responding to the pandemic, constituted a force majeure event within the meaning of Article 13(4) of the lease. In reaching this conclusion, the court emphasized that: (i) the Plaintiff relied on foreign tourists as a major source of revenue for the shop; (ii) if the Plaintiff maintained the business with a 90% sales drop, continued losses would be inevitable; and (iii) neither party was able to foresee the COVID-19 outbreak or the extended restrictions that followed; and (iv) this cannot be attributable to any party.

The Court further held that even if there was no force majeure clause in the lease, the Plaintiff would still have the right to terminate under the doctrine of change in circumstances. Termination of a contract under this doctrine is recognized as an exception to principle of *pacta sunt servanda*.[3] The Korean courts have applied theexception strictly in a very narrow manner. The Court cited earlier court decisions which recognized the doctrine of change in circumstances to apply only when (i) there was a substantial change in the objective factual circumstances[4] that were the basis for the contract; (ii) the parties did not foresee the change; (iii) the change was not foreseeable when the parties executed the contract; (iv) this change was not

attributable to the party seeking to terminate the contract; and (v) it would be contrary to fairness and good faith to maintain and force a party to comply with the terms of the contract.[5] The court held that all of these requirements had been satisfied, and it would have been contrary to the principles of fairness and good faith to conclude that the lease terms were still binding on the parties.

The Defendant elected not to appeal the judgment.

4. Comment - uncertain how these principles might apply under different fact patterns

This is the first Korean judgment the authors are aware of where the court held that the economic consequences of COVID-19 restrictions fall within the scope of both force majeure and doctrine of change in circumstances. This is particularly significant because historically the Korean courts have only allowed termination on these grounds in limited circumstances.

There is no statutory definition of force majeure under Korean law. The principles are based on how the Korean courts interpret the force majeure clause in the contract. Most of the court decisions refer to the following two requirements: (i) the cause was beyond the control of a party and (ii) it was impossible for a party to foresee or prevent such event despite having taken all reasonable measures.[6] Applying these principles, Korean courts have found the requirements for force majeure were satisfied in cases of a ship collision with unforeseeable underwater objects,[7] a record-breaking rainfall,[8] and government travel bans to particular countries.[9] The threshold is generally regarded as high. Historically, the Korean courts have not regarded the difficulty of performance, or an additional financial burden of performance, as sufficient to be regarded as a frustrating event.

This is also true for termination based on the doctrine of change in circumstances, where the Korean courts have adopted an even stricter approach. Although the Korean courts have frequently affirmed the doctrine in theory, they have rarely applied it in practice. Most cases where the courts applied the doctrine were cases of continuous guarantee contracts. It was only in 2020 when the Supreme Court first conclusively admitted termination of a lease contract based on the doctrine of change in circumstances.[10]

The judgment is likely to embolden other litigants to test the limits of force majeure and the doctrine of change in circumstances. As the pandemic drags on into a third year, it will be interesting to see how the Korean courts will apply these principles to different facts.

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[1] This article has been published on Lexology as of 17 December 2021 under the title 'Court allows lessee to terminate commercial lease as COVID-19 force majeure' (authors Robert Wachter and Saemee Kim).

[2] Seoul Central District Court Judgment No. 2020GaDan5261441 dated 25 May 2021

[3] Latin for "agreements must be kept", is a fundamental principle of law.

[4] It requires that the circumstances that were altered must be 'objective' factual circumstances that the contract was based upon, and not a party's subjective or personal circumstances (Supreme Court Judgment No. 2013Da26746 dated 26 September 2013)

(5) Supreme Court Judgment No. 2004Da31302 dated 29 March 2007; Supreme Court Judgment No. 2012Da13637 dated 26 September 2013.

(6) Supreme Court Judgment No. 2008Da15940, 15957 dated 10 July 2008; Supreme Court Judgment No. 2005Da59475, 59482, 59499 dated 23 August 2007

(7) Supreme Court Judgment No. 2004Da8494 dated 8 July 2004

(8) Supreme Court Judgment No. 2001Da48057 dated 23 October 2003

(9) Seoul Central District Court Judgment No. 2017GaHap545837 dated 6 July 2018. This case involved a travel ban to Libya.

(10) Supreme Court Judgment No. 2020Da254846 dated 10 December 2020. In this case, the lessee entered into a lease contract for a land for the purpose of constructing a show house for housing construction project and this purpose was explicitly specified in the lease contract. When it became impossible to build a show house due to the government's denial to approve construction of a temporary building, the lessee claimed termination of the lease contract based on the doctrine of changes in circumstances and the court ruled in favour of the lessee.

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Lee & Ko
Hanjin Building 63 Namdaemun-ro, Jung-gu Seoul 04532, Korea | Tel: +82-2-772-4000 | Fax: +82-2-772-4001/2 | www.leeko.com