IMPACT OF CHANGE OF MANDATORY RULES FOR THE ENFORCEMENT OF CONTRACTUAL OBLIGATIONS

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Abstract
This research deals with the issue of the impact of the change of mandatory legal norms on the performance of contracts. It is conducted from a comparative perspective explaining the problems of the interaction between changes in imperative legal provision and the performance of contract in civil law and common law legal traditions, as well as in *soft law* instruments. The problem of performance of contracts after the change of imperative legal norms has not been the subject of a more detailed legal analysis. Therefore, this research is one of the first attempts to identify the problems in this area and suggest effective solutions to them. The authors have chosen the Republic of Lithuania as the primary jurisdiction for the analysis, taking into account that Lithuania is one of a few jurisdictions that have an explicit provision on the issue of the impact of the change of mandatory legal norms on the performance of contracts. The article, taking into account the provisions of foreign states and soft law, seeks to assess the extent to which the legal regulation of Lithuania and the relevant case law ensures the balance of interests of the parties to the contract in the context of changes of mandatory rules.

Keywords: *mandatory rules, enforcement of contractual obligations, hardship, force majeure, pacta sunt servanda.*

Introduction

For businesses, especially those operating in areas that require long-term and costly investments, one of the key guarantors of their success is the stability of the state's legal and tax environment. Economic and political instability has already become a feature of many societies around the world. In such a situation, the question arises as to whether contract law has prepared a solution which would be offered to the parties affected by the mandatory changes in the law.

The traditionally dominant principle of *pacta sunt servanda* provides that a lawfully concluded contract has the force of law. This means that performance of the contract is binding on the parties to it. However, the principle *pacta sunt servanda* has almost never been absolute and has been mitigated (amortized) through the doctrines of impossibility and changed circumstances. In some cases, the impossibility of performing an obligation based on factual and legal circumstances is recognized as "an obstacle to discharge" (Baranauskas and Zapolskis, 2009). An analysis of the events that led to the material change in circumstances has shown that such events include, but are not limited to, changes in the law and various decisions of public authorities, which are therefore binding on the parties to whom they are relevant performance of the contract becomes very difficult or impossible.

It should be noted that the practice of foreign states usually tries to solve this problem through legal institutions of change of circumstances: 1) impossibility of performance of the contract due to substantially changed circumstances, also called force majeure, and 2) complication of performance of the contract due to substantially changed circumstances. The common goal of these institutions in separate legal systems is to regulate cases when the circumstances substantially change after the conclusion of the contract and as a result further performance of the contract becomes impossible or possible only under fundamentally different conditions, often to the detriment or even detriment of one of the parties. Nevertheless, these legal institutions are not only named but also applied differently in different states. Germany, France and England illustrate three distinct approaches to the problems of contract performance following changes in mandatory law. The *soft law* instruments, i. e. UNIDROIT Principles of International Commercial Contracts (UNIDROIT Principles, 2016), Principles of European Contract Law (PECL, 2002) and Draft Common Frame of Reference (DCFR, 2008), as well as the United Nations Convention on Contracts for the International Sale of Goods (CISG, 1980), do not contain specific provisions to deal with the problem of performance of a contract in the event of a change in mandatory law. Meanwhile, all these international instruments establish legal institutes for the impossibility of performing a contract due to substantially changed circumstances and for the complication of performing a contract due to substantially changed circumstances, with the exception of the CISG, which does not contain special provisions to deal with complication of performance of the contract due to substantially changed circumstances.

In Lithuania, in order to solve the problems of performance of contracts due to changes in mandatory legal norms, the Lithuanian legislator has established a separate provision. Article 6.157 (2) of the Civil Code of the Republic of Lithuania (CC, 2000)[1], regulating the relationship between mandatory legal norms and a contract stipulates that a change in mandatory legal norms after concluding a contract does not affect the terms of the contract; the effectiveness of the practical application of this rule is in doubt. Meanwhile, Article 6.253 of the CC specifies the actions of the state in addition to other grounds for non-application and exemption from civil liability. The establishment of these legal institutions creates a need for their theoretical interpretation and practical application. This article, taking into account the legal regulation and practice of foreign countries and soft law, seeks to answer the question whether the legal regulation in force in Lithuania best ensures the balance of interests of the participants of legal relations in the event of changes of mandatory rules.

1. SOLUTIONS TO THE PROBLEM OF CONTRACT PERFORMANCE IN FOREIGN COUNTRIES AND INTERNATIONAL INSTRUMENTS AFTER CHANGES IN MANDATORY RULES

1. 1. Germany

The principle of fault (*Verschuldensprinzip*) is inherent in German law, therefore negligence on the part of the defaulting party must be established at the very least in order to impose liability for non-performance of contractual obligations (Ridder and Weller, 2014, p. 371, p. 373). Article 276(2) of the German Civil Code provides that a person is deemed to have acted negligently if he fails to observe the requirements of reasonable care (BGB, 2002). Therefore, the occurrence of unavoidable and external events affecting the impossibility of contract performance would not normally require special interpretation and references to specific legal provisions relating to force majeure.

For example, state-imposed restrictions on import and export could be seen as changes that create a legal impossibility (*rechtliche Unmöglichkeit*) to perform a sales contract. In contrast to absolute (physical) impossibility, the supply of goods remains possible because such goods can be purchased on the international market. However, restrictions imposed by public authorities render contract performance unlawful, thus creating an objective impossibility which prevents both the debtor and anyone else from performing the contract. It is considered that no one can be obliged to break the law or expect the law to be broken (Kokorin and Van Der Weide, 2015). In addition, pursuant to the doctrine of liability for which fault must be established, Article 275(1) of the BGB provides that the requirement to fulfil an obligation is rejected if it is

[1] All translations of the Lithuanian texts into English have been made by the authors of this article.

impossible for both the debtor and any other person to fulfil it. This provision means that the impossibility of fulfilling an obligation relieves a party of performing the obligation, regardless of whether the circumstances of the impossibility of performance arose from the party's own actions. It is also irrelevant for the application of Article 275(1) of the BGB whether the impossibility is objective or subjective, partial or complete (Fikentscher, Heinemann and Schuldrecht, 2006, p. 188; Schuldrecht, 2002; Schlechtriem, 2003). It should be noted that German law does not provide for automatic termination of a contract - it would still remain in force (Hondius and Grigoleit, 2011, p. 58). However, performance of a contract cannot be binding. The debtor shall remain liable until proven that the debtor is not responsible for the obstacles which have arisen, or the debtor could not have been aware of the obstacles at the time of entering into the contract in a situation where the obligation could not be fulfilled at the time of the transaction (Articles 280, 311 of BGB).

The question is whether the temporary impossibility of performing a contract resulting from acts of the state of temporary nature always obliges the creditor to terminate the contract. It is not hard to imagine that in such cases contract termination may be the wrong thing to do, and the debtor would suffer disproportionate losses. BGB does not have a special provision governing cases of temporary impossibility. In practice, German courts take a nuanced approach, analysing all the facts relevant to each case and balancing the common interests of the parties (Mazzacano, 2013). A creditor does not always have the right to terminate a contract due to a delay in performance thereof caused by temporary impossibility to perform the contract. This is particularly important in contracts where the deadline for performance of the contract is irrelevant. On the other hand, even if the circumstances of impossibility of performing a contract are of temporary nature, they may be equated to permanent impossibility, if it is not possible to predict when these circumstances will disappear and whether they will disappear at all (Brunner, 2009, p. 251). Temporary impossibility is also considered to be permanent if it calls into question the achievement of the objective of the contract (Brunner, 2009, p. 252), i.e. where the deadline for performance of the contract is essential. Thus, the German legal system takes into account the legitimate interests of the creditor and the debtor in determining whether the circumstances of impossibility of performance of a contract require termination thereof.

According to literature, if the impossibility of performance of a contract arises after the conclusion thereof, fault shall be determined by taking into account whether the party who promised to fulfil the contract is responsible for the fact that the obstacle is preventing to fulfil that contract (Markesinis, Unberath & Johnston 2006, p. 485), and not whether or not the party knew or should have known of such an obstacle. It goes without saying that mandatory requirements imposed by the state typically arise independently of the will of the debtor, thus the debtor cannot be held at fault. If the state's plans to adopt mandatory rules are published before the conclusion of the contract, such

statutory provisions affecting contractual relations between the parties may have been provided at the time of conclusion of the contract. Although German laws do not have a clearly defined requirement for unforeseen circumstances, such conclusion can be drawn by considering the institution of initial inability to perform the contract, according to which the debtor must inquire and assess whether it is in fact capable of performing the contract before concluding it. If the state reveals its intention to take certain steps by adopting mandatory provisions impeding contract performance, which will enter into force during the performance of the contract, the requirements of fair and equitable distribution of risk dictate that the debtor shall be fully liable for the non-performance of its obligations.

1.2. France

Like German law, French law, following the Roman tradition, essentially recognizes a fault-based liability regime. The concept of force majeure in French law can be found in Article 1148 of the so-called Napoleonic Code or the French Civil Code (*CC*), adopted in 1804. The article has established that "there is no reason for indemnification of damages if the debtor was prevented from transferring or performing its obligations, or has done what was prohibited for it due to force majeure or an accidental event (*cas fortuit*)." The current version of Article 1218 of the CC provides that "In contractual relations, force majeure circumstances shall mean events beyond the control of the debtor, which could not have been reasonably foreseen at the time of conclusion of the contract, and the consequences of which cannot be avoided by any means, thus preventing the debtor from fulfilling its obligations". The same article also provides: "if, due to these circumstances, the debtor is unable to temporarily perform the contract, performance of its obligations shall be suspended, unless such delay would justify the termination of the contract. If such circumstances are not temporary, the contract shall be terminated in accordance with the procedures established by law, and the parties shall be released from their obligations under the conditions provided for in Articles 1351 and 1351-1".

In the event of force majeure, the debtor shall be released from performance of its primary obligation (specific performance) which becomes logically impossible, as well as its secondary obligation (compensation for damage). In any case, the exception existence or no fault scenario must be proved by the debtor. The only difference is that in fault-based civil liability systems the court will assess the debtor's fault (which apparently does not exist in cases of force majeure), whereas under a strict liability system the court will analyse whether one of the exceptions to strict debtor liability applies. Admittedly, the French system appears to be almost identical to the system of "strict liability", where the debtor is released from liability for damages only if its failure to fulfil its obligations is justified (Brunner, 2009, p. 67).

The regulation of consequences of force majeure under French law is similar to that in Germany, which stipulates that contractual obligations shall

remain in force, while the claims for performance of the contract and compensation for damages are rejected. Such result is determined by the contract protection principle which is deeply rooted in French contract law. If the debtor fails to fulfil its obligations, the creditor shall acquire the right to go to court to terminate the contract, but will typically not be able to unilaterally terminate the contract out of court, unless the parties agree otherwise (Laithier, 2005). This is how French law differs from German law, which generally allows the creditor to terminate the contract unilaterally if the debtor fails to comply with its obligations within the notice period set by the creditor (*Nachfrist*) (*BGB* § Article 323(1)).

As already mentioned, the impossibility of performing a contract due to force majeure circumstances does not in itself lead to the termination thereof, but only relieves the debtor of its liability for non-performance of the contract. As long as the French law provides that the obligation to do what is impossible is null and void (*impossibilium nulla obligatio*), the initial impossibility of performing a contract should render the contract null and void, with restitution and the other consequences that follow. According to Nicholas, the same rule should apply to the subsequent impossibility of performing a contract where the breached obligations "are the totality of performance of material obligations of the debtor under the contract" (Nicholas, 2013). However, the authors do not share this view and consider that contract invalidity does not automatically result from the impossibility of subsequent performance of the contract. This view is supported by the French legal doctrine: "*La stabilité des contrats a été pour notre jurisprudence le principe essentiel*" ("The stability of contractual relations is a cornerstone of our case law") (Terré, 2009, p. 588).

The French courts retain some flexibility in determining the grounds and consequences of impossibility. However, this discretion is more limited than that found in German law, which takes a nuanced approach for reasons of fairness. French courts generally take into account the practical consequences of force majeure (partial or total non-performance) and the temporary nature of the event (temporary or permanent inability to perform the contract) when deciding the fate of the contract. In cases where the award of damages may be prevented by the application of Article 1148 of the CC and termination of the contract would become redundant, the courts may reduce or change the creditor's obligations in order to offset the reduced obligation of the debtor (Nicholas, 2013, p. 26–27).

Thus, the German and French courts shall examine the legitimate interests of the parties by taking into account, inter alia, whether the impossibility of performing the contract is temporary or permanent, in whole or in part. From a judicial point of view, the issue of force majeure should be a very balanced action. When the impossibility of performing a contract due to force majeure is full and permanent, it is almost certain that the French court would allow terminating the contract.

To prove the existence of force majeure circumstances under French law, the debtor must prove that performance of the contract has become physically or legally impossible, and not merely difficult. However, French

courts might be inclined to interpret force majeure circumstances more broadly, and to apply this exception when the purpose of the contract fails (Case of Dispot Merlin v. Robillard, 1843). In addition to the impossibility of performing the contract, the defence of force majeure requires proof of such elements as: (i) the irresistibility of the event; (ii) the unforeseeability of the event; and (iii) external nature (Malaurie, 2011, p. 499; Terré, 2009, p. 585).

If a contractual party has foreseen or should have foreseen an event preventing the performance of the contract, it shall be deemed that such party should have been prepared for all the negative consequences thereof. The predictability of events should also be reflected in the terms of the contract, such as pre-arranged price adjustment mechanisms. Otherwise, assuming commercial risk is likely. As seen in the previous analysis, the concept of predictability of events is the most problematic. Unfortunately, there is not much clarity in the French legal system regarding this necessary element of force majeure. Despite the prevailing view that the requirement of predictability must be examined objectively, there is a tendency (at least in academic circles) to take into account the element of relativity. It is disputed whether the courts must rely on the standard of prudent, diligent, attentive, i.e. rational, reasonable conduct of a person (*bonus pater familias*) applicable to the defendant's activities and level of specialization (Tourneau, 1982). Therefore, reasonable predictability may be outweighed by specific predictability of events, enhanced by the experience and specialization of the contractual party. Subjectivity is likely to have an impact only if the qualifications of the contracting party are higher than, but not lower than, the *bonus pater familias* standard of conduct, at least in business transactions.

The standard of the average intelligent person is very high in the eyes of the French courts, making such a person almost a prophet who knows the past and sees the future. That is why the position of the French is stricter than of the Germans. This means that the possibility of a future event (e.g., embargo, changes in the law) arising from past events, no matter how remote and insignificant it may seem, may imply predictability of the event. As suggested by the court of arbitration in one case, if a party "has the slightest doubt regarding its ability to perform the contract, it must carry out all the necessary inspections before committing to such a contract (ICC Case, 2009).

Such a strict approach can hardly be justified from both a moral and an economic point of view. It is wrong to punish someone for failing to do what is impossible, provided that the party could not reasonably foresee such an event and act accordingly in good faith. Such a situation may be contrary to the purpose of contract law if we look at it from the perspective of increasing economic efficiency. It should be noted that each case is unique and there may be valid arguments enabling to blame the defaulting party for failure to fulfil its contractual obligations, such as when the party is the bearer of the highest risk. For example, subjective factors such as professional knowledge or special understanding would indicate a subjective anticipation of an event that renders the performance of the contract impossible. In the words of Guenter Treitel, "conclusion of a contract before the inevitable restriction intended to be

imposed by the state, and anticipation that this restriction will affect business activities are not very different from conclusion of a contract after the entry into force of such a restriction (Treitel, 2004, p. 508). Therefore, decisions taken by the state should be inevitable and not just hypothetical.

1.3. England

Modern theory of English law, based on extensive case law, states that parties may be released from further performance of the contract by terminating the contract on the basis of frustration, if after conclusion of the contract certain circumstances arise which make the performance of the contract physically or commercially impossible, or completely different from what it was at the time of conclusion of the contract (Chitty, J. & Beale, H. G., 2004, p. 1311). K. Zweigert and H. Kötz point out that the doctrine of frustration may apply, inter alia, in the event of legal impossibility (Zweigert and Kötz, 2001, p. 448). The legal impossibility of performing a contract when its party is released from performance thereof on the basis of frustration includes: a) performance of the contract becomes impossible due to changes in legal regulations or legal practice (subsequent legal changes); 2) after the conclusion of the contract, performance thereof becomes illegal (subsequent (supervening) illegality).

An example of subsequent illegality after the conclusion of a contract could be the gradual imposition of restrictive measures on Russia by the US and the EU since March 2014. Under English law, a party which has a contractual relationship with a sanctioned person may also consider whether its contract has become void, i.e. whether it can be terminated in order to avoid illegality, since performance of contractual obligations has become impossible. However, this is not a doctrine that could be easily applied by English courts.

English courts tend to argue that contracts do not become void due to the imposition of sanctions. In the case of *Melli Bank v. Holbud Ltd*, the court has ruled that the imposition of EU sanctions alone does not mean that the contract could not be enforced. In the case of *Islamic Republic of Iran Shipping Line Group v. Steamship Mutual Underwriting Association*, the defendant insurance company claimed that the insurance protection granted to the designated Iranian entity has become void following the 2009 financial restrictions order on Iran in the United Kingdom. The Court of Appeal of England rejected the defendant's arguments, holding that the insurance was not void. The judge ruled that the license, if properly formulated, would allow insurance coverage to continue to be provided for those risks that require insurance coverage under the Convention. In addition, the license also allowed meeting all the requirements, by taking into account those risks. Therefore, companies should keep in mind that alternatives may need to be used for contract enforcement before attempting to rely on the doctrine of frustration as a basis for terminating the contract.

The innocent party may be entitled to terminate previous contractual obligations for the possibility of breaching sanctions if the contract is

performed under the force majeure clause, provided that such a clause is sufficiently broadly defined in the contract. The extent of protection provided by the force majeure clause would depend on how this clause is defined in the contract under the law applicable thereto.

1.4. CISG Convention and soft law instruments (UNIDROIT, PECL and DCFR principles)

It is no secret that Lithuanian civil law has transposed the principles of UNIDROIT contract law into its regulation. In the UNIDROIT Principles, the principle of freedom of contract enshrined in Article 1.1 defines the freedom to conclude contracts and to determine their content. UNIDROIT Principles associate the main restrictions on freedom of contract with the requirements of fairness and mandatory rules. Article 1.4 of the Principles states that: "Nothing in these Principles shall restrict the application of mandatory rules, whether of national, international or supranational origin, which are applicable in accordance with the relevant rules of private international law". The comment to this article states that neither these principles as a single source of soft law, nor a transaction made based on these principles may impose rules or conditions that are contrary to the mandatory rules of national law. Mandatory national rules are those which are determined autonomously by the state and which derive from international conventions or public international law. However, although these rules are not equivalent in different legal systems due to different regulation, they are typically linked to the general principles of public policy (UNIDROIT Principles, 2016).

CISG Convention, UNIDROIT, PECL and DCFR principles do not contain specific provisions governing contract performance cases in the event of changes in mandatory rules. Meanwhile, all of these international legal instruments establish the legal institutions of contract performance impossibility and contract performance impediment due to substantially changed circumstances, as well as discuss the conditions of application of these institutions. CISG Convention is the only one that does not lay down specific provisions aimed at resolving contract performance impediment due to substantially changed circumstances, where contract performance becomes very difficult but not impossible.

The doctrine of law states that obstacles falling within the scope of Article 79 of the CISG Convention could only be objective circumstances which do not fall within the scope of the debtor's risk (Flambouras, 2001, p. 266). Such obstacles also often include legal barriers (confiscation (expropriation) of goods, embargoes, restrictions on foreign imports and/or exports, and/or bans, etc.) (Flambouras, 2001, p. 266). To summarize the provisions of contract performance impossibility due to substantially changed circumstances enshrined in the aforesaid international legal instruments, it can be concluded that, despite their different aspects, they set out very similar grounds and rules for the application of this institution. Perhaps the biggest difference is that the principles of PECL (Article 9:303(4)) and DCFR (Article

3:104(4)) provide that a contract is automatically terminated when performance thereof becomes impossible due to a permanent impediment. Meanwhile, the CISG Convention (Art. 49 and 64) and the UNIDROIT Principles (Article 7.1.7(4)) leave it to the injured party in whose favour the contract was to be performed to terminate the contract unilaterally.

The grounds, rules and consequences of the application of the legal institution of contract performance impediment due to substantially changed circumstances set out in these international instruments for the harmonization of contract law are also similar. When discussing differences, it should be noted that: firstly, unlike PECL and DCFR, UNIDROIT Principles propose to apply the provisions of the legal institution of contract performance impediment due to substantially changed circumstances not only where contract performance impediment is caused by post-contractual circumstances but also where these circumstances also exist at the time of conclusion of the contract (PECL, 2002; Ambrasiene, Cirtautiene, Dambrauskaite, Selelionyte – Drukteiniene and Tikniūte, 2013, p. 301); secondly, all of these instruments provide for mandatory preliminary negotiation procedures before applying to court regarding contract amendment or termination, but give them different meaning. Pursuant to DCFR, pre-litigation negotiations themselves may not take place at all, since it is essential that the injured party fulfils the obligation to request negotiations from the other party before going to court. According to UNIDROIT Principles, negotiations must also be requested by the injured party, however these negotiations must take place, and this must be done properly. PECL Principles attach the utmost importance to negotiations, not only because negotiations can be requested by both parties, but also because a party can claim damages if the other party unreasonably refuses to negotiate or conducts negotiations improperly (Ambrasiene, Cirtautiene, Dambrauskaitė, Selelionyte – Drukteiniene, and Tikniute, 2013, p. 300).

To summarize the provisions of both contract performance impossibility and contract performance impediment due to substantially changed circumstances enshrined in the principles of UNIDROIT, PECL and DCFR, it can be seen that priority remains to be given to the principle of *pacta sunt servanda*.

2. SOLUTIONS TO THE PROBLEM OF CONTRACT PERFORMANCE AFTER CHANGES IN MANDATORY RULES IN LITHUANIAN CIVIL LAW

2.1. Aspects of regulation of the legal institution for contract performance after changes in mandatory rules

In contrast to the example of most other national and international practices, in Lithuanian civil law, the Lithuanian legislator has laid down a separate provision in Article 6.157(2) of the CC which establishes that changes in mandatory rules after the conclusion of a contract shall not affect the terms and conditions thereof in order to resolve the issues of contract performance in

the event of changes in mandatory rules. This section of the article discusses the validity of a contract when changes are made to the law and new mandatory rules are established after the contract has been concluded. Given that the law does not apply retroactively, such amendments to the law shall not affect the contract. However, this rule applies only when the new law does not provide for the possibility of such retroactive application. In addition, pursuant to the case law of the Supreme Court of Lithuania, this rule must be interpreted and applied based on the continuing nature of contractual relations. Thus, contract amendment must comply with the mandatory rules in force at the time of amendment or performance of the contract and not at the time of conclusion thereof (Mikelenas, 1996, p. 197).

The rule of Article 6.157(2) of the CC supplements the general principle of law enshrined in Article 1.7(2) of the CC that the law shall have no retroactive effect (*lex procipit, non respicit; lex retro non agit*). This principle has been repeatedly emphasized by the Constitutional Court of the Republic of Lithuania (1994) and the Supreme Court of Lithuania (2000; 1999). The principle that the law has no retroactive effect means that it only applies to future events, i.e. to civil relations arising after the entry into force of the law. However, it should be noted that most legal relationships are continuous, therefore even if the legal relationship arose before the law came into force, provisions of the law shall apply to the rights, obligations or facts arising after the entry into force of that law.

In terms of long-term plans established by individuals, it becomes particularly important for legislators to ensure the confidence of these individuals in the state, and to act consistently when adopting certain legal acts. This way individuals acquire rights on the basis of such consistent legal regulation, based on which certain legitimate expectations are also established. In order not to violate these constitutional values, it is important to ensure that legal acts do not have a retroactive effect, except in cases when this is directly required by the public interest, or such legal acts are favourable to the person. It should be noted that one of the main areas in which the principle of protection of legitimate expectations applies is the retroactive effect of legal acts (Gedmintaite, 2016, p. 83).

It should be noted that force majeure is not the only legal institution in the Lithuanian legal system on the basis of which a party can expect to be released from civil liability for non-performance of its contractual obligations. More circumstances affecting contract performance under which a party may be released from civil liability for contract non-performance are provided for in Article 6.253 of the CC of the Republic of Lithuania. According to the authors, one of the circumstances established in Article 6.253 of the CC of the Republic of Lithuania, i.e. actions of public authorities which may also include changes in mandatory rules, is also related to the institution of force majeure.

Article 6.253 of the CC of the Republic of Lithuania identifies the actions of the state as a separate ground for non-application or exemption from civil liability. Application of state actions as one of the grounds for non-application or exemption from civil liability always relates to certain actions or

acts of public authorities which prevent the obligated person from fulfilling his contractual obligations or which render him unable to fulfil a particular obligation. According to Article 6.253(3) of the CC, actions of the state are obligatory and unforeseen actions or acts of public authorities, due to which it is impossible to fulfil an obligation and which the parties have no right to contest. The definition of state actions as a ground for exemption and non-application of civil liability in the above-mentioned rule of law presupposes the conclusion that a set of relevant conditions (cumulative conditions) is necessary to establish this ground: 1) actions (acts) of public authorities; 2) actions (acts) must be unforeseen and binding on the person; 3) actions (acts) must be such that it would be impossible to fulfil the obligation; 4) the person did not have the right to challenge the actions (acts) in court or administratively. Thus, the actions (acts) of public authorities which make it impossible for a person to fulfil an obligation may, inter alia, be grounds for not applying civil liability only in cases where these actions could not have been foreseen (Supreme Court of Lithuania, 2019).

Exemption from civil liability when it becomes impossible to perform a contract due to actions of the state is sufficiently closely related to force majeure. Often, actions of the state that prevent the performance of a contract are recognized as force majeure circumstances that release a party from civil liability. However, there are a number of fundamental differences between state actions and force majeure circumstances. First of all, force majeure circumstances are considered to be circumstances which could not have been predicted and foreseen. Whereas the actions of public authorities can often be predicted (e.g., a draft of a certain legal act is debated in the parliament) (Mikelenas, 2003, p. 351). If, however, the actions of public authorities could not have been foreseen, this would be a ground to release a party from liability for non-performance of a contract. However, if the actions of public authorities could have been predicted, then there would be no reason to release a party from civil liability, since the parties could have foreseen such actions and therefore had to bear all the risks involved. It should also be noted that, unlike force majeure circumstances, the consequences of which are unavoidable, the negative consequences of the actions of public authorities can be remedied by challenging them in court (Mikelenas, 2003, p. 351). These two institutions are also not always properly separated in the case law of Lithuanian courts.

2.2. Law v. contract in Lithuanian case law

There are a number of cases in the case law of the Supreme Court of Lithuania (2010; 2017) in which the parties tried to rely on Article 6.157(2) of the CC, however most of these attempts were unsuccessful, since the Supreme Court of Lithuania has developed a consistent practice that, in the case of a continuing legal relationship, the mandatory rules that are changed during the term of the contract must be applied to further relations between the parties. Contract amendment or performance must comply with the mandatory rules in

force at the time of amendment or performance of the contract and not at the time of conclusion thereof.

For example, in 2005, the Supreme Court of Lithuania examined a civil case on the award of seaport land lease fee. The plaintiff had entered into a seaport land lease agreement with the defendant. Pursuant to Article 23(2) of the Law on Klaipeda State Seaport, the seaport land lease fee amount and procedure is approved by the Minister of Transport and Communications upon recommendation of the Seaport Authority, who has approved under Order No 370 of 15 December 2000 a new procedure for calculating the seaport land lease fee effective as of 1 January 2001, according to which the defendant was obligated to pay a higher land lease fee for 2001 than was established in the procedure approved by order of the Minister of Transport and Communications in force at the time of conclusion of the lease agreement. The Court of Cassation clarified that knowledge of laws and regulations is presumed in law, therefore after the Order No 370 of the Minister of Transport and Communications of 15 December 2000 was published in the Official Gazette on 20 December 2000, which approved a new procedure for calculating the Klaipeda state seaport land lease fee, repealed the previous such procedure, and specified that the new procedure will take effect as of 2001, the defendant should have been aware that the seaport land lease fee applied to the defendant would be calculated in accordance with the regulations of the newly approved procedure. There were no legal grounds to continue applying the invalid legal act on the basis of which the seaport land lease fee was calculated before the expiration of the act, and the application thereof would violate the mandatory rules.

The Supreme Court of Lithuania examined a civil case in 2013 regarding amendment of public procurement contract conditions establishing the contract price after an increase in the VAT rate. The chamber of judges of the Court of Cassation explained that Article 6.157(2) of the CC states that changes in mandatory rules after conclusion of a contract do not affect the terms and conditions thereof. Hhowever this rule is not applied mechanically but based on the conditions of the contract and the nature and objectives of the specific applicable mandatory rule. Furthermore, given the continuing nature of the contract, i.e. given that the rule was changed during the performance of the lease agreement, a conclusion can be made that the provision of Article 18(8) of the Law on Public Procurement, which allows to change the conditions of a public procurement contract in accordance with the requirements of the law, also applies to the lease agreement of the parties concluded before this rule was changed. According the the Supreme Court, such changes have entered into force before the expiration of the contract and the contractual relationship between the parties was still ongoing. The court has stated that "the principle of *lex retro non agit* is not infringed under such circumstances, since, if circumstances arise during contract performance which could form grounds for amending the contract, the rights and obligations of the parties shall be subject to the rule of law in force at the time of occurrence thereof, which provides for the possibility of amendment. The principle of non-retroactivity could be infringed if amendment of the contract would also cover the period during

which it was prohibited (until the entry into force of the new version of the law)."

Given this rule formulated by the Supreme Court, both the wording of the rule enshrined by the legislator in Article 6.157(2) of the CC, and the effectiveness of its practical application are questionable, since the application of this rule of law makes it unclear in which cases, in the opinion of the legislator, the parties to the contract could ignore the changes in the mandatory rules in the performance of the contract by giving priority to the conditions of the contract.

In the last few years, the largest number of disputes in which the Supreme Court of Lithuania has ruled on the interpretation and application of substantive rules of law regulating the impact of changes in mandatory rules on contract performance has arisen in the field of energy legal relations, in which applicants sought damages for non-performance of obligations resulting from the adoption of new legal acts on the acquisition of energy resources. The courts have found that the energy resource market is governed by rules of public law, i.e. a specific area regulated by the state, thus the adopted regulations on the acquisition of energy resources were binding on the parties. The defendants did not purchase biomass from the applicants under contract not because contract performance was hampered by any factual circumstances, but because of changes in the rules of public law, obliging the defendants to purchase the relevant quantity of biomass on the Exchange. Such changes in legal regulation meant that contracts could no longer be performed objectively. The court has ruled that the defendants were not liable for these changes, therefore, due to the absence of fault or illegality of actions, there were no grounds for applying contractual civil liability (in the form of penalties). The courts also found that the parties to the case had an ongoing contractual legal relationship. The provisions of Article 191 of the Law on Energy Resources Market entered into force during contract performance by the parties, therefore these provisions are applicable to the stage of performance of biomass supply contracts which lasted from the moment of entry into force of the provisions. Such conclusion does not conflict with the principle of *lex retro non agit* and the rules of law expressing this principle, including Article 6.157(2) of the CC, because the prospective (future-oriented) validity of the legal regulation is recognized precisely for the stage of the contractual legal relationship that lasts from the entry into force of the regulation (Supreme Court of Lithuania, 2018).

According to the authors, the courts did not apply the rules of law properly in the discussed cases. Article 191 of the Law on Energy Resources Market examined in the specified cases of the Supreme Court of Lithuania, and the new legal regulation laid down therein were formally future-oriented, however the said new legal regulation did not modify the performance of contracts (their continuity), but simply altogether prevented the performance of these contracts, i.e. in full. When applying and interpreting Art. 6.157(2) of the CC and the mandatory rules adopted and entered into force after the conclusion of the contract and during the performance thereof, a fair and balanced legal relationship must be established between the rules of the CC regarding the

binding nature of the contract and the rules of public law. The contractual obligations assumed by the parties to the dispute under the legal acts in force at the time cannot be completely denied or disregarded. Pursuant to the Constitution which protects business and property, including legitimate contractual expectations, Art. 6.157(2) of the CC and the mandatory rules adopted and entered into force after the conclusion of the contract and during the performance thereof cannot be interpreted so that the negative consequences of contract non-performance would be transferred only to the private business entity, or that an intervention, which effectively prevents the continuity of a lawful contract, into a legal relationship established by law and a lawful contract would be justified.

In the case examined in 2011, in which the issue of amending the lease agreement was raised by recognizing the grounds for applying the regulations of Article 6.204 of the CC, the Supreme Court also acknowledged that the burden of changed circumstances must be shared by both parties to the contract, and not just one of them. The courts did not comply with this principle in the cases discussed above since the negative consequences of contract non-performance resulting from changes in the mandatory rules adopted and entered into force after the conclusion of the contract and during the performance thereof were transferred exclusively to the private business entity, while the defendants were fully relieved of the burden of such circumstances by granting them the right to terminate contracts and releasing them from contractual liability for contract non-performance.

When settling disputes arising from a contractual relationship, ignoring the will of the parties to the contract and simply following the provisions of the law is the wrong approach. Pursuant to the case law of the Court of Cassation, the freedom to enter into contracts and the principle of the binding nature thereof (*pacta sunt servanda*) can be considered a guarantee at constitutional level (Constitutional Court of the Republic of Lithuania, 1996). The principle of freedom of contract is purposefully recognized and defended by the state – it gives meaning to the coordinated intentions of the parties. An agreement reached between the parties, formalized in accordance with the procedures recognized by legal acts, becomes a legally binding act and an important instrument of public self-regulation. This act (agreement) establishes rights and obligations. In order to achieve economic efficiency, the state undertakes to enforce these obligations by imposing a legal requirement to comply with contracts (*pacta sund servanda*) and, if necessary, by enforcing them through court. When settling disputes arising from a contractual relationship, the will of the parties to the contract must not be ignored and it is not enough to simply follow the provisions of the law alone, since a contract also has the force of law (Supreme Court of Lithuania, 2010).

The principle of protection of legitimate expectations presupposes the duty of the state, as well as of those exercising state power, and of other public authorities to comply with the obligations assumed by the state. This principle also means the protection of acquired rights, i.e. persons are entitled to reasonably expect that their rights acquired in accordance with the applicable

laws or other legal acts which are not in conflict with the Constitution will be maintained for a specified period of time, and may be actually exercised (Constitutional Court of the Republic of Lithuania, 2008; 2010).

For the purposes of state reform in certain sectors, in terms of essentially "cancelling" contractual obligations by law and transferring resulting negative financial burden exclusively to the private business entity, the authors believe that the law should provide for a mechanism for compensating the parties for negative consequences for the disproportionate violation of their legitimate expectations arising from the conclusion of contracts prior to the establishment of the law, otherwise this would mean a possible incompatibility of such a law with the Constitution, because such a situation would raise the question of compatibility of such a law with the principle enshrined in Article 7(2) of the Constitution which states that the law is not retroactive, the principle of inviolability of property enshrined in Article 23 of the Constitution, as well as the constitutional principle of a state under the rule of law, and the principle of proportionality.

In summary, a conclusion can be made that the case law of the Supreme Court of Lithuania regarding the interpretation and application of the rules of substantive law regulating the impact of changes in mandatory rules on contract performance does not actually identify the problems that arise, and Article 6.157(2) of the CC is not effective in dealing with such situations. Therefore it is considered that, when deciding the fate of a contract in the event of changes in the mandatory rules, it is necessary to look for legal measures that can best meet the interests of the parties and restore the balance of interests between them. This should depend on how the changed mandatory rules relate to and affect the performance of the contract concluded between the parties. In the absence of such a relation, it is considered that the changes in mandatory rules should be regarded as not affecting the terms and conditions of the contract. It should be noted that changes in laws are also an event beyond the control and foresight of the parties.

Conclusions

Situations in which the mandatory rules change after the conclusion of the contract may be classified as events that cause a substantial change in circumstances, as a result of which the further performance of the contract may become significantly more difficult or impossible. These situations are dealt with by applying the legal institutions of the impossibility of performance of the contract due to a material change in circumstances and the difficulty of performing the contract due to a material change of circumstances.

The German, French and English legal systems recognise that a party should not be liable for non-performance of a contract if performance has become impossible (physically or legally) due to unforeseen, insurmountable and external events. Despite the theoretical similarity, the practical application of the institution of *force majeure* may differ depending on the interpretation of the court terms "predictability" and "inevitability". The French courts have

set a relatively high threshold for unforeseen events, so if similar events have occurred in the past, it can be assumed that all future similar incidents will be considered foreseeable in the future. Another important aspect of events that the parties could not have foreseen and avoided is their effect on the fate of the contract. In both the German and French legal systems, the impossibility of performing a contract does not *per se* mean the termination of a contractual obligation. English law, in which the doctrine of frustration developed by the courts may release the parties from the obligation to perform the contract and compensate each other when performance of the contract becomes impossible due to a material change, the purpose of the contract fails and the change of circumstances delays or radically alters their content reflects a much more flexible approach to this phenomenon.

In Lithuanian civil law, in order to solve the problems of performance of contracts due to changes in mandatory legal norms, the Lithuanian legislator has established a separate provision. This provision enshrined in Article 6.157 (2) of the CC casts doubt on the effectiveness of the practical application of this norm, as taking into account the case law of the Supreme Court of Lithuania, it is not clear in which cases the parties could ignore changes in mandatory legal norms. The case law of the Supreme Court of Lithuania provides such an interpretation of Article 6.157 (2) of the CC that a change in mandatory legal norms after the conclusion of a contract does not affect the performance of contracts, must be interpreted and applied taking into account the changing or performing rather than concluding a contract. However, it is clear that this rule is not effective, so it is necessary to look for other legal measures that would restore the balance of the parties' contractual obligations in the event of a change in the mandatory rules, rather than shifting the full burden of negative consequences to only one of them. Otherwise, in the long run, the negative consequences of the change in the mandatory legal norms will have a negative effect on the state itself.

To answer the question of which legal institute to apply in the Lithuanian context, it is necessary to first analyse whether it would be possible, after changes are made in mandatory rules, to amend a contract in such a way that its further performance would be acceptable to both parties or, nevertheless, the only possible solution would be its termination. If a contractual party relies on changes in the mandatory rules, such change in legal regulation in the context of a dispute between contractual parties must be assessed in accordance with the special rules of law of the CC, regulating the grounds and procedures for exemption from liability and/or contract amendment in accordance with Articles 6.204, 6.212 or 6.253 of the CC.

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