As per 01 April 2020

Implications of the Corona Pandemic for Contracts under German Law

In this memorandum, the implications of the corona pandemic for the most common contracts between companies are discussed. The "performing party" is the party who provides the main service (i.e. delivers the purchased goods, performs the works, rents the premises), while the "receiving party" is the party who receives the main service and pays the remuneration.

In the following, the various claims and options for action (damages, rescission, discontinuation of the basis of the transaction, etc.) are first explained in general terms; under Sections 2 et seq., the consequences of this for the individual types of contract (purchase agreement, contract for work and services, commercial agency agreement, etc.) are then clarified by means of examples.

The consequences of the corona crisis on the claims and obligations of the contracting parties depend on the circumstances of the individual case, namely on the agreed contractual clauses. As a result, the outcome of any subsequent litigation is often difficult to predict. However, the following explanations at least make it possible to assess whether one's own legal position is strong or rather weak and how one should act to improve this position. If you know the arguments that strengthen your own contractual position, you can use them to reach an advantageous agreement which is usually more favourable than many years of legal proceedings.

1. PRINCIPLES

1.1 Damages

If the performing party is unable to perform its services (impossibility) or only performs them late, the receiving party is liable for damages unless it can prove that it is not responsible for the impossibility or the delay (impediment to performance). The performing party is responsible for its own fault as well as for the fault of third parties it uses to perform its services.

So if the performing party cannot deliver at all or not in time due to the effects of the corona pandemic, the question arises whether this is due to the fault of the perform-

ing party. This is not the case if the performing party can neither foresee nor avoid the impossibility or delay. Hence, it depends on the specific case. Anyone who cannot deliver a machine on time due to corona is not excluded from liability from the very beginning. Rather, the question arises as to what he could have done to avoid the delay nevertheless, for example by relocating production to less affected countries, switching production (fewer employees present at the same time, but two shifts instead) or replacing suppliers. On the other hand, the performing party may even be liable for intent, for example if the closure of its business was based on an entrepreneurial decision. So ultimately it depends on the circumstances of the individual case whether the performing party is liable for damages or not.

Frequently the question is asked whether the corona pandemic is a case of "**force majeure**" (often referred to in English contracts by the French term "force majeure"). It should be noted that this term is not used by the German legislator in connection with impediments to performance (in contrast to Anglo-American law, for example). As mentioned above, the law is rather concerned only with whether the performing party is "responsible" for the impediment. Nevertheless, in contracts subject to German law, clauses are often used which define the concept of "force majeure" and provide for certain consequences for its existence (e.g. suspension of the obligation to perform, obligation to notify the affected party). Then these regulations take precedence over the law and it must be verified whether their requirements are met. According to most of the clauses that the signatory has found in contracts, the corona pandemic is a case of force majeure.

1.2 Rescission

If the performing party does not fulfil its obligation, the receiving party may rescind the contract. As a rule, the receiving party must first set a reasonable period of grace for performance; only after this period has expired can rescission be declared. In certain cases, however, it is not necessary to set a grace period, especially if it is clear from the outset that the performing party will not be able to perform (on time). In cases of doubt, it is recommended to set a grace period to be on the safe side. It is important (and dangerous for the performing party) that the rescission can be declared regardless of whether the performing party is responsible for the impediment or not. So, the right of rescission exists precisely in the classic corona cases.

It must, though, always be checked whether the right of rescission has been restricted by contractual provisions. For example, the usual force majeure clauses provide for delivery dates or deadlines to be postponed as long as the impediment persists.

A right of rescission only exists for contracts that are aimed at a one-time service (although the service can also be provided in several parts over a longer period of time).

This contrasts with the so-called continuing obligations, in which new obligations to perform constantly arise (such as lease agreements, licence agreements, contracts for regular deliveries, etc.). For these contracts, the termination of the contract replaces the rescission (see 1.3 below).

1.3 Termination

On the one hand, continuing obligations can be terminated "properly". The details, i.e. period of notice and earliest possible termination, are usually expressly stipulated in the contract. On the other hand, German law also provides for the possibility of "extraordinary" termination without notice for good cause; this right of termination cannot be excluded by contract.

Good cause for termination without notice shall be deemed to exist if, taking into account all circumstances of the individual case, the party giving notice of termination cannot reasonably be expected to continue the contractual relationship until the expiry of the ordinary period of notice. In most cases the important reason lies in the person or behaviour of the other contracting party. But, in exceptional cases, a circumstance for which neither of the contracting parties is at fault (such as the corona crisis) may also constitute good cause. However, especially in this case, the interests of the other contracting party in the continuation of the contractual relationship must be given due consideration. The outcome of such a balancing exercise in a dispute depends strongly on the circumstances of the individual case and can hardly be predicted. It should also be borne in mind that such litigation is decided at a time when the corona crisis has (hopefully) long since passed; in this case, the court might, in retrospect, rather conclude that the terminating party could reasonably be expected to continue the contract.

1.4 Interference with the Basis of the Transaction

Section 313 of the German Civil Code (BGB) provides that a contractual partner can demand adaptation of the contract if (a) circumstances which "have become the basis of the contract" have changed seriously after the conclusion of the contract and the contractual partners, if they had foreseen this change, would not have concluded the contract at all, or would have concluded it with a different content and (b) the contractual partner cannot be expected to adhere to the unchanged contract. In our case, therefore, it depends first of all on whether it has become the basis of the contract that the repercussions which the corona pandemic now has on the implementation of the contract do not materialise.

If it is no longer possible for the performing party to render the service, this is not considered to be a case of discontinuation of the basis of the transaction; rather, the rules

explained above under the heading "compensation" apply. As regards continuing obligations, the rules on the discontinuation of the basis of the transaction are not applicable; instead, termination for good cause may be considered.

In the context of corona, the most relevant case is that the receiving party is no longer interested in the service (example: the marketing concept ordered is no longer usable because the advertising budget has been cut; the new machine is no longer needed because the business is being discontinued due to the crisis; the goods ordered are not for sale which has forced the retail outlets to close). Here, the principle applies that the risk of use lies with the party to receive the service, i.e. it has not been made the basis of the contract (by both contracting parties). Accordingly, the Federal Court of Justice decided that after the entry into force of the laws for the protection of non-smokers, an innkeeper cannot demand an adaptation of the lease agreement if he suffers a decline in turnover as a result. There is also no right of adaptation, even if the tenant no longer needs the hotel room ordered due to a cancellation of the event. However, a claim for adaptation of the contract was upheld in the case of a beer importer resident in Iran who had concluded a beer supply contract with a brewery but was no longer allowed to sell alcoholic beverages after the Islamic Revolution.

Even if the courts come to the conclusion in a possible legal dispute that the usability of the service was as a matter of exception the basis of the transaction, it must be further examined whether it is unreasonable for the receiving party to adhere to the non-adapted contract. This depends on the circumstances of the individual case, taking into account the interest of the performing party in the unaltered performance of the contract. In each individual case, the receiving party must weigh up the risk for itself of not accepting the service and not paying the remuneration. If there is only the risk of being sued for acceptance and payment, it might be sensible to accept this and hope for a later settlement. If, however, if, the receiving party in a continuing obligation, for instance, withholds part of the remuneration with the comment that it cannot use the service as intended due to the corona pandemic, this can lead to the other party terminating the contract due to late payment. In this case it might be too risky to rely on a subsequent positive decision by the courts.

1.5 Payment of Remuneration

If the performing party is unable to perform due to impossibility (see 1.1 above), the claim to the consideration (remuneration) is also basically cancelled. In the event of partial performance, the remuneration shall be reduced in accordance with the value of the partial performance. This applies regardless of whether the performing party is responsible for the impossibility or not. However, if the receiving party is solely or largely responsible for the impossibility, the performing party retains the right to remuneration. Examples are given in Sections 3 and 4 below.

1.6 Contractual Penalty

A claim for payment of a contractual penalty may arise from the contract. Often such clauses do not expressly regulate whether they apply in every case of an impediment to performance or only if the impediment to performance is the fault of the other party. As a rule, however, they are to be interpreted as requiring a duty of representation - if liability for damages already exists only in the case of a duty of representation, this must apply all the more to a contractual penalty which is to be paid irrespective of any damage actually incurred.

1.7 Information and Documentation

In all cases of impossibility, delay in performance or a possible discontinuation of the basis of the transaction, it is important that the party affected by the impediment to performance informs the other contracting party in good time and also subsequently keeps the other party informed of the current status. Often this is also contractually stipulated, for instance in the customary force majeure clauses. If the affected party does not comply with this information obligation, the contractually agreed consequences (e.g. loss of rights) apply. Even if nothing is contractually regulated, there may be an obligation to pay damages if damages would not have arisen or would have been reduced for the other contractual partner if it had been duly informed.

In addition, the party affected by the impediment to performance should document why it is prevented from performing as intended. For example, it should be recorded which official prohibition made timely performance impossible - as has been shown, official requirements change almost daily at times, and if a legal dispute does not reach the decisive stage until a few months later, it can be difficult to reconstruct the situation at any given time. It should also be documented what measures were taken to remove the impediment to performance and why these measures were not successful.

1.8 General Terms and Conditions

Contractual provisions that become relevant as a result of the corona crisis are often contained in general terms and conditions. General terms and conditions (GTC) are all contractual conditions that are pre-formulated for a large number of contracts (at least three) and are specified and laid down by one contracting party to the other party. On the one hand, this raises the question of whether GTC have been effectively incorporated, i.e. made the contents of the contract. On the other hand, the German Civil Code contains detailed regulations on which provisions in GTC are invalid (for example: exclusion of claims for damages or warranty claims, exclusion of offsetting or rights to refuse performance, etc.). In general, in case of doubt, GTC are invalid if

they are not compatible with essential basic ideas of the legal regulation from which they deviate. For instance, the exclusion of the right of rescission in force majeure clauses may be invalid in individual cases if it is regulated in GTC.

2. PURCHASE AGREEMENT

Example: The manufacturer of a machine is unable to deliver the machine at the contractually agreed time due to lack of personnel (employees cannot come to work because they have to look after children; a complete ban on leaving the premises is imposed - which has not been the case so far) or due to missing vendor parts. Consequence: There is a strong case for the manufacturer not being responsible for the delay and therefore not being liable for damages (1.1 above). However, the purchaser is probably entitled to a right of rescission, unless this is effectively limited in the purchase contract, for example by a force majeure clause, and the conditions of the clause - for example immediate notification by the manufacturer - are fulfilled) (1.2 above).

The fact that the buyer is no longer able to use the machine due to the changed circumstances usually does not justify an adaptation of the contract or even a rescission by the buyer (1.4 above).

3. LONG-TERM SUPPLY AGREEMENT

Example: Company A has undertaken to company B to supply components regularly according to B's requirements and at agreed prices; the contract has a fixed term until 2022. Consequence: To the extent and as long as A cannot deliver because of the corona crisis, there is much to be said for the fact that A is not liable for damages (1.1 above). On the other hand, A has no claim to payment of the purchase price (1.5 above). If, in B's view, the impediment to performance is not merely temporary and B has an alternative source of supply, it is conceivable (but unlikely) that B has a right of termination without notice (1.3 above).

Example: As above, but B has undertaken to purchase at least 1,000 pieces per month. But at present B only needs 200 pieces per month. Consequence: It depends on the contractual regulations: If the contract provides for a claim for damages in the event that B does not reach the minimum purchase, there is a strong case for liability even if B is not responsible for the failure to reach the minimum purchase (purchase guarantee). Sometimes, however, the contractual provision is only confined to the fact that company A has a right of termination if the minimum quantity is not reached.

4. CONTRACT FOR WORKS AND SERVICES

Example: A service company regularly carries out service and preventive maintenance work on the machines, lifts, computer systems etc. located at the receiver's premises and is reimbursed annually for this work. The receiver cancels the agreed service date because he has decided to temporarily stop production and retains part of the remuneration. Consequence: The service company retains the right to full remuneration, as the recipient is responsible for the fact that the service company is unable to perform (1.5 above). There should be no case for the discontinuation of the basis of the transaction (at least if the impediment exists for only a few months).

5. LEASE AGREEMENT

Example: The lessee of commercial real estate (office space, retail business) claims that it can only use the premises to a limited extent or not at all due to official restrictions and therefore retains part of the rent. Consequence: A case of the discontinuation of the basis of the transaction is not likely to exist (1.4 above). Rather, the lessor can terminate the lease under the current legal situation if the lessee is in default of payment of the rent (according to the law: two consecutive monthly rents or a total of two monthly rents). Since 28 March 2020, though, a special regulation has been in force: According to this, the lessor cannot terminate the lease agreement for rent debts from the period 1 April to (for the time being) 30 June 2020 if the delay in payment is due to the effects of the corona crisis. As of 30 June 2020, the lessee has more than two years to settle the rent arrears resulting from this period.

6. COMMERCIAL AGENCY AGREEMENT

Example: The commercial agent is only able to place orders to a limited extent because his travel options are limited and the customers no longer receive an agent. Consequence: The commercial agent is not liable for damages as he is not at fault. But he can only demand commission for the contracts actually arranged.

Example: The commercial agent continues to place orders, but the business operator cannot accept them because his production has come to a standstill. Consequence: In case of doubt, the business operator is not liable for compensation for lost commissions, as he is not acting culpably.

In both cases, in case of doubt, there is no right to terminate the contract without notice, as it should be reasonable for both parties to adhere to the contract.

7. LICENCE AGREEMENT

Example: Company A has granted company B a licence to manufacture products using the trademarks / patents / know-how of A. A unit licence fee and a monthly minimum licence fee have been agreed. Consequence: In case of doubt, the minimum licence fee is to be interpreted as a no-fault guarantee. Thus, if A does not reach the specified quantities due to the corona crisis, it is still obliged to pay the minimum licence fee.

Matthias Stecher
(Matthias.Stecher@bblaw.com)