

COVID-19 and Force Majeure



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OVERVIEW

How to handle existing contractual liabilities and enter into new contracts?

Force Majeure clauses are used in many contracts in the most diverse business areas. These contractual provisions are rarely invoked in practice in Latvia, as the parties usually do not face any circumstances that could qualify as Force Majeure. However, the current rapid spread of the COVID-19 virus and the containment measures that the government has taken in response have shown that contracts can be directly affected by circumstances the parties could not have foreseen at the time they entered into a contract, and circumstances which they cannot currently prevent.

The issue of whether or not the consequences and restrictions caused by the COVID-19 crisis and the 12 March 2020 decree of the Cabinet of Ministers (**CoM**) on declaring the state of emergency (together with the amendments and supplements thereto) constitute Force Majeure circumstances, has triggered extensive public discussions. We have here summed up some practical recommendations, which will help to better orient in the current situation as well as to prepare for future challenges.

What does Force Majeure mean?

In Latvian legal literature and case law, it is recognized that the concept of Force Majeure is comprised of four mandatory elements. Force Majeure is an event:

- ⊖ which is impossible to avoid, and the consequences whereof are impossible to overcome;
- ⊖ which a reasonable person could not foresee at the moment of conclusion of the contract;
- ⊖ which has not occurred due to the actions of the party or a person controlled by the party;
- ⊖ which render the fulfilment of liabilities not only cumbersome, but also impossible.

When assessing the impact of COVID-19 on contractual liabilities and the possibility to refer to Force Majeure as the basis for failure to fulfil the contract, each separate case is to be assessed individually.

What matters the most is the evaluation of whether the fulfilment of liabilities, due to new circumstances, has become cumbersome, for example due to financial difficulties, or absolutely impossible.

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COVID-19

When **IS** COVID-19 Force Majeure?

Legal consequences of Force Majeure occur only when all of the above-mentioned criteria are met. COVID-19 will most likely be recognized as Force Majeure circumstances, if the CoM decree would prohibit conducting particular economic activity.

EXAMPLE

For example, amid the prohibitions imposed by the CoM on cross-border passenger carriage, it is impossible for the passenger carriage enterprises to fulfil their contracts on performance of the relevant carriage. In such situation, the failure to perform the particular carriage obligation must be regarded as caused by Force Majeure circumstance.

Nevertheless, it is important that the impact of Force Majeure be assessed with respect to each particular contractual relationship.

The fact that the Force Majeure circumstances are impacting the enterprise in performing certain obligation (for example, in passenger carriage) does not, per se, mean that the enterprise is entitled to similarly claim that the same Force Majeure may cause its default under all other concluded contracts, for example, with employees, suppliers and cooperation partners.

When is COVID-19 **NOT** Force Majeure?

For the enterprise to be able to claim that its default is due to Force Majeure circumstances, all criteria of Force Majeure must be met. Civil law principles require that the Force Majeure circumstances and their impact on a contract are subject to narrow interpretation.

Therefore, it is important to separate Force Majeure from “plain” difficulties in fulfilment of obligations. This approach has also been recognized by the Supreme Court in its practice, when evaluating the impact of the global financial crisis of 2009 on contractual obligations.

EXAMPLE

The Court has recognized that Force Majeure is to be separated from the difficulties faced when a certain event considerably modifies the contractual balance (for example, the performance costs of one party have increased or the value of the performance received by one party has decreased)*.

In the current situation, COVID-19 to a large extent is not to be regarded as a Force Majeure circumstance in the absence of additional circumstances, such as the CoM decrees prohibiting certain activities.

* Judgment of the Department of the Civil Cases of the Senate of 26 January 2011 in case SKC-11/2011

Force Majeure consequences

Where the occurrence of Force Majeure circumstances is detected in the particular contractual relationship, generally it has the following legal consequences:

- ⊖ fulfillment of the contractual obligations are suspended for the period of duration of the Force Majeure circumstances;
- ⊖ the losses caused to the other contracting party are not subject to compensation;
- ⊖ no adverse effects of overdue performance can occur.

Parties to the contract may have agreed upon additional provisions in the event of occurrence of Force Majeure, such as the duty to timely notify the other party of the Force Majeure circumstances, rights to withdraw from the contract, etc.

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PRACTICAL ADVICE TO ENTREPRENEURS

With respect to application of the Force Majeure clauses, the following steps are, inter alia, advisable:

- ☰ To develop an action plan, if the Force Majeure circumstances continue, and to consider all possibilities for mitigating the adverse effects of the Force Majeure circumstances and minimizing losses;
- ☰ To assess the concluded contracts and the applicability of the Force Majeure clauses contained therein to COVID-19;
- ☰ To actively communicate with cooperation partners regarding potential threats to fulfilment of obligations and prevention of adverse effects, trying to achieve a compromise satisfactory to both parties;
- ☰ To constantly monitor the restrictions imposed by the CoM, assessing the impact of these restrictions on the fulfilment of the obligations undertaken by the enterprise;
- ☰ To systematically retain evidence of communication with cooperation partners regarding the impact of COVID-19;
- ☰ To actively express a standpoint, if cooperation partners attempt to justify their default with COVID-19 as Force Majeure;
- ☰ To review the terms and conditions of existing insurance contracts, in order to check the definition of Force Majeure and the applicability of COVID-19 thereto.

What to consider when entering into new contracts?

Even though COVID-19 has considerably hampered economic activities in Latvia, enterprises continue entering into new contracts. COVID-19 is expected to affect business activity also henceforth, therefore it is important not to ignore this circumstance in the contracts being entered anew. It would be advisable to specifically focus on at least the following circumstances:

Most likely, it will be impossible to refer to the current COVID-19 crisis as Force Majeure with respect to the new contracts

Under current circumstances, there is a risk present that it will be impossible to refer exactly to the current COVID-19 crisis and the CoM decrees adopted as a result thereof as Force Majeure justifying any default.

EXAMPLE

Even if the CoM would currently impose more rigid restrictions, making the fulfilment of obligations impossible in increasingly larger number of sectors, the contractual parties, most likely, would not be able to assert that they could not foresee such restrictions. The unpredictability of the circumstances, as noted previously, is one of the mandatory prerequisites for detecting Force Majeure.

To specifically address in the new contracts the issues related to the impact of COVID-19

Even if it would not be possible to refer to COVID-19 as Force Majeure in the new contracts, it would still be highly advisable for the parties to specifically agree in the contract on the impact of the current crisis on the fulfilment of the contract.

EXAMPLE

For example, the parties may prescribe that they are entitled to withdraw from the contract if COVID-19 response measures endure for a longer period of time. Or they could agree on just the contrary, that the circumstances related to COVID-19 do not release the parties from the fulfilment of the obligations agreed upon in the new contracts. The parties may also provide in the contract for the possibility to amend the contractual price and terms for fulfilment, depending upon the practical impact of COVID-19 on the fulfilment of the contract.

To pay attention to the Force Majeure clauses and the consequences thereof in the new contract

At present and going forward, when entering into contracts attention should be paid to the content of the Force Majeure clause. The spread of COVID-19 and measures for containing it clearly demonstrate that the Force Majeure clauses are not merely declarative contractual provisions, but they can have significant economic meaning in crisis circumstances.



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