

The Development of the General Latvian Contract Law after the Renewal of Independence and Future Perspectives in the Context of European Commission's Solutions for Developing Unified European Contract Law

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Abstract

The given publication presents a review of historical development of Latvian contract law after renewal of independence, the analysis enables not only to identify those improvements in contract law provisions that have been implemented as of today but to define more specifically the directions of development of Latvian contract law provisions in future. By analysing different legal terms, the article provides an insight into the improvements that have to be made putting emphasis, among other things, upon the role of the European Union in elaborating unified contract law. Although several amendments have been made in the Civil law during the last few years, thus improving legal regulation in the area of contract law, there are still some juridical problems that have not been solved by the law and that create not only problems in the theoretical but also in the practical work. Especial attention has been paid to the analysis of legal remedies, as, for, example, change of circumstances clause whose regulation is not provided in the Civil law.

Keywords: European contract law, European Union contract law, harmonization of contract law, EU Common frame of references, change of circumstances (hardship) clause, *pacta sunt servanda* principle, force majeure, exemptions from the binding force of contract, modernizing of the Civil law and contract law.

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Introduction

After renewal of Latvia's independence that marked a transition to a democratic state and market based economy a topical issue was the need for a corresponding regulation of contract law. In any free market economy a contract is the most frequent mode how people regulate their mutual property relations¹, and its aim is not only to achieve a certain specific and practical result in the interests of the contracting parties, but also to ensure clear-cut administering of civil justice, which after all has an essential macroeconomic role in development of the state economy.

1 Development of Latvian general contract law after renewal of independence

After regaining of independence of Latvia the opinions of legal scholars were uniform, namely, that 1964 Civil code of the Latvia SSR² will not be able to ensure those required needs that are determined by laws of free market³, therefore the work was begun to reinstate the regulation of civil justice of the pre-war Latvia⁴. On September 1, 1992⁵ the Civil law was partly reinstated but starting from September 1, 1993 it was reinstated fully before that passing separate laws that regulate the procedure of enacting the Civil law⁶.

Although the Civil law was reinstated, it had been adopted in 1937 based on the understanding of those times about regulation of the contract law. Besides, looking from a historical perspective, one should take into account that the Civil law that was reinstated and is in force now is not a new set of civil provisions that was created in 1937 but a set of improved civil legal provisions dating back to the 19th century⁷. Almost a 50 year break in operation of the Civil law that had to do with the loss of independence of Latvia, terminated development of this law and prevented it from improving it to correspond to the needs of the times. Also during the period of time from 1992–1993 when the Civil law was re-enacted, the provisions of this law were not actually either supplemented or improved. After reinstatement of the Civil law a continuous work of elaboration and enactment of special civil law was done, because such legal regulations as commercial activity law, competition law, safety of commodities and other areas related to contract law had to be developed completely anew.

Although the special contract law was designed in compliance to the latest scientific assumptions and understanding, regulation of general contract law was neglected⁸. 15 years after the Chapter on Obligation Rights of the reinstated Civil law came into force⁹, which to a large extent regulates general civil legal issues, one must admit that the world is changing and even good laws cannot be everlasting¹⁰. Civil law as a branch is incessantly supplemented with important acts that reflect new trends and problems.

The events of the last decade in view of updating and unification of contract law of the world and Europe¹¹ as well as the fact that the Civil law of Latvia to a large extent is a reflection of legal thought of the 19th century and even of earlier times, makes the legal scholars of Latvia foreground the question: whether Latvian contract law complies to the latest demands and changes of contract law?

A big contribution in modernizing of contract law can be made by adoption of Part D of the Commercial law which will regulate commercial transactions. Although provisions of commercial activities will be improved and updated, these innovations will refer only to one part of society – to individual merchants. Besides,

many issues that are regulated by the Civil law of the Republic of Latvia will not be included in the new part of the Commercial law¹².

At the age of harmonization of Commercial law when in a comparatively short period of time several documents systemically unifying principles of commercial law have been developed (UNIDROIT Principles¹³, European commercial law principles¹⁴, European Contract Code¹⁵, Draft of common frame of references¹⁶ henceforward – DCFR) and others), a particularly topical is the issue about improvement of contract law in Latvia taking into account unified understanding of European contract law and contents.

Taking into account integration of Latvia in the European Union and hence also in the system of common understanding of European law, development of Latvian contract law in future cannot take place ignoring common activities in improvement of European contract law.

The beginning of a purposeful elaboration of unified European contract law dates back to 1982 when European Contract Law Commission was established whose work resulted in Principles of European Contract Law (henceforward – PECL), finding a compromise among conceptually different legal systems – the legal system of continental Europe that includes most of the EU members states and the Anglo-Saxon legal system based on case law that dominates in Great Britain. European Contract Law Commission continued its work till 2003 when all the three parts of PECL were finished. To continue the work of the European Contract Law Commission the Study Group on a European Civil Code was set up (henceforward SGECC)¹⁷, taking as its basis PECL. It must be noted that during its activities SGECC has expanded its initial tasks and works out much more extensive ECC that includes not only the contract law principles but also regulation of separate contracts and even regulation of separate sectors, as for instance, family law¹⁸, Principles of European Sales Law¹⁹, which regulates all the legal issues concerning purchaser and seller including the duties of purchaser and seller, civil legal remedies, adequacy of goods, risk transfer and others. As the last novelty in working out unified European contract law one should mention DCFR that has been elaborated by renowned civil law scholars. Although DCFR is still at a draft stage and has been delivered to public discussion only in January 2008 (with supplements in 2010), yet their elaboration is an additional step in creating unified understanding of contract law which ultimately can lead to working out unified and modern provisions regulating contract law both in each individual European state including Latvia and in the whole of the European Union as well.

The above mentioned documents are a considerable step towards formation of unified understanding about European contract law but it should be noted that for the time being it is only an academic type of material which in the legal relations between the parties as a source of law is applicable only if the parties have agreed on that in their contract. Thus the uncertain status of the mentioned documents is not a secure help in successful implementation of the four EU freedoms – freedom of movement of goods, services, capital and persons. Yet taking into consideration the European Union role in improvement and harmonization of contract law, DCFR is to be considered as the most serious achievement for reaching this goal. Participation of official institutions in its elaboration places it on a higher level than all the previous attempts to create unified European contract law that were based only on academic initiatives.

2 Historical background for elaborating DCFR

The first official appeal to create unified European contract law was expressed in the 1989 resolution of the European Parliament (henceforward – EP)²⁰, as well as later in the resolution of 1994²¹. It was indicated in the resolutions that harmonization of separate areas of private law is essential for ensuring functioning of internal EU market. Since the mentioned appeal was not supported by the European Commission, the European Parliament started a research about the given issue and submitted to the European Commission in 1999 a report on necessity of harmonization of private law. The mentioned document served as the basis for the resolution adopted by the EP in 2000²², in which the EP appealed to the European Commission to start a study about the question of European contract law harmonization.

Referring to this appeal in 2001 the European Commission presented a document under the title “Communication of European contract law”²³ that started so far the largest discussion on development of unified contract law principles with participation of governments, professional organizations, practitioners and legal scholars.

To ensure a successful operation of a large economic organization, unified principles are needed whose concord refers not only to their contents and form but also to their application. The existing differences among legal systems of EU member states may be a considerable obstacle for successful functioning of the internal market. That is to be associated not only with the condition that existence of different legal systems in different countries may not only decrease the wish of individual merchants to start cross-border trade²⁴ but also with the fact that parallel activities in different legal environments requires larger resources – the national imperative provisions must be brought in compliance with those that may differ in different countries (restrictions of the principle of freedom of contract); different provisions of concluding, fulfilling, terminating and other provisions must be observed. The United Kingdom Parliament elaborating a report on development of the European contract law has indicated that “lack of knowledge about other countries’ legal systems is an essential obstacle especially for small and medium small enterprises and for consumers”²⁵. Evidence for that can be found in the existing differences among EU member state contract law²⁶. For example, if in France, Belgium, Spain and Luxemburg the debtors’ domicile is considered to be the place for making of payments, then in some other member states it is the creditor’s domicile. While in Latvia the mentioned issue has a third solution because Section 1820 of the Civil law of the Republic of Latvia²⁷ provides that if nothing has been agreed regarding the place of performance then the performance may be requested or offered at any place where it can be provided without hardship or inconvenience to the other party. Likewise differences can be identified in concluding the contract between the parties who are not present.²⁸

Since such differences hamper creation of unified understanding about contract law in the European space, the aim of “The European Contract Law Communication” is to resolve the above mentioned problems, creating unified basis of European contract law²⁹.

To find the best solution for achieving the set goal, the European Commission proposed four options of action and submitted them for public discussion: (a) not to do anything, thus leaving it all for market economy, (b) to elaborate unified contract law principles thus decreasing the differences among national legal systems, (c) to improve quality and harmonization of the existing EU legal acts, (d) to adopt

a new legal act on the level of the EU which would regulate contract law of all the member states³⁰.

Option number 1 of the action that was to leave the resolution of the mentioned issue in the competence of enterprises and merchants without participation of the EU institutions did not receive support and was rejected motivating it by the fact that the merchants and enterprises do not have the capacity of resolving the contradictions that are caused by the differences among national laws (see the reference of the International Chamber of Commerce to "Communication on European Contract Law"³¹). European Contract Law Commission and the SGECC had similar arguments indicating that cross-border market economy cannot create unified principles of European contract law on which further progress depends³².

Much wider support was gained by options 2 and 3 of the action plan. Option No. 2 proposed to identify the common elements of national contract laws taking as a basis four points of reference:

- 1) to the national legislators when elaborating new legal acts;
- 2) to the national courts in cases of resolution cross-border disputes;
- 3) to merchants when cross-border contracts are concluded.

In legal science the above mentioned approach is called a Restatement option whose designation has been borrowed from interpretation of the USA Laws³³. The second option of activity envisages to elaborate a document similar to Interpretations of the USA Laws and even though they would not be binding and would not apply to a specific legal system they would still classify common legal frameworks, language and terminology, which would considerably make it easier for merchants to draw up cross-border contracts and for the EU institutions to work out new directives.

As the basis of the second option of activity PECL was mentioned, although it was indicated that it is necessary to move on from general formulations to identification of specific regulations of contracts³⁴, and even to creation of common European civil law³⁵. The criticism of the second option was directed at its goal to create non-binding principles of European contract law. Since they would have a recommending character they could be ignored, which would mean that working out of unified commercial law would be considerably encumbered.

The third option of action proposed revision and improvement of the binding EU normative regulations making them simpler and improving their quality. It was pointed out that that the most essential obstacle in for the future harmonization of the European contract law are the existing incompatibilities on the level of EU directives³⁶, which are manifested in two ways:

- 1) member states have integrated the EU directives into their legal acts differently;
- 2) there are contradictions and ambiguities within the EU directives themselves.

In the first instance differences have originated because the EU directives stipulate the minimum standard that must be fulfilled by a member state. In the area of consumers' law separate EU member states have provided for a higher degree of consumer protection. For example, Article 6 of the Distance contract directive³⁷ stipulates that the minimum time during which the consumer may use the rights of refusal is seven days while Article 14 of the Directive grants to the member states the rights to define a longer period. This is the reason why different EU member states have different regulation: in Belgium, England, Spain and the Netherlands

this period is 7 days but, for example, in Italy it is 10 days³⁸, while in Latvia as well as in Germany these rights can be used within 14 days³⁹.

In the second case there are differences and incompatibilities in the EU directives themselves. Firstly, lack of harmonization is found in the directives regulating one field. For example, if Article 6 of the Distance contract directive provides for a consumer the rights of refusal within 7 days, then Article 5 of the Directive on the protection of purchasers in respect of certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis⁴⁰ stipulates that rights of refusal may be used within 10 days from the moment of signing the contract (in Latvia a different period has been stipulated – 14 days⁴¹).

Secondly, incompatibilities refer to the legal terminology used in the directives, for instance “damage”. In accordance to Article 5(2) of the Directive on shipment of goods⁴² the carrier has the duty to be responsible for the damage caused to the consigner but the Directive does not define if moral damage is also included. Majority of the EU member states by implementing the provisions of this Directive in their national legislative acts have been guided by the national contract law regulation, as a result the consigner can also claim compensation for moral damage⁴³.

Such a discrepancy creates several problems. The first is that in different EU member states the directives entail different legal effects or looking from the opposite perspective in different EU member states different civil legal remedies and mechanisms of their application can be used. On the one hand one may say that the aim of the directives is to set minimum standard that must be implemented by the member states but on the other hand different legal effects can hardly facilitate creating a unified market which in its turn impedes free movement of goods in the broadest sense of the word.

Because of the different regulation of the directives there are problems in their application. If a dispute arises on application of a directive then its implied meaning and aim can be clarified guided by the specific directive or by the EU law at large. By logic there should be no differences because the specific directive is part of EU law. But since the specific directive and the dispute about it always concerns an EU member state then by interpreting the directive the national legal system of the EU member state in which this directive has been transposed must be taken into account.

The 4th option was a proposal to elaborate a new legal act on the EU level which would regulate the mutual contract law in cross-border relations of the parties. The basis for this legal act could be the legal provisions developed in future by PECL, CECL as well as SGECC transforming the mentioned documents into unified European civil law and granting to this new legal act normative force in the entire EU. This variant of action stipulated direct impact by the EU institutions upon the national legal systems.

Summarizing all the opinions about “Communication on European Contract Law” the European Commission published in 2003 the next document “A more coherent European contract law. An action plan”⁴⁴, in which it offered the subsequent action plan to elaborate unified European contract law⁴⁵.

The basis of the action plan was a further development of action options 2 and 3 which consisted of three tasks:

- 1) the improvement of the existing EU normative acts in the field of contract law;
- 2) activate elaboration of standard provisions for EU contracts;

- 3) further support of elaboration of unofficial documents of European contract law.

Although elaboration of a new European Civil Code is rejected for the time being and the Commission has even characterized it as “an unrealistic goal”⁴⁶, still activities in this sphere are to be expected because it would help to implement the tasks of the 2nd and 3rd activities in a better way.

In order to achieve the tasks set in the action plan the Commission undertook to develop the above mentioned Common frame of reference⁴⁷, whose goal will be establishing of unified legal terminology and the basic concepts (principles) of jurisprudence, as, for example, definition of loss, legal consequences in case of breach of a contract and so on. The second goal of the Common frame of reference is to create a basis for future European contract law.

In the meetings of the working group on elaboration of the Common frame of reference in 2003 their contents was expanded, including such issues as conclusion of a contract, conditions under which an expression of will is regarded as binding, provisions about the form of the contract, use of rights of refusal, prescriptive period, regulation on breach of contract and compensation of losses, the scope of authority of representatives, determination of liability and its scope as well as the methods by which acceptance of standard agreement is established. After the work of several years the Common frame of reference or DCFR is available for discussion and anyone can evaluate its adequacy and necessity for developing unified European contract law. But the public discussion has not been planned for long because approval of the final text has been planned already for 2009.⁴⁸

As indicated by the legal scholar O. Lando, the Common frame of reference must provide solutions in those instances when the EU directives or some other EU legal acts create uncertainties⁴⁹. One should agree that in case of inadequacy of the EU legal acts an additional source is needed but given the unclear status of the Common frame of reference (for the time being, it has not been planned that it would be binding to the member states), one must conclude that the task put forward by the European Commission may not reach the expected goal.

3 The most essential contract law innovations of DCFR

DCFR submitted for public discussion regulates the main issues of contract law paying especial attention to regulation of separate special types of contracts.

The authors of DCFR or Common Frame of Reference finished the work at it only at the end of 2008 while the full text of their work that includes examples of legal acts and practical materials from member states was published only in 2010. The authors of DCFR Project emphasize that one of the aims of developing the frame of reference is “to serve as a draft sample for developing “political” Common Model”⁵⁰

Despite the fact that the provisions included in the DCFR to a large extent originate from the guiding principles of the European contract law⁵¹ that have also been included in the DCFR project in a revised form⁵², one cannot deny that the DCFR project's scope is to be considered wider. Mainly because the DCFR draft includes rules concerning specific types of contracts, which according to the authors of the DCFR “expand and make more detailed also the general rules”⁵³. Thus it is important to emphasize the topicality of the rules included in the DCFR draft, taking into view not only the fact they were developed recently but also the included changes within the context of the guiding principles of the European contract law⁵⁴.

In view of the fact that DCFR will be to a large extent the basic document for development of unified contract law, which is confirmed, among other things, by the Green paper of the European Commission⁵⁵ “On policy options for progress towards a European Contract Law for consumers and businesses”⁵⁶, it is essential to examine the innovations of DCFR in the area of contract law. A large part of the most progressive innovations in the area of contract law have been summarized in the Principles of the European contract law and many of these innovations have been analyzed previously in the legal literature⁵⁷, hence the attention in the context of the present article will be focused more on the most topical and innovative principles of contract law thus providing an insight into the development of contract law theory during the last few years.

As one of the most significant differences compared to the Civil law of Latvia and DCFR, the setting in of in the case of absence of will at the moment of concluding the contract must be mentioned. Chapter 7:101 of the DCFR Book II indicates two separate grounds for considering the contract invalid. Similarly to the Civil law they are as follows:

- 1) absence of will (duress, mistake or fraud) and unjust use;
- 2) violation of imperative principles.

The first one of the grounds reflects a situation that in the understanding of the Civil law is to be classified as lack of will and is regulated in the third sub-chapter of Chapter 1 on the obligation rights of the Civil law, while the question on unjust use is not to be found in the Civil law.

Unlike the Civil law DCFR provides that a transaction is in force till the moment when the injured party uses its rights of reversal (see Chapter II.7:212), which means that the contract does not terminate by itself but relative validity applies to it.

The second case of exception of validity of the contract relates to unlawfulness of the contract if the imperative provisions of the contract are not complied to. In this case deficiencies in expressing the will by the parties may not be identified but despite that it is unlawful for some other reasons. As also indicated by Professor K. Torgāns, the General Model in addition to the already known grounds of lack of validity stipulates also the use of dishonest circumstances⁵⁸.

In accordance to the provisions of the Civil law in those cases when elements of duress and mistake are identified, there arises a solution when in one case the contract would be invalid already initially, while in another one it is contestable⁵⁹. Concerning duress Sections 1445, 1447, 1452 of the Civil law provide for cases when duress eliminates all the force of the transaction, namely, they are invalid transactions. Also in the case of physical force in accordance to Section 1463 of the Civil law the transaction is to be considered as invalid if the person's intent cannot be identified⁶⁰. In the case of mistake and fraud Sections 1461 and 1468 of the Civil law provide that the transaction is contestable.

In DCFR, unlike the Civil law in regard to lack of intent invalid and contestable transactions are not singled out separately. The same approach can be seen in the Principles of European contract law where the lack of intent is one of the grounds to grant the rights to the injured party to recognize the contract as invalid by sending the corresponding notice to the other party (Section 4:112)⁶¹. DCFR regulation (Section 7:209) provides for an identical regulation. The procedure of sending such a notice is regulated by the general rules on notice in DCFR (Section 1:109). In accordance to these rules the moment when the notice comes into force is stipulated similarly in the Civil law⁶², with the so-called “mail box principle”, whose essence

is not the moment of expression of intent but the moment when it reaches the addressee (an exception is sending of notice to a merchant when there are special regulations)⁶³.

Thus, for the contract to become invalid in case of absence of expressed intent, in accordance to DCFR the court ruling is not necessary, the very fact of sending a notice is the grounds for the rights to consider the contract nullified and not to honour the contract. Such a solution can be found also in contract law of several European Union member states, for example, in German law the force of a transaction is eliminated by a unilateral expression of the empowered person⁶⁴, in Netherlands' law the transaction validity is revoked with an out-of-court notice or a court judgement⁶⁵, according to Polish law it is possible to avoid the transaction with a unilateral written notice⁶⁶, also Estonian Civil code of 2002⁶⁷ provides for avoidance by submitting a unilateral notice to the other party.

According to the Civil law in those cases when a transaction is contestable (mistake, fraud) contesting of the transaction takes place when the authorized person brings action in the court and the contested transaction can be recognized as invalid only by a court judgement⁶⁸. Till passing of the judgement such a contract must be formally honoured⁶⁹. A similar approach exists, for example, in Greece⁷⁰, France, Belgium and Luxemburg⁷¹, where, in case such a notice is not accepted by the opposite party, intervention of court is necessary in order to nullify the transaction⁷².

DCFR stipulates that the notice on loss of validity/non-acquisition of force of the contract must be notified to the opposite party in a reasonable time when in view of the specific circumstances the party that avoids the contract found out or it would be reasonable to believe that it should have found out about the respective circumstances or after it got a possibility to act freely (II. Section 7:210)⁷³. In order to ensure confidence in transaction security⁷⁴, a restriction is necessary that the rights to avoid the contracts are granted to the parties after a reasonable period of time after they have found out or they could have found out about the respective circumstances (and not that merely existence of such circumstances grant the rights to avoid from the contract) or have got free from the other party's fraud or unfair impact⁷⁵.

The approach defined in DCFR when legal effects, irrespective of classification of lack of intent, are more well-founded compared to the provisions of the Civil law. Also Prof. K. Balodis, commenting the regulation in the Civil law, has indicated that a more suitable solution would be a solution according to which in the case of duress, mistake or fraud the transaction is contestable⁷⁶. Such an opinion is well-grounded because the parties to the transaction are granted rights of choice – to challenge the transaction or not, at the same time entrenching the principle of freedom of contract. The interests of society cannot be the grounds for intervening into the mutual private relations of the parties, dogmatically recognizing the transaction to be invalid already initially. It is opposite in those cases when the circumstances of concluding the contract and its substance are incompatible with the fundamental principles of a legal system⁷⁷.

As an additional innovation in modern contract law one must mention the rights to derogate from the principle of the validity of the binding contract in those cases when the term of agreements has not been set.

In accordance to Book III of DCFR III, the second part of Section 1:109 in case of contracts that are associated with long-term or periodic execution, the parties are granted the rights to step back from the contract by submitting a unilateral notice.

It follows from the principle that contractual relations even if they are stipulated as termless can be terminated if neither of the parties can be bound with the other one for infinite time⁷⁸. To terminate such relations the party must submit a reasonable notice about it⁷⁹. Such a situation is possible only if the contract does not stipulate the period of its validity or it has been regulated as termless⁸⁰. Correspondingly such rights cannot arise in the cases when the contract stipulates a fixed period of its validity or a specific term for its termination, for example, a six month period for submitting a notice. In case the contract prescribes a period for submission of a notice, the contract itself can be considered as termless, and yet it contains solutions how to forestall it. Thus if it has been prescribed not only when the contract terminates but also how the termination process is executed, from the position of the above mentioned provision it is to be considered as a terminated contract. This refers also to the cases when the contract has been concluded for a period of time, for example, till a certain events occur or a certain other goal is achieved. Thus in every instance when the end of validity of such a contract is associated with a certain event that can occur in reality, the contract is to be considered as nullified and cannot be terminated on the grounds of the above commented provision⁸¹.

The authors of DCFR indicate that also in the cases when the contract has been concluded for “reasonable time” it can be interpreted in the context of the corresponding circumstances⁸² and can be considered for a specific period of time, as a result it will not refer to the regulation of the above commented provision.

Also in this case, similarly to the rights of refusal from the contract if there is a lack of intent, by sending to the other contracting party a notice if the term of validity of the contract has not been specified, the expression of the will to step back from the contract must be sent in the form of a notice that acquires validity according to the “mail box principle”.

As the next essential regulation in the future European contract law must be mentioned a change of circumstances clause which is based on the doctrine according to which the civil legal liability does not set in for a person for non-fulfilment of the contract. Two principles are confronted at the basis of such a doctrine. One principle stipulates the binding force of the contract (*pacta sunt servanda*), according to which contractual obligations must be fulfilled irrespective of any changes of circumstances after concluding the contract, while the other one is the principle of the goal of the contract, i.e., that by concluding the contract the parties have entered legal relations given the circumstances that existed at the moment of concluding the contract and not the subsequent circumstances (*rebus sic stantibus*)⁸³. Legal theory recognizes that in separate instances there exist exemptions from the duty of honouring the contract. Yet certain circumstances must exist for the party to refer to this doctrine and not to fulfil the obligations undertaken by signing the contract.

Looking from a historical perspective it must be concluded that the Roman law did not include the clause *rebus stic stantibus*, yet its motivation was found by the lawyer Afrikan (*L.38.pr.D. de Solution; Ius et libertionibus* 46.3), who pointed out that if “someone gets a promise that something will be given to him, it would be right to decide, that the third persons have to pay him, when the latter would be in the same state as he was when the stipulation (conclusion of the contract) happened”⁸⁴.

In contract Law of Latvia similarly, for example, to Czech Republic but unlike the neighbouring countries Lithuania and Estonia and a number of West European

countries there is no legal regulation of unexpected circumstances clause, taking into consideration that in Czech Republic this issue could be solved via the good faith principle⁸⁵.

The clause that under certain circumstances gives rights to step back from the principle of the absolute force of the contract historically was not recognized, it was associated with the school of natural law that maintained that the clause encumbers both the legal system as well as the economic life because any contract could be contested with its help. Changes in this view were caused only by World War I, after it began the so-called *Loi faillot* principle was adopted which provided that in regard the trade transactions concluded before August 1, 1914 the contracting party can postpone execution of the contract or to refuse from it if it can prove that a subsequent fulfilment of the contract will lose sense. A similar view existed also in Russia. Article 92 of Part II of the Civil Code draft determined that “the change of circumstances was even so important that the contracting parties would not have entered into the contract, if they had known about it, in conformity with the general law it can not serve as a basis to terminate the contract.”⁸⁶

In the course of time when industrial society developed and an increasing role was played by scientific achievements, situations emerged when a contracting party could not refer to *force majeure* (obstacle) in fulfilling obligations of the contract because science reduced the number of those obstacles that could not be overcome. For example, if earlier a thunderbolt would have been considered to be *force majeure* then today in most cases this obstacle can be overcome with the help of a lightning conductor. If in the past floods were *force majeure* then today there are technologies that allow theoretically protecting specific regions with ramparts. Thus due to science there are fewer obstacles that are unsurpassable. In view of the fact that one of the elements that defines *force majeure* is that the obstacle cannot be overcome⁸⁷, then in all the cases when the obstacle can be overcome, reference to the *force majeure* clause is impossible, even if the encumbrance for the contracting party to fulfil the contract is as large as in the case of *force majeure*.

In view of this situation the change of circumstances clause was introduced in the European contract law that in separate cases mitigates the principle *pacta sunt servanda*. This is demonstrated also by the latest academic studies that include contract law principles, as, for example, the Principles of European Contract Law⁸⁸, UNIDROIT principles⁸⁹, DCFR⁹⁰ and others.

In accordance to regulation of Article 1:110 Book III of DCFR performance of a contractual obligation becomes so onerous because of an exceptional change of circumstances that it would be manifestly unjust to hold the debtor to the obligation. In such a case the court is granted rights to vary the obligation in order to make it reasonable and equitable in the new circumstances or terminate the obligation at a date and on terms to be determined by the court.

The reason to define such an exception (clause) is associated with the circumstance that in contract law the mutual relations between the parties are not to go beyond the borders of fairness⁹¹, i.e., a formal theory on the binding force of the contract irrespective of consequences is not to be more important than ensuring fairness because as mentioned before, the purpose of law is to protect person's interests in their equal relations with other persons⁹². While the other argument in favour of this clause in legal theory⁹³ is the fact that it is impossible to take the risk (risk of change of circumstances) that is impossible to predict.

Change of circumstances clause is similar to the clause of forecast of losses, they both have the same fundamental principle – a person cannot be required to fulfil obligations whose substance could not have been foreseen at the time of concluding the contract.

Proceeding from this basic position, it must be noted that the person will not be able to refer to the change of circumstances clause if the change of circumstances is caused by the activities of the person or subjective impossibility⁹⁴. This is determined with a test during which the judge verifies if the changes of circumstances that have occurred are objective, i.e., whether by placing instead of the transgressor any other member of society, the impact of the change of circumstances would be the same as for the transgressor, i.e., that the contents of the contract to be fulfilled has objectively changed irrespective of the subject of the contracting party. Yet it must be noted that impossibility in the understanding of this clause is not equal to impossibility of fulfilling obligations (insurmountable obstacle). The difference between the two impossibilities lies in the fact that in the case of an insurmountable obstacle the obligations cannot be fulfilled at all, while in the second case fulfilment of the duty is possible but it is too cumbersome and unjust. The borderline between a situation when fulfilment of obligations is impossible due to an objective obstacle (insurmountable obstacle) and when it is impossible because it would require too big resources from the debtor, can be determined only by a court⁹⁵.

It is important to add that the clause of change of circumstance is not applicable when the person undertakes the natural contract advantageousness risk. For example, a person cannot ask to begin negotiations about changes in the contract if the goods purchased by the importer have no demand in the local market or competition has increased in the market that could have not been foreseen.

DCFR regulation provides for a somewhat different approach from the one stipulated in Section 6:111 in the Principles of European Contract Law. The Principles of European Contract Law stipulate first of all the duty for the parties to hold negotiations with an aim to adjust the contract or to terminate it. As a result of non-fulfilment of this duty the party that has refused to enter negotiations or terminated negotiations contrary to good faith, could have the duty of compensating the loss that the other party suffered resulting from it. The authors of DCFR have taken into account criticism voiced by the interested parties that such a procedure is to be considered as undesirably complicated and cumbersome. Mainly the argument was taken into consideration that the creditor in his obligations can act as a fiduciary and therefore be placed in a complicated conflict of interests situation if there is a provision imposing on him the duty to agree to refuse from a certain benefit⁹⁶. Therefore DCFR does not provide the duty to both parties to get involved in negotiations process any more, it merely provides for the debtor the duty to try to achieve reasonable and just adjustment of obligations by way of agreement in good faith⁹⁷. The possibilities of application of circumstance clause in such a narrower sense must be evaluated ambiguously because by discarding the duty to enter negotiations on changes of substance of the contract and compensation of loss resulting from it and if such a duty is not fulfilled the preventive force of civil legal remedy is reduced. Namely, the person loses motivation to continue negotiations about changes in the contract if the law does not provide for negative legal effects. On the other hand, the argument that formal holding/non-holding of negotiations in itself cannot be a precondition for defining the activities of a party as lawful or unlawful.

The necessity for inclusion of the change of circumstances clause in the Civil law is not changed by the condition that the legislator has rejected the planned amendments in the Civil law in their initial edition because non-adoption of the amendments does not change the regulation of the Obligations part of the Civil law, and neither does it revoke the good faith principle laid down in Section 1 of the law. It must also be noted that the process of discussing the draft law shows that the legislator did not agree about an acceptable edition of the provision – the proposal to amend Section 1587 of the Civil law by supplementing it with provisions of Section 6:111 of PECL was conceptually supported in the first reading, it was considerably modified in the second reading and eventually in the final reading it was deleted from the draft law. Thus even though unlike the initial draft the change of circumstances clause was not included in the final edition of the amendments of the Civil law approved by the Saeima it is necessary to return to this question in future as fast as possible once again, setting inclusion of change of circumstance clause and other modern contractual obligations principles as the nearest task of the legislator and legal scholars, by that ensuring compliance of Latvian contract law to the latest trends of European contract law, which ensures just application of the *pacta sunt servanda* principle.

4 Future development of DCFR and European contract law

Although DCFR has not yet been granted an official status it is expected that in cooperation with legal scholars the European Commission will arrive at a final edition of the text of the document in the nearest future establishing its status legally. It is yet not known in what way DCFR or the Common framework will function but an approximate direction of its development can be inferred from the Green Paper of the European Commission⁹⁸ “On Policy Options for Progress Towards a European Contract Law for Consumers and Businesses” and from the comments received from public. The aim of the Green Paper is to start public discussion, to collect opinions on policy options in the area of European contract law. Differences among contract law of states incur additional costs of transactions and facilitate legal uncertainty for businesses and consumers therefore the European Commission has defined and is offering in the Green Paper for evaluation several solutions in regard to the future of legal character of the European contract law instrument, its scope of application and its scope of substance. As for the legal nature of the contract law instrument it is indicated in the Green Paper that the European Contract Law instrument could be both a non-binding instrument whose aim is to improve consistency and quality of legal acts of the European Union, as well as a binding instrument as an alternative to the existing diversity of contract law regimes in various states offering one set of provisions for contract law.

319 comments about the future ways of harmonization of the European contract law proposed in the Green Book were received from the European Union states, institutions and private persons⁹⁹. The Cabinet of Ministers of the Republic of Latvia on February 8, 2011 also expressed its position about future improvement and harmonization of the European contract law¹⁰⁰.

Latvia considers as the most suitable from the different solutions of problems of contract law mentioned in the Green Paper the Regulation by which the Optional Instrument of the European Contract Law is created (“*the2nd regime*”), which would exist in each member state along with the national regulation. Latvia emphasizes

that by developing such an instrument it will ensure a high degree of protection of rights, it must be sufficiently clear to an average user and it must be as independent as possible so that when it is applied the probability that the national regulation would have to be applied in regard of a certain issue would be excluded to a maximum degree. Latvia also holds a position that the choice of the instrument to be applied is left to the consumer and not to the supplier of goods or services. It is additionally emphasized that it is necessary to continue discussions on interaction of the Optional Instrument of the European Contract Law with other instruments of European private law.

Latvia does not see a significant added value of the different solutions of contract law mentioned in the Green Paper by developing an official set of set of instruments for the legislator or in the proposal of the European Commission on European contract law.

Latvia holds the view that developing of a directive on the European contract law in regard to all the contract law (B2B, B2C or C2C) is not to be supported because harmonization of all the areas of contract law in the member states is not a proportional solution to achieve the goal defined in the Green Paper. While application of the directive on European Contract Law on relations between enterprises and consumers (B2C) would not ensure a significant added value because a number of directives have already been adopted in this area which still do not entail unified enforcement and interpretation of provisions set out in them.

Regulations by way of which European contract law adoption might be achieved, could be considered by Latvia only in regard the regulation between enterprises and consumers (B2C).

Likewise Latvia does not support the Regulation with which European Civil Code is established, because harmonization in all the member states of all the areas of contract law, of delict and relations that follow from unjust enrichment is not a proportional solution to reach the goal set in the Green Paper.

As for the scope of application of European contract law the government of Latvia has expressed an opinion that in case the Optional Instrument of European Contract Law is going to be developed as a Regulation, Latvia is inclined to support its application both to contracts between enterprises, as well as to contracts between enterprises and consumers because the problems caused by differences in contract law as identified in the Green Paper are observed in both these areas therefore are to be solved in a complex way. Yet the Optional Instrument of European Contract Law should be applied only to cross-border transactions (including transactions concluded online) because an instrument that would be applicable both to cross-border and domestic consumer contracts could cause problems both for consumers and the transactions between enterprises.

As for the material sphere of application of European law, the official position of Latvia is that the material scope of application of the Optional Instrument of European Contract Law must be sufficiently wide – embracing all the aspects of contractual relations – starting from the pre-contractual relations and ending with liability for breach of the contract. Thus by developing the Optional Instrument of European Contract Law the legal environment would not be made complicated and no problems in its application would be generated because by applying a wide instrument a probability would be excluded to the maximum that the national regulation would have to be applied to some issues¹⁰¹.

A similar position is held by the EU European Economic and Social Committee (plenary session 468 on January 19 and 20, 2022, promulgated on March 17). From different solutions proposed by the European Committee, the Committee gives preference to a mixed solution which provides for reduction of costs and for legal certainty by setting up

- 1) “a set of instruments”, i.e., the unified model offered to the parties for elaboration of transnational contracts and that are consistently updated;
- 2) optional legal regulation by which the most favourable foundation is developed for the parties using “new, progressive optional regulation” to which they can refer in transnational contractual relations instead of referring to the national provisions as long as the “set of instruments” and the Regulation are available in all the languages of the Community, and on the basis of more progressive methods of legal remedy ensure legal certainty to population and enterprises.

Such a regulation does not prohibit member states to enforce more stringent activities of consumer protection.

Despite the long-lasting efforts of the European Union developing unified contract law, apart from public discussion of DCFR, the work is being done to develop the basic positions of European contract law. On April 1, 2010 the European Commission established an expert group whose task is to develop the fundamental principles of European contract law taking as the basis DCFR¹⁰². The materials developed by the above mentioned expert group will be used as the basis for beginning harmonization process already on a political level¹⁰³.

Although as of today a decision has not been made on the European Union level about a clear direction in developing unified European contract law, further harmonization processes of law are to be expected in the nearest future which in future will have a direct effect upon regulation of contract law in Latvia. The task of legal scholars in Latvia is to follow the latest trends of development of European contract law and to participate actively in further development of unified European contract law.

Summary

The article presents an analysis of historical development of contract law in Latvia providing an insight into not only reinstatement the Civil law after renewal of independence but also identifying the most essential innovations in regulation that have been adopted to improve regulation of contract law in Latvia. Particular attention has been devoted to activities of the European Union in order to develop common and unified contract law, including the analysis of the most significant achievement in developing unified contract law – the Common frame of reference. The mentioned non-binding regulation of contract law has been analysed in the context of the substance of contract law in Latvia providing an insight into state of affairs in contract law in our country and at the same time putting forward proposals about the areas where contract law in Latvia should be still modernized.

An approximate trend of harmonization of European contract law can be inferred from the European Commission Green Paper “Policy Options for progress Towards a European Contract Law for Consumers and Businesses” whose aim is to begin a public discussion to gather opinions on possible policy solutions in the area of European contract law.

Despite the long-lasting efforts of the European Union to develop unified contract law, it must be noted that apart from elaboration of the Common frame of reference or DCFR, the work is being done to develop the basic positions of European contract law which is done by a group of experts established by the European Commission with an aim to develop the fundamental principles of European contract law using DCFR as the basis.

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- ⁴ Unlike Lithuania and Estonia that worked out entirely new Civil law, Latvia re-enacted its 1937 Civil law. The reason for such a difference was the fact that neither Lithuania, nor Estonia had its national Civil law.
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