RANDA HAVEL ■ LEGAL

Newsletter_Practical legal information_III.

Legal Consequences of the Coronavirus Epidemic for your Contractual Relationships

Due to the COVID-19 disease, the government declared a state of emergency in the territory of the Czech Republic on March 12, 2020. In this context, the government also issued a series of crisis measures which are published as government resolutions in the Collection of Laws of the Czech Republic. Prohibitions, restrictions, and orders resulting from the state of emergency and crisis measures can have a major impact on individual parties in terms of meeting their contractual obligations. This will be particularly important in the case of long-term customer-supplier relationships, in projects in construction and energy sectors, or for investment projects.

However, the legal consequences of the current emergency situation may vary from case to case. An ongoing epidemic may be a reason to change the contract price, postpone deadlines, or waive the obligation to pay damages. In some cases, the contract may also be terminated. However, these legal consequences may not occur automatically in all cases. Each contractual relationship needs to be assessed individually.

In general, some of the following legal principles may apply in the context of an ongoing epidemic:

-**force majeure** (applicable particularly in situations where the proper performance of the contract is hindered by extraordinary and unforeseeable external circumstances);

-**subsequent impossibility of performance** (applicable in particular in situations where the contract objectively cannot be performed); and

-**a substantial change in circumstances** (applicable particularly in situations where performance of the contract has become extremely disadvantageous to one of the parties).

A more detailed description of these legal principles and the prerequisites for the application thereof can be found in this newsletter. However, it can already be pointed out that the conditions or consequences of force majeure, a subsequent impossibility of performance, or a substantial change in circumstances may (and generally will be, in practice) be regulated individually in the relevant contracts. Therefore, when examining the legal implications of the COVID-19 outbreak to your supplier-customer relationships, it is not enough to only apply statutory rules, but primarily, it is vital to search for relevant arrangements in your contractual documentation.

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Force Majeure

What is force majeure? There is no legal definition of force majeure in Czech law. Nevertheless, this expression is used in the Civil Code and can also be found in other Czech statutes. Generally, force majeure is considered to be an extraordinary, unforeseeable and insurmountable obstacle that arises independently of the will of the person concerned. In addition to the concept of force majeure, the Czech Civil Code also uses the words "unpredictable circumstance" and "unpredictable and insurmountable cause / obstacle". In our opinion, it is possible that in a number of legal relationships, the current epidemic of COVID-19 could be considered an event of force majeure. In this context, for the sake of completeness, we would like to point out that force majeure will not apply if a contract has already been concluded at the time of the outbreak or with the knowledge of the ongoing epidemic. In such a situation, it will no longer be possible to regard the COVID-19 epidemic as an unforeseeable event.

What is the result of force majeure? If a force majeure event occurs, it may bring about a number of different legal consequences, which usually take the form of (i) release from a specific obligation, (ii) change to the obligation or (iii) extension of deadlines. According to the Czech legislation, it may include, for example, the following consequences:

-the obliged party may be released from the obligation to compensate for any damages incurred by the other party;

-the limitation period may be suspended;

-a court may decide to increase the price of the work in question if it was determined according to a budget, or to cancel the contract for work in which price was negotiated according to a budget;

-an entrepreneur may change some of the information in a contract concluded with a consumer which it communicated to the consumer prior to the entering into the contract;

-an eligible party to a contract may withdraw from the contract if it had the right to choose from several variants of the performance of such a contract, but the possibility of such a choice was frustrated as a result of a force majeure event;

-the deadlines for submitting a promissory note (bill of exchange) may be extended, etc.

At the same time, it should be noted that a force majeure event does not automatically lead to a release from the obligation to pay liquidated damages (a contractual penalty) to the other party unless such an exemption is expressly agreed in the contract. Indeed, liability for liquidated damages (a contractual penalty) generally (unless expressly agreed otherwise) arises absolutely - i.e. irrespective of fault.

The contractual arrangements for force majeure events are essential. It is customary for the parties to negotiate force majeure clauses in their contracts which govern (i) what specific events are considered to be force majeure events under the given contract and/or (ii) what specific consequences the force majeure has regarding the rights and obligations of the parties. Such individual arrangements will generally take precedence over statutory regulation of force majeure. Each contract must therefore be subject to an individual legal analysis. In this context, please note that some contract templates (e.g. FIDIC) may contain specific clauses governing force majeure events.

Beware of any international element. In the case of contracts with an international element, it is first necessary to consider the law applicable to the contract in question. This is because force majeure legislation may differ substantially from one legal system to another. In addition, it should be noted that some international treaties (e.g. the Vienna Convention on the International Sale of Goods - CISG) may contain their own rules for force majeure events.

How to proceed in case of a force majeure event? As mentioned above, the specific procedure may depend on the contractual regulation of force majeure. In general, however, the following steps may be recommended to a party to a contract affected by a force majeure event:

-notify the other party without delay that a force majeure event has occurred;

-carry out a legal analysis of the relevant contract to determine what your course of action should be;

-continually assess the impact of force majeure on your obligations and provide evidence to help you demonstrate the impact of the force majeure event on your obligations;

-try to minimize the consequences of the force majeure event.

Subsequent Impossibility of Performance

What is the subsequent impossibility of performance? Under the expression "impossibility of performance", the Czech Civil Code regulates a situation in which the payment of a certain debt or complying with an obligation becomes objectively impossible. In this context, the Civil Code states that performance is impossible if it cannot objectively be fulfilled, not even (i) under difficult conditions, (ii) at a higher cost, (iii) with the assistance of another person, or (iv) after a specified period elapses.

What is the consequence of subsequent impossibility of performance? In the event that a particular performance becomes objectively impossible, the relevant obligation to provide such performance ceases to exist by operation of law. According to the Civil Code, the obligation can also completely cease to exist even if the performance is impossible only partially, but due to the nature of the obligation or the purpose of the contract (which was known to the contracting parties at the date of the contract), the performance of the remaining portion of the obligation is pointless for the entitled party (the creditor).

Contractual clauses on subsequent impossibility of performance. The consequence that an obligation automatically ceases to exist if its fulfillment is objectively impossible cannot be excluded by contract. However, the contracting parties may agree to a wider range of situations when the obligation ceases to exist (e.g. where performance is objectively possible, but only at significantly higher costs). Likewise, the parties may contractually adjust the scope of the liability for damages in the event of subsequent impossibility of performance. Each contract must therefore be subject to an individual legal analysis.

Beware of any international element. In the case of contracts with an international element, it is first necessary to consider the law applicable to the contract in question. Indeed, the rules governing the subsequent impossibility of performance (and, where appropriate, the related compensation) may differ considerably from one legal system to another.

What to do in case of subsequent impossibility of performance? As mentioned above, the specific steps to take in the event of subsequent impossibility of performance may to some extent be regulated by the contract. In general, however, the party the performance by which has subsequently become impossible should immediately notify the same to the other party. In this context, we would like to point out that under the Czech Civil Code, a contracting party which has not notified the impossibility of performance in time is obliged to compensate the other party for any damage caused by such late notification of the subsequent impossibility of performance.

For completeness, we would like to mention that subsequent impossibility of performance may in some cases be caused by governmental measures in crisis or by the announcement of the state of emergency. In such a case, compensation for damages against the state under the Crisis Act can be requested if the statutory conditions are met. You can find more information on this topic in a newsletter of our law firm dealing with this issue.

Change of Circumstances

What is a substantial change in circumstances? The legal regulation of substantial change in circumstances primarily regulates a disparity in the rights and obligations of the parties that occurs as a result of a change in external circumstances. Typically, it is a change of circumstances caused by war, a coup, revolution, embargo, boycott or prohibition of certain goods. However, this legislation may be also applied to changes in circumstances caused by epidemics and quarantines.

Legal regulation of substantial change in circumstances relates in particular to longer-term liabilities and facilitates. It makes easier the path to the continuation thereof despite unexpected fluctuations in important external factors. In this context, it should be noted that not every change in circumstances is a reason for a change of the obligation (typically to a contract). The mere fact that, as a result of objective external causes, the performance of the contract becomes less favorable does not alter the continuation of the obligation to perform the contract, even under these difficult conditions. From the point of view of legal implications, only a change in circumstances that brings surprising (extreme) impacts on the parties' position in the contractual relationship (one that does not correspond to any reasonable review and assessment of risks) is substantial.

The Czech Civil Code lays down the following defining features of a substantial change in circumstances that must be met simultaneously: (i) the existence of a change of circumstances; (ii) the unpredictability of the change; (iii) the uncontrollability of the change; (iv) absence of acceptance of a future risk of a change of circumstances; (v) the occurrence of a particularly gross disproportion in the rights and obligations; and (vi) causal link between the change and the emergence of a particularly gross disproportion.

What is the consequence of a substantial change in circumstances? If all the above statutory prerequisites are met, then the affected party has:

1.primarily the right to pursue a renewal of the contract negotiation (thus, the law urges the parties to reopen the contract, to consider changes that have occurred and to restore the balance that the original distribution of rights and obligations in their original arrangement was aimed at); and

2.in the event of unsuccessful negotiations of the parties to restore balance, the right to ask the court to modify the content of the obligation by its own decision or to cancel the obligation as of the date and under the conditions specified in the decision.

Contractual clauses on substantial change in circumstances. In the basic statutory regime, the legislation is based on the principle that each contract is concluded subject to a change in circumstances. However, the parties may deviate from this legal regime in their contract. The parties may assume the risk of a change in circumstances and, as a result, bear the costs resulting therefrom. This may include assuming all risks or only some of the risks (e.g. all currency risks, technical, legal, etc.) or risks specifically laid down by the parties. Each contract must therefore be subject to an individual legal analysis of whether and to what extent the risk of change of circumstances has been assumed by either party.

Beware of any international element. In the case of contracts with an international element, it is first necessary to consider the law applicable to the contract in question. The rules governing substantial change

in circumstances may, in principle, differ from one legal system to another.

What steps to take in case of a substantial change in circumstances? The party concerned (i) must exercise its right to resume contract negotiations vis-à-vis the other party, (ii) shall state the reasons on which its right is based, and (iii) prove the facts that justify its claim. The said right should be exercised within a reasonable period of time, which – as the default - the Civil Code regulates to be no later than two months after the party must have ascertained the change in circumstances. The consequence of this deadline elapsing in vain is that the party concerned loses the right to demand the subsequent restoration of the contractual balance by a court.

If you so wish, we shall be pleased to provide you with the necessary legal assistance in analyzing your contracts and applying the relevant clauses (if any) on force majeure, subsequent impossibility of performance, or substantial change in circumstances. In cooperation with our partner offices from the network act legal, we will gladly provide you with the relevant legal services even in the case of cross-border legal relationships or contracts governed by governing law different from Czech law.