

## Impacts of the COVID-19 coronavirus pandemic on contractual relations

The COVID-19 coronavirus pandemic poses rarely encountered challenges to all market participants and as a result, contractual obligations become substantially burdensome or impossible to perform. This memorandum summarizes the legal solutions offered by the Hungarian legal system to address the impact of the coronavirus pandemic on contractual relations.

### I. The coronavirus as vis maior

It is widely accepted that under extraordinary circumstances – may they be natural or man-made – parties to a contract may be absolved from contractual obligations, if the force hindering them from fulfilling their obligations is such that "human weakness cannot resist it."

Under Hungarian law, in the absence of statutory definition, the rules of vis maior have been carved out in the court practice. According to the Curia's (the Hungarian Supreme Court) definition, vis maior is an absolute, irresistible force – may it originate from natural or man-made causes – that cannot humanly be avoided, and due to which, performance of contractual obligations becomes impossible. In most judicial decisions vis maior is declared because of natural disasters. A seminal example, often cited by commentaries, is an epidemic.

This, however, does not mean that the current public health situation would automatically entitle parties to suspend performance of their contracts. It is not uncommon (in certain sectors, market standard) that the parties' contract sets forth a definition of vis maior events and/or the impact of such an event to their respective contractual obligations.

In the lack of contractual agreement, the contracting parties may rely on vis maior only if performance of a specific contractual obligation becomes objectively impossible. In order to make such assessment, each contractual obligation must be examined individually – and cases where performance of obligations become more burdensome, albeit not impossible, cannot be construed as vis maior.

The pandemic itself or certain measures by public authorities in connection with the extraordinary situation (e.g. curfews, quarantines, lockdowns, closures) may be qualify as vis maior. However, additional, more distant negative consequences of the pandemic or the relating measures (e.g. shortage of labour, disruption of supply) are generally not likely to be considered vis maior. According to court practice developed e.g. in connection with the economic turbulences relating to the change of regime in 1989-1990, economic recession – even if placing severe burdens on contractual parties – cannot, in itself, substantiate a vis maior claim.

Vis maior leads to the termination of contracts due to the impossibility of performance. However, parties are still obliged to settle accounts. Fee for services provided before the termination of the contract must be paid, and fees paid in advance for services that have become impossible must be returned.

The vis maior situation also does not exempt the parties from their obligation to cooperate in good faith. If a party to a contract realizes that its performance may become impossible, due to the vis maior situation, it must give notice to its contractual partner without delay, and parties are obliged to cooperate in good faith to find a solution. Failure to comply with these obligations will establish liability for damages, even if the rules of vis maior otherwise apply. If notification of the occurrence of vis maior is late, and the notified party cannot timely procure replacement services, the party affected by vis maior will be liable for damages. Or, e.g. a contractor might be relieved from its obligation to complete the construction, but it may be required to continue guarding the construction site.

In situations, where the performance of the contract becomes objectively impossible, not as a result of external circumstances, but as a result of the contracting party's behaviour (such as letting employees go, cancelling orders, terminating contracts), the contract will be terminated, but the party responsible for rendering the performance impossible will be liable for damages caused to its contractual partner.

## II. Circumstances not qualifying as vis maior – coronavirus and breach of contract

### (a) Exemption from liability, if the contract cannot be performed because of the epidemy

Pursuant to the new Civil Code, which entered into force in 2014, in order to be relieved from liability, the party in breach of a contract must prove that it fulfilled the following conditions:

- » the breach was caused by circumstances beyond its control,
- » which could not have been foreseen at the time of the contract,
- » and it cannot be expected to avoid the occurrence of these circumstances or eliminate the damages

There might be situations that are related to the epidemy but do not reach the level of vis maior.

Some of these situations do not qualify as vis maior, because they are not absolutely impossible to foresee and control. Most of these situations will also not exempt the party from liability for breach of contract, because in this respect, the test for breach of contract is the same as vis maior: the breaching party must show that it was objectively unable to influence the circumstances of the breach, it could not have, even theoretically controlled the situation. Thus, problems relating to the organization or functioning of the breaching party's internal operations, behaviour of its employees, difficulties on the market or of supply are generally not considered as unforeseeable circumstances falling beyond the control of the party.

Some of these situations will, however, not qualify as vis maior, because, even though they are unforeseeable and beyond control, they do not render the performance of the contract objectively impossible. In such cases, the breaching party may prove that it did everything it could have reasonably done, but nevertheless, it could not avoid the breach. The test of the breaching party's behaviour in such cases will be, whether it acted with the diligence and care that can be generally expected in such situations. While the public health situation is relevant for the purposes of assessing the situation of the breaching party, it is to be seen, whether court will apply a permissive assessment of the breaching party's conduct.

### (b) Liability for breach of contract when reliance on the circumstances relating to the epidemy is groundless

If a contracting party's denial or suspension of performance is groundless, because the conditions of vis maior are not met, then it will be liable for breach of contract.

Any failure to perform an obligation in accordance with the terms of the contract (such as deadline, contract specifications, etc) qualifies as a breach of contract. Denial of performance without just cause (such as vis maior) is however considered a specific type of breach. In such cases, the other party may choose to either:

- » continue to proceed on the basis of the contract and claim performance. In this case, the party suffering the breach is also entitled to withhold a proportional part of his own services until the breaching party tenders performance or provides adequate guarantees. And, if its interest relating to the performance of the contract has terminated in the meanwhile, it may terminate the contract; or
- » consider the contract terminated. In such a case, the party suffering the breach is also relieved from its obligations.

In addition, unless the breaching party can exempt itself from liability in accordance with the exemptional cases outlined in point (a) above, the party suffering the breach is entitled to damages caused by the breach of contract.

Similar rules apply, when the other party simply fails to perform as agreed, without any communication. In certain cases, these rules may be applicable eve before the other party's performance becomes due, if it is obvious already before the due date that the other party will not be capable to perform.

Notwithstanding the above, the contractual partner's actual or alleged breach does not automatically exempt the party suffering the breach from every obligation. It may also be in breach, if it fails to take the measures, issue the required statements for enabling the breaching party to perform. Further, it must always take the reasonable steps to prevent or mitigate damages.

### III. Amendment of the contract by the court, due to changes brought about by the pandemic

Finally, it is a question worth considering whether a party may be able to avoid a contract, which, as a result of the pandemic, has become much more burdensome than what it has originally undertaken.

According to the Civil Code, either party may request to have the contract amended by the court, if, as a result of a change in circumstances occurring after entering into the contract, performance under the same terms as before infringed a material, lawful interests of the party, and the possibility of such a change of circumstances could not have been foreseen at the time of entering into the contract, it was not the party itself, that caused such a change of circumstances, and such a change in circumstances cannot be regarded as normal business risks.

It is easy to imagine scenarios where certain contractual obligations become disproportionately burdensome as a result of circumstances relating to the pandemic, e.g. increased disinfection or hygiene measures may be such an extra burden on suppliers that performance, as originally agreed, would subvert the economics of the contract. To assess, whether such change of circumstances could have been foreseeable, or whether it was normal business risk, a case-by-case, factual analysis must be conducted. In the past, courts have been reluctant to interfere with the contractual bargain of private parties on the basis of general socio-economic changes (such as increased inflation or exchange rates).

### IV. Recommendations

Irrespective of whether your company may find itself in difficult situation or its business partners are likely to rely on the public health situation to avoid their contracts, a thorough assessment of the situation is recommended.

- » First, the relevant contract should be thoroughly analysed: does it contain a vis maior clause, setting forth special rules deviating from the general rules set out above? As general preparation, it may be advisable to analyse every or every relevant contract of the company and identify contracts whose performance is at risk.
- » If the company's insurance policies may provide coverage for vis maior event (affecting either the company's or its business partners' performance), the terms and conditions of the policy should also be checked; with particular regard to the required notices and information that are necessary for the application of the coverage.
- » It may be necessary to notify contracting partners in advance and intensively cooperate with them in order to mitigate risks. It might be considered to provide general information to customers, detailing the potential impacts of the pandemic, and how it might affect your company. Suppliers might be informed in advance that groundless reliance to circumstances out of their control will not be accepted, giving notice of the extent you expect them to continue performance.
- » If the performance of a contract becomes objectively impossible, a detailed and specific notification (describing the circumstances that arose, how it affects the contract, etc.) must be given to the other contracting party.
- » The Hungarian Chamber of Industry and Commerce is entitled to issue so called vis maior certifications, which can assist in substantiating the existence of vis maior.
- » Neither vis maior, nor the other party's alleged or actual breach provides a carte blanche to immediately and fully suspend performance. Parties must, in all cases, take all steps required in order to prevent or mitigate damages; otherwise, they can be held liable.
- » To prepare enforcement of damages at a later stage, communication with contracting partners should be conducted in writing, memos or minutes of meetings and telephone calls should be prepared and circulated in e-mail. Extra costs, other damages must be kept track of, the underlying financial and other should be preserved.

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