

COVID-19: Guide to Force Majeure and Commercial Contracts

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Intro

Existing pandemic situation forced the majority of national governments worldwide to apply extraordinary measures affecting day-to-day activities of ordinary people and business to overcome unexpected challenges facing the global community today. These challenges have not spared Armenia and, on March 16, 2020, the Armenian Government declared state of emergency throughout the whole country due to a significant increase of SARS-CoV-2 (a.k.a. COVID-19) cases.

Such extraordinary developments compelled local businesses to seek for efficient solutions to mitigate potential financial implications under rapidly changing circumstances. Caring of well-being of our clients, Ameria team has prepared this alert with respect to some of Armenian Contract Law provisions, which, we believe, may be of use to local businesses to have an overall understanding of the present situation.

However, this alert should not be considered as legal advice and it is not recommended that one's decision-making is based exclusively on the information mentioned herein. Neither Ameria CJSC, nor the authors of this review bear any liability for the consequences of any decisions made in reliance upon the information provided herein, as it may become obsolete or be incomplete. If you are looking for proper legal advice, please reach out to us at legal@ameria.am.

Existing restrictions have already resulted in a number of events of default by local companies due to their inability to honor contractual undertakings occurred prior to COVID-19 outbreak. Force majeure provisions could be last resort for companies experiencing this kind of problems by allowing them to avoid potential exposures that may be caused by non-performance of contractual obligations.

What is force majeure?

The concept of force majeure comes from French civil law and has been introduced to majority of jurisdictions across the world, including Armenia. Force majeure regime operates by excusing non-performance by a party of contracts, where such non-performance is a result of events outside the affected party's control.

Force majeure under the Civil Code of Armenia

Under Armenian law, a party involved in business activities is liable for non-performance of contractual obligations even in the absence of non-performing party's fault, except where such non-performance is caused by irresistible force (force majeure), which is defined as events that are extraordinary and unavoidable under given circumstances. Consequently, existence of irresistible force is the only situation, where business entities can be released from liability for non-performance or undue performance of contracts.

Remedies

Notwithstanding a limited number of statutory rules to regulate the matter in question, application of force majeure regime assumes existence of certain pre-conditions to preclude the liability of non-performing party.

Under the Civil Law, companies and sole proprietors that engage in business activities are not liable for non-performance, delay or undue performance (including damages) caused by force majeure. Note that there is no rule under Civil Code expressly enabling one of the parties to terminate contract unilaterally due to force majeure event. In practice, majority of commercial contracts usually contain a provision that allows the parties to terminate the contract, if force majeure remains effective upon expiration of the period defined by the parties.

Exemptions

Under the Civil Code, events that cannot qualify as force majeure are as follows:

- 1) Contractual breach committed by the counterparty of the affected party;
- 2) Absence of relevant products on the market;
- 3) The affected party does not have money to perform its monetary obligations;
- 4) The parties expressly agreed that force majeure does not release the non-performing party from liability under the contract.

Force majeure test

Analysis of statutory provisions on force majeure and interpretation thereof given by local courts demonstrate that companies and sole proprietors may claim for force majeure to excuse non-performance, if the following requirements are met:

- 1) An objective event or situation affecting the party is extraordinary, exceptional and rarely occurring;
- 2) An event or situation is out of the affected party's control and cannot be remedied or overcome by the efforts of such party;
- 3) An event or situation was unforeseeable at the time of entering into contract and the affected party was not aware of circumstances that could have made performance of the contract impossible;
- 4) There is a causal link between the event qualified as force majeure and the affected party's ability to perform the contract, i.e. non-performance of contract happens due to force majeure event.

It is important that the party claiming for force majeure bears the burden of proving existence of the force majeure event. Failure to meet the above test by the affected party reduces the affected party's chances in potential litigation significantly.

Though the circumstances constituting the force majeure are not expressly specified by the Civil Code currently in force, contracting parties are free to incorporate the list of force majeure events in the contract (provided those events satisfy the above requirements). The case-law practice shows that situations, where parties pre-agreed on the events constituting force majeure, mainly increase the chances of the affected party in court.

In any case, an outcome of each separate case will depend on the wording of the contract signed by the parties and steps taken by the affected party after the force majeure event occurs. It is recommended that non-performing party utilize best of its efforts to mitigate negative impact of force majeure and notifies the counterparty of its inability to perform the contract pursuant to provisions of the relevant contract. If the affected party fails to take the above-mentioned steps in a due manner upon non-performance of contract, it may not invoke force majeure.

Alternative Remedies to Force Majeure

Material change of circumstances is an alternative to force majeure that enables parties of a contract to terminate or change contract for the purposes of mitigating potential exposures.

Under Armenian law, in the absence of mutual consent termination or change of the contract due to material change of circumstances in out-of-court procedure is impossible and may only happen based on court ruling.

Material change of circumstances test

Termination or change of a contract due to material change of circumstances is connected with a number of practical complexities and mainly parties apply it, unless other remedies set forth by the contract or law exist. In addition, many commercial contracts contain provisions defining that each party shall bear the risk of potential change of circumstances by excluding possibility of termination/change based on this ground.

Typically, material change of circumstances enables the parties of the contract to claim for change or termination of such contract, if:

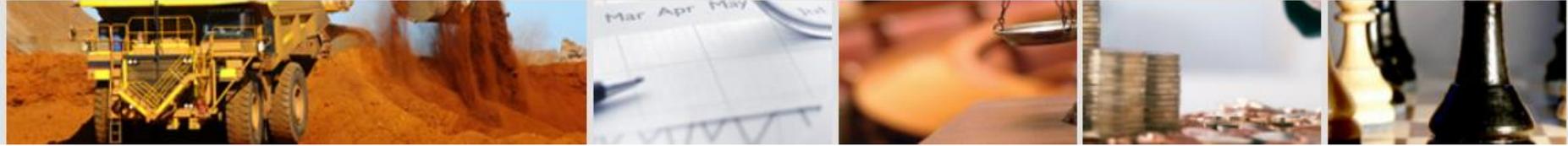
- 1) The parties entered into contract on the assumption that no such material change of circumstances will happen in future;
- 2) The change of circumstances has been caused by such reasons that interested party is unable to overcome;
- 3) Such change would make continued performance of the contract on its original terms egregiously inequitable to the affected party by preventing such party from the receivables that it assumed to receive upon execution;
- 4) It does not follow from the nature of contract or business practices that risk of change of circumstances shall be borne by the interested party.

Recommendations

If your business has been affected by COVID-19 and force majeure is considered as a potential solution to your situation, we recommend that the following actions be made:



- ✓ Analyze the impact of COVID-19 outbreak on the ability of your company to continue performance of contractual obligations (including existence of causal link between the outbreak and impossibility to perform contract);
- ✓ Review each contract and pay an especial attention to force majeure clauses, notification timelines, other procedural requirements and steps to be taken according to the contract;
- ✓ Consider possible actions to be taken to mitigate the impact of non-performance; and
- ✓ Keep in mind that preliminary discussion with the counterparty may be an essential part of successful completion of the process.



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