

# Frustration of contract, impossibility and COVID-19 in Spanish law

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This article provides guidance on termination of contract due to frustration and impossibility, and alteration of contract due to excessive hardship under the *rebus sic stantibus* doctrine, under Spanish law, in the context of the 2019 novel coronavirus disease (COVID-19) pandemic.

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## Frustration of contract and impossibility

In the event of frustration of contract, a party can seek to terminate the contract under Article 1124 of the Spanish Civil Code. This article states that a party may seek to terminate the contract if its counterparty chooses not to perform its obligations, or cannot perform them (performance is impossible).

## Serving notice of termination on grounds of frustration

Generally an obligor can terminate a frustrated contract by giving notice to the obligee following the occurrence of an unforeseen event that renders the terms of the contract impossible to perform. The obligee may accept the termination or, alternatively, challenge the lawfulness of it.

## Terms of the contract

Sometimes contracting parties agree specific provisions allocating risk between them which also apply in a context of frustration, so it is always necessary to check the contract terms. For example, in sale contracts, commonly the buyer bears most risks. Contracting parties must be careful in the negotiation of their contracts as risks and liabilities around frustration might not otherwise be distributed equally between them.

## Notices and time limits

There are no mandatory rules around the serving or registering of notices, except as may be agreed between the parties in their contract. For example, the parties may agree on notices being sent by certified post or equivalent registration. It is common for contracts to prescribe provisions governing formal communications between the parties, and any such requirements should be complied with.

There are no specific time limits for serving notices, unless the relevant contract specifies otherwise. However, a general obligation of good faith applies in the performance of all contracts under Article 1258 of the Civil Code. Acting in good faith is likely to include the timely serving of important notices, such as in relation to frustration or force majeure: a judge may find a breach of good faith where a significant amount of time has elapsed between the occurrence of the relevant events and the serving of notice.

## **Court hearings or other judicial processes**

Where parties agree that a contractual relationship has ended due to frustration or impossibility, there may be no need for judicial proceedings. The will of the parties can be enough to terminate the contract. However, if a party seeks to contest the other party's assertion that the contract is frustrated, then judicial proceedings usually follow (for example, one party disagrees that the circumstances amount to frustration of contract and seeks performance of the agreed terms). Either party is free to seek the intervention and ruling of a judge to resolve the conflict.

## **Alteration of contract**

Spanish law also provides for modification of a contract, as distinct from the more extreme outcome of termination due to frustration. This is possible under the *rebus sic stantibus* doctrine, which is best understood as a remedy against undue hardship.

*Rebus sic stantibus* originates in academic doctrines and case law and is not legislated in the Civil Code. The doctrine is only applied in very exceptional circumstances, usually subject to much debate; it is not easy to modify a contract without the agreement of the parties.

*Rebus sic stantibus* does not permit a party to "exit" a contractual relationship, only to seek modification of the contract terms. However, a party might seek termination of the contract on frustration of contract principles under Article 1124 where a request for modification of a contract under *rebus sic stantibus* fails.

A party seeking to rely on *rebus sic stantibus* must prove the following:

- There has been an extraordinary change in circumstances since the time when the contract was concluded.
- The change in circumstances breaks the contractual "equilibrium" between the parties' obligations, meaning that performance has become significantly more burdensome for one party than for the other party.
- That all of this has occurred due to unforeseeable and unexpected circumstances.
- That the problem cannot be remedied in any other way.

The doctrine applies if unforeseeable circumstances in a contract break the "equilibrium" or economic balance between the parties. The unforeseeable circumstances must cause

an excessive burden for one of the parties that no longer corresponds to the original consideration agreed.

It is important to note that the main difference between *rebus sic stantibus* and frustration is that under the former, fulfilment of the obligation is still possible (although excessively burdensome for one party). Under the latter, there can be no fulfilment of the obligations and considerations originally agreed by the parties when they entered the contract due to the change of circumstances induced by the unforeseen, intervening event which has frustrated the contract's objective.

## **New legislation in consequence of COVID-19 related disruption**

At the time of writing, there is no new or pending legislation such as will change the law on contractual relationships between private parties as summarised here. However, it is noteworthy that a group of legal professionals has proposed the legislated application of *rebus sic stantibus* for contracts affected by disruption following the 2019 novel coronavirus disease (COVID-19) pandemic. This independent group suggested that the government legislate for application of *rebus sic stantibus* as follows:

"... If, as a consequence of the COVID-19 pandemic or of the economic crisis caused by it, the circumstances that conditioned the purpose of a contract under civil or commercial law change in an unforeseeable and extraordinary manner, pending performance of said contract, and one of the parties becomes disproportionately burdened by the performance of the contract or the circumstances frustrates the purpose of the contract, the party whose performance is affected has the burden of requesting a renegotiation of the terms thereof. The special circumstances of each case and the distribution of risk within the contract that makes it unreasonable to request fulfilment of the contract should be considered. Parties should engage in good faith negotiations within a prudential timeframe.

If it is not possible to reach an agreement, the party that is burdened as a result of the contract not being modified could request its revision, and if this is not possible or the revision could not be imposed on the other party, the former could request that the contract be terminated.

The request to terminate the contract could be granted when there is no option of obtaining a proposal or several proposals from each of the parties to reinstate the equilibrium between the considerations of the parties.

If there is no proof that the parties have engaged in good faith negotiations between themselves, any claim that seeks to revise or terminate a contract should not be admitted into litigation.

If the claim of a party to the contract is granted and said party obtains terms or a similar solution that is less favourable than the terms for settlement offered by the other party either during or before litigation, it should be ordered to pay any costs generated after the first rejection of the offer.

If one of the parties rejects any offer of renegotiation in bad faith, the other parties will be able to claim for any damages caused regardless of whether the contract is revised or terminated."

It remains to be seen if the doctrine is legislated for in the way proposed. Within sectors of the economy, broader contingency plans are being developed to deal with COVID-19 disruption, but it remains to be seen what effect these will have on contractual relationships.

## **Mitigation of loss**

Case law has established that a party affected by a breach of contract situation or tortious wrongdoing must minimise the loss and damage suffered. Breaching this obligation results in a limiting of the damages which may be recovered from the other party.

Further, the parties are bound to conduct negotiations in good faith. In the context of frustration and impossibility, this means with the aim of mitigating losses and rebalancing the terms of the contract. Even when applying force majeure or frustration/impossibility, courts have emphasised that termination of the contract is a last-resort remedy following the intervention of unforeseeable circumstances.

Also, judges in Spain are reluctant to apply *rebus sic stantibus* if the parties cannot demonstrate that they have conducted good faith negotiations aimed at reaching agreement to save the contract.

## **Evidential requirements and the burden of proof**

Generally, Spain's judges are quick to reject dubious claims. It is for the claimant to provide evidence of the facts alleged in a claim. However, in a frustration/impossibility situation it will be for the defendant to prove that the performance of its contractual obligation is impossible.

Generally, no special evidence to prove the existence of a pandemic or official measures adopted by the government to address it would be necessary: under the Civil Procedure law, well-known facts do not need specific proof.

However, in a claim based on frustration/impossibility or *rebus sic stantibus*, a party basing its case on the effects of COVID-19 will need to prove that:

- The pandemic has affected the performance of the contract, either by rendering performance impossible or by breaking the contractual equilibrium.
- The specific effects of the pandemic could not have been foreseen (the timing of the contract will be relevant for this purpose).
- There is no other remedy available.
- The parties have not specifically agreed who is responsible for the risks of a pandemic.

*(Supreme Court, judgment of 17 January 2013 (RJ 2013, 1819).)*

In addition, a party claiming that *rebus sic stantibus* applies must prove it has attempted to engage in good faith negotiations and, where appropriate, that the other party has not.

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