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Impact of Coronavirus Emergency on Contract Law

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Impact of Covid-19 pandemic on contractual relationships:
the case of Estonia

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1. General contract law rules: restrictions due to the Covid-19 pandemic as force majeure

Estonian contract law contains a general force majeure clause in § 103 LOA (Estonian Law of Obligations Act¹) modelled after art 79 CISG and comparable provisions of PICC and PECL.² In order to qualify as force majeure, an impediment has to be 1) beyond the control of the debtor; 2) unforeseeable at the time of conclusion of the contract and 3) not reasonably possible for the debtor to avoid or overcome. Under such definition, restrictions due to Corona-19 pandemic can in principle be qualified as force majeure³ but it surely depends on the circumstances of each case. For example, in construction contracts where foreign workforce cannot enter the state or already ordered materials are stuck abroad, it is important to ask whether the debtor can overcome these obstacles eg by hiring local workforce or buying building materials from local stores. As for the unforeseeability requirement, one can argue that if a contract was concluded after COVID-19 was called pandemic by WHO on 11 March 2020 such impediments would most probably not constitute force majeure any more.

One must bear in mind, however, that force majeure under Estonian law only relieves the debtor from damages claims and penalty payments and the creditor retains the right to terminate the contract, reduce the price or withhold performance (§ 105 of LOA).⁴ Moreover, under the principle of party autonomy parties may agree upon different risk allocation.⁵ The force majeure provision applies to all contracts, including consumer contracts. However, solvency problems due to loss of job etc fall within the risk sphere of a person and do not qualify as force majeure.⁶

2. Adaptation or termination of contracts due to Covid-19 pandemic under the doctrine of change of circumstances

Estonian law also contains a change in circumstances clause in § 97 LOA, very much comparable to § 313 BGB and the respective provision in PICC allowing for adaptation of the contract if there is a change in circumstances underlying the contract, the change was

¹ RT I 2001, 81, 487; RT I, 08.01.2020, 10.

² Paul Varul and others, *Võlaõigusseadus. Kommenteeritud väljaanne*, (1st vol, Juura 2016) 481.

³ In depth on the meaning of force majeure in Estonian contract law see Karin Sein, 'Mis on vääramatud jõud?' (2004) 8 *Juridica* 511–519.

⁴ Varul and others (n 2) 485, 496.

⁵ Varul and others (n 2) 487; Sein, 'Mis on vääramatud jõud?' (n 3) 519.

⁶ Decision of the Supreme Court no 3-2-1-50-06.

unforeseeable at the time of conclusion of the contract and if it is not reasonable for the debtor to bear the risk.⁷ If adaptation is not possible or reasonable, the contract may be terminated under § 97 (5) LOA. Until now courts have been very reluctant to adapt contracts under the change in circumstances doctrine, especially in case of one-off contracts. By 2015 there were virtually no cases where courts would have adapted contracts under that provision although especially after the 2008 financial crisis debtors often tried to invoke it in court proceedings.⁸

In 2015 the Supreme Court for the first time admitted that the economic crisis of 2008 can be considered a case of change in circumstances in case of a rental contract of a store as the rental prices had dropped by 50%.⁹ In other contexts resorting to § 97 LOA would be problematic, especially in case of one-off contracts as it was twice rejected for sale of land after the 2008 crisis.¹⁰ Similarly, loss of job or not getting credit to finance a project has not been considered reason enough for adaptation or eventual termination of a contract.¹¹ The doctrine of change in circumstances applies also to consumer contracts but in practice this has not been applied even once.

3. Regulatory allocation of risks for specific contract types

In case of rental contracts, the tenant bears the risk for the profitability of the rented premises and is thus obliged to pay full amount of rent even if he is not able to use the premises due to the pandemic-induced restrictions. It has been argued, though, that such restrictions constitute restrictions of use under § 296 of LOA, entitling the tenant to rent reduction or even to termination of the rental contract.¹² This argument should not be followed as these restrictions have nothing to do with the quality of the rented premises and thus there is no breach of contract on behalf of the landlord. Therefore restrictions due to

⁷ See more on this: Irene Kull, 'About Grounds for Exemption from Performance under the Draft Estonian Law of Obligations Act (Pacta Sunt Servanda versus Clausula rebus sic Stantibus)' (2001) 6 *Juridica International* 44-52; Sein, 'Mis on vääramatul jõud?' (n 3) 518-519; Mari Ann Simovart, 'Lepingu muutmise nõue riigihankelepingu kohustuste vahekorra muutumisel' (2008) 4 *Juridica* 219-224; Karl-Erich Trisberg, 'Majandussituatsiooni muutus: kas piisav põhjus kestvuslepingu muutmiseks või ülesütlemiseks?' (2010) 6 *Juridica* 427-437; Karin Sein, 'The Principle of Change in Circumstances in Estonian Contract Law – "Much Ado About Nothing?"' in Kalvis Torgāns and Jānis Pleps (eds), *Jurisprudence and Culture: Past Lessons and Future Challenges* (University of Latvia Press 2014).

⁸ Sein, 'The Principle of Change in Circumstances in Estonian Contract Law' (n 7).

⁹ Decision of the Supreme Court no 3-2-1-179-15, paras 34-35.

¹⁰ Decisions of the Supreme Court 3-2-1-76-10; 3-2-1-136-11.

¹¹ Decision of the Supreme Court 3-2-1-76-10, para 13.

¹² Piret Jesse, 'Advokaat selgitab: viibimiskeelud ja liikumispäringud võivad anda aluse üüri alandamiseks' *Delfi Ärileht* (Tallinn, 19 March 2020) <<https://arileht.delfi.ee/news/uudised/advokaat-selgitab-viibimiskeelud-ja-liikumispäringud-voivad-anda-aluse-uu-ri-alandamiseks?id=89273377>> accessed 5 May 2020; Tanel Tark, 'COVID-19: mis saab üürilepingutest?' (Tark Legal, 19 March 2020) <<https://tark.legal/covid-19-mis-saab-uurilepingutest/>> accessed 7 April 2020.

the pandemic typically lie within the sphere of risk of the tenant who is therefore obliged to continue rental payments despite the reduced possibility to use the premises. Under § 296 (3) LOA tenants are only entitled to deduct gains of the landlord, eg diminished costs for electricity or heating.¹³ The same applies to businesses whose activities do not directly fall under the statutory restrictions but who have nevertheless closed their doors due to the lack of clients or health reasons.¹⁴ It should be possible, however, to achieve reduction of rental payments under the change in circumstances doctrine as the Supreme Court allowed for it in the 2008 financial crisis¹⁵ and the current situation should be treated as being at least equally unforeseeable.

The situation is, however, different for stores or other businesses who have rented their premises in big shopping centres: in these cases landlords were forced to restrict the access of tenants to their rented premises with the consequence that the tenants are entitled to reduce the rent to a considerable extent under § 296 (2) LOA.¹⁶

It is currently also under discussion how to allocate the risks arising from the pandemic in case of construction contracts. As the rentability risk is usually upon the construction company¹⁷ it should not be possible to claim a higher fee or additional expenses just because the works have become more expensive due to unforeseeable events. However, it can be argued that it should be possible to prolongate the initially agreed deadline under the change in circumstances doctrine, if the work has to be temporarily stopped or postponed due to the pandemic restrictions.

There are no specific consumer protection rules for situations like the current one, meaning that the regular mandatory rules eg for consumer credit contracts or housing rental contracts apply. For example, it is forbidden to terminate consumer credit contracts unless the consumer is in default with 3 months' payments (§ 416 LOA) or housing rental contracts unless the tenant has been in delay with substantial amounts of rental payments for 3 months (§ 316 of LOA).

4. New regulatory provisions due to the pandemic crisis?

Until now there have been no pandemic-induced changes to contract law in Estonia. Estonian Chamber of Commerce and Estonian Food Industry Association with the support

¹³ Piia Kalamees and others, *Lepinguõigus* (Juura 2017) 176.

¹⁴ Karin Sein, 'Eriolukorra mõju üürilepingutele Eesti ja Saksa õiguse kohaselt' (2020) 3 *Juridica* 180, 183.

¹⁵ Decision of the Supreme Court no 3-2-1-179-15, paras 34–35.

¹⁶ Sein, 'Eriolukorra mõju üürilepingutele Eesti ja Saksa õiguse kohaselt' (n 14) 183–184.

¹⁷ See § 639 LOA; Paul Varul and others, *Võlaõigusseadus. Kommenteeritud väljaanne*, (3rd vol, Juura 2006) 56; Decision of the Supreme Court no 3-2-1-102-14, para 22.

of the Ministry of Finance made a proposition to modify the force majeure clause in LOA. The draft was proposed by the organisations to the Legal Affairs Committee of the Estonian Parliament (Riigikogu) to add a new § 1031 LOA, a provision stating that every non-performance of the obligation during the emergency situation is presumed to be excusable. It meant to reverse the burden of proof so that the creditor must prove the non-performance of the debtor was not due to the pandemic crises. This would have led to unacceptable consequences as it would have applied also to monetary obligations. Moreover, the draft raised questions about the purpose of the amendment and what protection it seeks to provide to the debtor. For example, that amendment would not have affected the creditor's right to require additional securities or to terminate the contract due to debtor's late payment. It was also discussed whether one should follow the example of Germany, where the legal amendments provided for statutory moratoria for credit agreements for a limited period under certain conditions. As clarity and explanations were needed in society, legal experts and the Ministry of Justice have produced guidelines with simple explanations.¹⁸ Another draft foreseeing a 3-month moratorium on credit contracts concluded with SMEs and consumers has been prepared but not brought to the final parliamentary discussions. Both proposals were discussed in the Legal Affairs Committee of the Parliament in 24.03.2020.¹⁹ The Ministry of Justice stated at the meeting and later in its answers to the stakeholders²⁰ that amendments to contract law are not necessary. It was argued in the meeting that it is not unreasonably difficult to prove the circumstances of force majeure and existing legal provisions already protect debtor's rights where it is necessary. A debtor is in the best position to prove that the obligation is obstructed by the specific event due to the unforeseeable facts. For the other party, proving such a negative fact would be significantly more complex and could lead to an unreasonable burden on the other party and his ability to defend its rights.

Moreover, the Estonian Banking Association has voluntarily agreed to offer postponement of credit payments under common principles.²¹ This, in turn was surely influenced by the decision of the Estonian Financial Supervisory Authority to adopt the guidelines of the European Banking Authority on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis.²² The current lack of interest of credit

¹⁸ Practical guidance by the Ministry of Justice <<https://www.just.ee/et/eesmargid-tegevused/praktilisi-nouandeid/lepinguoiguslikud-reeglid-javaaramatu-joud>> accessed 5 May 2020.

¹⁹ 'Protocol of the meeting' <<https://www.riigikogu.ee/tegevus/dokumendiregister/dokument/300ada23-c746-4643-9b19-7c9f1c7ae688>> accessed 5 May 2020.

²⁰ Letter of the Ministry of Justice to Finance Estonia (07 April 2020) <<https://adr.rik.ee/jm/dokument/7150688>> accessed 5 May 2020.

²¹ Estonian Banking Association, 'Common Guidelines on Moratoria on Loan Repayments due to the Emergency Situation' (24 April 2020) <<http://pangaliit.ee/files/Eriolukorras%20tingitud%20maksepuhkuse%20andmise%20%C3%BChtne%20kord.pdf>> accessed 5 May 2020.

²² Decision of the Estonian Financial Supervisory Authority of 20 April 2020 no 1.1-7/53.

institutions in terminating credit contracts and starting mortgage foreclosures is surely an economic one as the real estate prices are in decline. Possibly it is even further reduced due to the position held by the Supreme Court that if the creditor has breached the obligation of responsible lending then his repayment claim is restricted to the amount obtained from the forced sale of the property.²³ The current voluntary postponement offer of the banks is often not the most consumer-friendly one as consumers still have to pay interests and some banks have reserved the right to raise the interest rate or are demanding additional postponement fees.²⁴

As in other European countries, a package for various subsidies has been adopted, which is mostly sector-specific. However, the government has also promised specific targeted subsidies for rent payments: these are foreseen for these shops located in shopping centres that were forced to close down by government decree due to the pandemic.

5. Contractual clauses used in practice and their impact on contractual allocation of risks

There are several typical standard contract clauses used in practice which foresee a specific allocation of contractual risks. In construction industry, for example, contracts are often concluded under FIDIC rules, which foresee specific force majeure clauses as well as certain possibilities for contract adaptation. Under FIDIC Yellow Book 2017 the constructor is entitled to extension of time if the completion of the work is delayed by unforeseeable shortages in the availability of personnel or goods (or employer-supplied materials, if any) caused by epidemic or governmental actions.²⁵ Moreover, insurance contracts often list pandemic or public travel restrictions as risks that are not covered by the contract.

²³ Decision of the Supreme Court no 2-14-21710, paras 44–45.

²⁴ Estonian Financial Supervisory Authority, 'Laenu- ja liisinguandjad on pakkunud klientidele erinevaid tingimusi maksepuhkuste andmisel' (23 April 2020) <<https://www.fi.ee/et/uudised/laenu-ja-liisinguandjad-pakkunud-klientidele-erinevaid-tingimusi-maksepuhkuste-andmisel>> accessed 5 May 2020.

²⁵ FIDIC Yellow Book, *Conditions of Contract for Plant and Design-Build*, (2017) art 8.5(d).