



# Legal Alert

March 2020

## Weinhold Legal

### CORONAVIRUS AND ITS IMPACT ON CONTRACTUAL RELATIONS

The coronavirus epidemic (COVID-19) is currently affecting almost all business areas. In addition to labour relations it has an impact also on customer supply chains. Given the measures taken and the overall situation, the performance of previously concluded contracts is often significantly more difficult and thus it can be expected that not only delays or cancellations of deliveries will occur more frequently but business can expect the consequent cash flow difficulties, and payment delays and an increased risk of insolvency of contractual partners.

#### Business should identify at risk contracts

With respect to the risks mentioned above (whether in the position of customer/client or supplier/contractor), the first step should always be to analyse the relevant contract, especially whether and how any force majeure issues are regulated or whether the contract contains a “material adverse change” clause (typically referred to as an “MAC Clause”), which is particularly typical for M&A transactions and credit contracts.

#### Force majeure regulated in the contract

If the contract contains a force majeure clause, the following shall apply:

- ▶ interpret whether the coronavirus epidemic fulfils the definition of force majeure in the contract (a non-exhaustive list of situations which could be considered as force majeure is often included in the contract), in most cases this is likely to be the case;
- ▶ clarify whether the coronavirus epidemic is the real cause of the relevant contractual failure;

- ▶ fulfil any other conditions stipulated in the contract (as a rule, a disclosure obligation – see below).

Satisfaction of the conditions mentioned above will usually lead to there being no breach of contract and the other party should not have the right to withdraw from the contract or to claim damages or a contractual penalty. However, each case (contract) needs to be assessed individually.

In some areas (typically in the construction industry) contracts often include a specific mechanism for claiming an extension of the time required to fulfil the obligation in question in the event of there being a force majeure situation. Often short prescription periods are set for claiming a time extension (for example, according to the 1999 FIDIC Red Book a contractual party has 28 days for notification). Thus, notification of a force majeure situation to other contractual parties should not be delayed.

#### Release from the duty to provide compensation (force majeure regulated by the Civil Code)

If parties did not regulate force majeure and its consequences directly in the contract, the Civil Code stipulates in Section 2913 (2) that a party that has breached the contract (“Reliant Party”) may be released from its duty to provide compensation under the following conditions:

- ▶ an extraordinary, unforeseeable and insurmountable obstacle temporarily or permanently prevented the Reliant Party from fulfilling its contractual duty;
- ▶ the obstacle was created independently of the will of the Reliant Party ;
- ▶ the obstacle did not arise from circumstances specific to the Reliant Party;



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- ▶ the obstacle did not arise when the Reliant Party was in default of performing its contractual duty;
- ▶ the Reliant Party was not contractually required to overcome the obstacle.

In the light of the above mentioned it should be added that although the Reliant Party is not liable for damages, it is still classified as a breach of the contract (unless it is a case of impossibility to perform – see below) and thus, all its consequences must be taken into account (e.g. the possibility of withdrawal from the contract by the other party or obligation to pay contractual penalty).

### Substantial change in circumstances

The Civil Code contains in Section 1765 the institute of so called substantial change in circumstance:

- ▶ after the conclusion of the contract, there is a substantial change in circumstances (contrary to the circumstances which the contracting parties expected when concluding the contract);
- ▶ the change causes a gross disproportion between the parties (disproportionate increase in the cost of the performance or disproportionate reduction in the value of the subject of performance);
- ▶ the affected party could not neither expect nor affect the change;
- ▶ the change occurred (or the party became aware thereof) only after the conclusion of the contract;
- ▶ the contracting parties did not assume the risk of a change in circumstances, i.e. they did not exclude the application of Section 1765 of the Civil Code (however, the exclusion of this provision is common practice).

If the above mentioned conditions are met, the affected party is permitted to seek a renegotiation of the contract with the other party (e.g. postponing performance for a later date), this right must be exercised within a reasonable time (in this case the presumption is that a period of two months is a reasonable time, but in specific cases it may be inferred that reasonable time is a shorter period). If, subsequently, there is no mutual agreement reached between the contracting parties within a reasonable time limit, a court may, on the application of any of the parties, decide to change the contractual obligation or to extinguish it. It is necessary to remember that the court is not bound by the applications of the parties (thus theoretically, it may decide otherwise).

### Subsequent impossibility of performance

Theoretically, the coronavirus epidemic may also lead to the extinction of entire obligation (the contract), this is because the fulfilment of the debt (e.g. the execution of a certain delivery) has become impossible (legal or factual). In the event of such an extinction, the other party would have to make restitution of unjust enrichment (performance already received). However, the extinction of obligation for this reason can only occur in very specific situations as the Civil Code provides that the obligation does not extinguish when the debt can be fulfilled:

- ▶ under more difficult conditions;
- ▶ at a higher cost;
- ▶ with the help of another person;
- ▶ only after a determined period (i.e. with delay).



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### Fixed obligations

In case of a contracting party's default of the performance of obligation it is also necessary to consider whether this is a so called fixed obligation, i.e. a contract where an exact period for performance is agreed and which also implies that the creditor does not want the late performance. Such obligations extinguish automatically upon the debtor's default, unless the creditor notifies the debtor without undue delay that it insists on due contractual performance. The termination of the obligation shall have the same effect as if the creditor had withdrawn from the contract.

### Recommendations

If you are unable to meet your contractual obligations as a result of the current situation, we recommend that you inform your business partners as soon as possible and try to negotiate, for example, an extension of delivery dates, a discount, etc. By timely information to the other party, you can achieve not only an agreed modification of the contractual obligations, but also such notification may ultimately affect, for example, the level of damage compensation. The relevant precautionary provisions contained in the Civil Code impose a duty on a party who has breached its legal obligation or who can and should know that it will breach it to notify a party who may suffer harm from such breach without undue delay and inform that party of the possible consequences.

The identification of the problematic contracts should be followed by an assessment of legal consequences of their breach and what possibilities of relief are provided by the contract or law to the party concerned.

In any case, we recommend that you already now start collecting relevant evidence of compliance with in this Legal Alert mentioned conditions, as well as evidence of measures taken to prevent (minimize) the damages.

We also recommend a review of insurance contracts and timely exercise of potential insurance claims (short periods are often set for notification). However, please note that many insurance contracts contain exclusions from insurance in case of pandemic.

This information in this bulletin is correct to the best of our knowledge and belief at the time of going to press. Specific advice should be sought, however, before investment and other decisions are made.

Nor should the information in this bulletin be considered an exhaustive description of the given matter and its possible ramifications. We also note that legal opinion varies regarding some of the issues raised in this bulletin due to ambiguities in the relevant provisions. Thus, it is possible that an interpretation other than the one presented here will prevail in future.

For more information, please contact your usual partner/manager or these Weinhold Legal attorneys:



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