

CERHA HEMPEL's extra newsletter regarding the coronavirus epidemic

Dear Clients,

It is now clear that all industries and service sectors will feel the negative effects of coronavirus pandemic. With globalised and extremely complex production chains, it is reasonable to assume that the effects will spread through countries and economies, and therefore severity of the problems caused and the damage wrought by the crisis are difficult to anticipate at this time. The pandemic has caused international and local border closures, halted production and created delivery disruptions. Such impediments can materially increase the cost and time requirements of the performance of contracts, or even render performance impossible altogether. The objective of this summary is to assist you in the successful management of the related risks from a commercial law perspective.

1. Has the appearance of the coronavirus in Hungary created a force majeure situation?

A force majeure event is an unforeseeable natural or other circumstance that is not humanly possible to prevent or avert. Therefore, the epidemic and the measures implemented in connection with it can qualify as a force majeure event in certain cases. However, neither the epidemic nor the special legal order or state of emergency declared in connection with it is in itself sufficient for a party to be released from its contractual obligations. None of the above will result in the automatic termination of a contract or authorise any of its parties to terminate it. Only those unavoidable circumstances qualify as force majeure events that objectively interfere with a party's ability to perform the contract. For example, a situation where a contract cannot be performed due to a border closure can qualify as a force majeure event. On the other hand, an increase in the costs of supplying the relevant product or service or the fact that the contract generates losses will not entitle the relevant party to invoke force majeure. A party will also be obliged to perform the contract if this requires more energy and cost expenditure than normal, and therefore it may be required to reorganise its work processes or rely on additional resources, even at the expense of its profits if necessary. It is important to understand that the qualification of a situation as a force majeure event is only the first step towards the resolution of the problem. The next step is determination of what claim or counterclaim you want to make on the basis of a failed or delayed supply. Many different legal consequences could apply depending the particular circumstances. The following questions and answers can help in the identification of consequences that can apply in your case.



2. What can be done if the performance of a contract is rendered impossible for good?

The performance of a contract can be rendered impossible definitively if the deadline is during the existence of the force majeure event and the relevant service cannot be performed later due to the nature of the service or any other contractual reason. If a contract cannot be performed definitively due to the epidemic emergency, the rules applicable to the impossibility of performance will have to be applied. If you believe that a contract can no longer be performed, you should explore the consequences of the impossibility of performance first: in such a case the contract terminates and the parties will have to bear the related damage or loss on the basis of their respective liability for the situation. Additionally, you will have to notify the other party about the impossibility of performance and start documenting the facts that confirm that the performance of the contract has been rendered impossible objectively and definitively. It is advisable to collect evidence for legal and physical causes for the impossibility of performance, because courts are more likely to accept these than economic causes. If you use the impossibility of performance defence on the basis of economic causes, you will have to prove that a fundamental change in market conditions has rendered performance objectively (for all other businesses) over the long term. Losses stemming from the continued existence of the contract or a temporary economic depression will not qualify as sufficient grounds for a court to rule that the performance of the contract has become impossible.

3. How can a contract be terminated?

The termination of a contract can be a solution that allows the parties to avoid further losses due to the epidemic emergency. The parties to a contract can always terminate the contract with mutual agreement. On the other hand, unilateral termination is only possible in the cases specified in the regulations and the contract itself. Contracts typically allow unilateral termination in the case of a breach of obligations. Statutory causes of termination include, for example, the lapse of interest in the continued existence of the contract. In both of the above cases, the right to terminate the contract exists regardless of whether the other party was prevented from performing the contract by objective, force majeure causes and it is therefore not liable to pay compensation. The right to terminate a contract is independent of the other party's liability. It is important to note,



however, that the specific impact of a force majeure event must be evaluated and confirmed in the case of every contract separately. If a party terminates a contract unlawfully or untruthfully claims that its interest in the contract has lapsed, it will be deemed to have committed a breach of contract and the relevant legal consequences will be applicable. Accordingly, if you want to terminate a contract unilaterally, you will have to identify the potential causes for termination or rescission, whereas a general reference to the coronavirus epidemic and a force majeure event will not be sufficient.

4. When can a contract be modified?

The modification of a contract can be a viable solution for the parties to adapt the terms of performance to the epidemic situation. If the parties mutually agree, a contract can be modified at any time. In that case they will only have to ensure that they properly assess and comprehensively regulate their needs, because later they will not be able to defend their inability to perform by citing circumstances that were known on the date of the modification and they will not be able to dispute the validity of the modification on the grounds that their assumptions were wrong. Unilateral modification is only possible in the cases specified in the regulations and in the contract itself. Court ordered contract modifications represent a rarely used option that is reserved for situations where the parties' circumstances change unforeseeably and in manner that goes beyond normal business risks with a fundamental impact on their interests associated with the contract. However, this option is not available in the case of negative circumstances that affect all businesses equally, such as an economic crisis or official measures implemented in response to an epidemic.

5. Who should bear the extra costs incurred due to the epidemic?

The general rules say that the party that is obliged to perform a particular obligation must bear the full cost of performance, including any extra costs incurred due to the epidemic. Exceptions to this rule include process-based service contracts ("megbízási szerződés"), where the costs of performance are payable by the client, and result-based service contracts ("vállalkozási szerződés"), where the contractor can demand the reimbursement of unforeseeable costs of additional work. If you have a flat-rate result-based service contract with a client and want to claim a



reimbursement of unforeseen costs incurred due to the epidemic, you should document the facts that confirm that you have incurred additional costs due to technical problems that could not be foreseen even with due care, and you should report these to your client.

6. What should you do if the epidemic emergency prevents you from performing the contract but it cannot be terminated or modified?

If the epidemic emergency prevents the performance of the contract but the contract cannot be terminated or modified, the only option left for the parties is to attempt the resolution of the situation with the application of the legal consequences applicable in the case of a breach of contract. In this case, you should notify the other party without delay about the circumstance that prevents your performance and about the related consequences, because the failure to provide such notification in itself establishes your liability for damages. Additionally, if the supply can be divided into lots, you should attempt to perform the contract at least partially. Additionally, you can minimise losses by correctly assessing the legal consequences of the breach of contract. This is the scenario where the parties can agree to accept the force majeure defence. If you breach the contract, you can try to seek exemption from the liability-based legal consequences that apply to you (damages or penalties) on the grounds that the breach was the result of a force majeure event that was beyond your control and could not be foreseen at the time when the contract was concluded, and you could not be reasonably expected to avoid such event or to prevent the damage. However, the force majeure situation will not prevent the application of legal consequences that are not liability-based, regardless of whether you have been absolved from the liability for the breach of contract. For example warranty claims (repairs, replacements, repair costs and price discounts) and contractual guarantees (e.g. bank guarantees) will be enforceable against you, and the other party will be entitled to terminate the contract (e.g. on the basis of the lapse of its interest in the performance of the contract).



In the light of the introduction to this extra newsletter, we would note that proper legal advice on specific situations can only be provided in full knowledge of the relevant circumstances and the applicable contract terms. If you have any questions or would like engage our services, please contact us, because we continue to offer our services without any disruptions.

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