The worldwide spread of Coronavirus COVID-19 (now classified as a pandemic by the WHO) is seriously disrupting global economic and trade systems.

Consequently, most businesses focus on maintaining their operations rather than assessing risks arising under their contracts. Still, contractual and legal obligations and the related liability regimes continue to apply or may reapply at any time. Despite the current situation, proper contract and risk management is essential to avoid a "rude awakening".

Even though formal legal disputes arising from the Coronavirus crisis may not yet materialize, good risk management requires preparing for the time after the crisis. After the crisis ends, and it will end at a certain point in time, market participants or the insolvency administrator, will try to collect damages and losses.

I. Identifying liability risks and proactively managing contracts

The assessment of liability risks and potential avenues for action depends on the law governing the contract. This article provides an overview of the most important provisions of German law, as well as clauses commonly used in commercial contracts. For the impact of COVID-19 on contracts subject to a variety of laws, you will find information on our global COVID-19 Client Resources Hub sorted by country.

Once the operational and legal risks of a contractual relationship have been identified, we recommend that the respective contractual and liability risks be managed proactively (see our article on "Proactive contract management to avoid disputes in the Corona crisis."). Ideally, such proactive management avoids risks or at least reduces them. In addition, the parties have the opportunity to jointly carry their business relationship on into the "post-Coronavirus period", while avoiding future disputes over Coronavirus-related issues.

II. Legal framework in Germany

The starting point for any assessment of Coronavirus-related liability risks are the contractual provisions. Many long-term contracts, for example, supply, (plant-) construction or project contracts, contain clauses on force majeure, business interruptions or similar provisions (such as material adverse change (MAC) or material adverse effect (MAE) clauses). German statutory provisions are applicable only to the extent that the contract does not, or not exclusively, provide for consequences of circumstances caused by the COVID-19 pandemic. The relevant provisions under German law are impossibility and unreasonableness (§ 275 German Civil Code, Bürgerliches Gesetzbuch – “BGB”), frustration of the contract (§ 313 BGB), non-performance (§ 281 BGB), default (§ 286 BGB) and default in acceptance.
III. Contractual clauses on *force majeure*

Especially in international business relations, contracts commonly include a *force majeure* clause. To what extent the COVID-19 pandemic and its consequences trigger a *force majeure* clause depends on the scope and form of such clause. If the clause specifically defines pandemics, epidemics, diseases or the corresponding quarantine measures as *force majeure*, the Coronavirus crisis is covered by that clause.

It becomes more difficult if the contract has an exclusive list of events of *force majeure*, but none of those events, even if interpreted broadly, covers the Coronavirus crisis. For example, the COVID-19 pandemic is neither a strike, nor a war or a terrorist attack. In case of an exclusive list of *force majeure* events, a (supplemental) interpretation of the entire contract will determine whether the parties, despite the exclusive *force majeure* clause, wanted the general statutory provisions to apply. Supplementary interpretation of a contract means that it will be determined (by a court) what the parties would have agreed at the time of entering into the contract if they had considered this issue. Foreign parties should note that German courts are much more willing to reform contracts according to their own views than, for example, common law courts.

If the *force majeure* clause just defines *force majeure* events in general, but not exclusively, the contract has to be interpreted to determine whether the COVID-19 pandemic and its consequences are deemed a *force majeure* event. This will often be the case, but is not mandatory. Factors taken into account when interpreting the contract include the agreed obligations as well as the allocation of risks.

If the contract does not contain any provision on *force majeure* and a supplementary interpretation of the contract is not possible, the German statutory provisions apply without restriction.

If the *force majeure* clause actually covers the COVID-19 pandemic and its consequences, the next step is to analyse their effects on the respective performance obligations. The mere existence of an event of *force majeure* is not sufficient to (temporarily) suspend an obligation to perform. In particular, a simple reference to the Coronavirus crisis cannot be used to refrain from performing an obligation that is actually still possible, even if performance is more expensive, more complex or takes more time. Thus, most *force majeure* clauses additionally require that performance of a contractual obligation is either impossible or economically unreasonable (undue hardship). Such impossibility or economic unreasonableness have to be assessed in each individual case. The burden of proof for a *force majeure* event is on the contracting party who seeks to be released from its obligation to perform.

It is worth noting that even if a party can successfully invoke *force majeure*, the party will still have to comply with ancillary contractual obligations. Such ancillary obligations commonly include, for example, special information and/or mitigation obligations. It should also be noted that most *force majeure* clauses provide for special termination rights if the *force majeure* event persists for a longer period of time (usually 30 to 90 days). What is more, in some cases a termination right is triggered already if it can just be expected that the *force majeure* event will continue for a certain period of time. In this case, particularly urgent action is required.

IV. Statutory German law

The general principles of German contract law are applicable if the contract does not contain provisions covering the COVID-19 pandemic or pursuant to the interpretation of the contract.

1. Impossibility (§ 275 BGB)
Under § 275 BGB, the obligation to perform ceases if the respective performance is impossible for anyone (objective impossibility) or just for the obligor (subjective impossibility). The same applies if the obligation to perform is economically unreasonable to the obligor, taking into account all circumstances and the principle of good faith. The requirements of impossibility are not met if it is still possible to perform, perhaps by involving third parties. Finally, impossibility requires a permanent impediment to performance. Temporary impediments (which are likely to exist in most Coronavirus-related cases) are generally subject to the provisions for non-performance and default (see below).

Objective impossibility requires that the performance of an obligation is not possible for anyone by nature or for legal reasons. An example in connection with the Coronavirus crisis would be if the obligor has to perform construction work for a new building, or a conversion of a building, which, however, is required for public purposes due to the Coronavirus crisis, and the building permit is withdrawn as a result.

An example of subjective impossibility would be a person who personally has to perform services but becomes permanently unfit for work due to COVID-19.

Impossibility in the form of economic unreasonableness requires that performance remains physically and legally possible (which is likely the case in most issues arising in connection with the Coronavirus crisis), but now requires completely unreasonable efforts or expenses. The efforts and expenses required for performance have to outweigh the other party's interest in performance of the contract. If those requirements are met, the obligor may refuse performance, but does not have to.

It is important to note that payment obligations are rarely deemed a case of impossibility. Therefore, e.g., payment cannot be refused due to (imminent) insolvency.

The legal consequences of (permanent) impossibility are in general: (1) the obligations for performance and payment of the consideration cease, (2) the beneficiary of the performance obligation may terminate the contract at any time, and (3) the party responsible for the impossibility (if any) is liable for damages. Such liability for damages is excluded only if the party obligated to perform has undertaken all reasonable actions to prevent the impossibility. This also includes the obligation to actively seek alternative options to perform the contractual obligations, even with delay or at increased costs.

2. Frustration (§ 313 BGB)

The Coronavirus crisis can lead to a frustration of the contract, which German law addresses as disruption of the basis of the transaction (§ 313 BGB).

The basis of the transaction is either formed by the parties' joint intentions at the time the contract is entered into or by the one party's intentions about the existence or future occurrence of certain circumstances, which the other party can recognize and has not objected to, provided that the parties' business objective is based on this intention. A disruption of the basis of the transaction means serious changes of those circumstances that have become the basis of the contract. Thus, the basis of the transaction is not disrupted by just any change of circumstances. An example where the basis of a transaction may be disrupted due to the Coronavirus crisis are agreed (short) delivery periods, which are based on the assumption that national borders are open or that there is sufficient airfreight capacity.

In the event of a disruption of the basis of the transaction, the affected party can first demand the adjustment of the contract. The adjustment shall be made to the extent that adherence to the unchanged contract is unreasonable. Thus, the adjustment is neither automatic nor can it be determined unilaterally by the affected party. There is only a right of the affected party to claim adjustment. However, the right to claim adjustment can be exercised by way of estoppel, i.e. by rejecting any demand for performance to the extent adjustment can be claimed.

In exceptional cases, if an adjustment of the contract is not possible or is unreasonable for either party (so-called
cessation of the basis of the transaction), the affected party can terminate the contract. Whether these conditions are met has to be assessed very carefully in each individual case. In the case of an unjustified termination, the terminating party may continue to be liable for performance and/or become liable for damages.

The burden of proof is on the party invoking a claim for contract adjustment or termination because the basis of the transaction is lost or disrupted.

3. Non-performance and default (§§ 281, 286, 293, 323 BGB)

The implications caused by the COVID-19 pandemic are likely to be temporary, albeit of unknown duration. Contract and risk management will therefore focus in particular on the issues of non-performance, late performance (obligor default) or late acceptance (creditor default).

If a contractual obligation is not performed at all, or as agreed on in the contract, at the due date because of to the Coronavirus crisis, the other party may set a reasonable deadline for the contractual performance. If this deadline expires, the other party may terminate the contract (§ 323 BGB) and/or seek damages for non-performance (§ 281 BGB). A claim for damages requires fault (intent or negligence) regarding the non-performance or insufficient performance. The termination right, on the other hand, is independent of fault. The mere fact of non- or insufficient performance is sufficient for the termination right to arise. This is the predominant risk in the Coronavirus crisis: If one party wishes to get rid of a contract that has become inconvenient, the termination right may come in handy. To avoid such termination rights arising, proactive contract management should be initiated at an early stage.

If a contractual obligation is performed after the due date, irrespective of whether or not the other party set a deadline for performance, the other party may not terminate the contract. The other party may have claims for damages, which, however, require fault (negligence or intent) for the delay. If the delay is solely caused by the Coronavirus crisis, there will often be no fault.

Another important aspect is default of acceptance, also known as creditor default. If the beneficiary of a performance obligation (creditor) cannot accept the performance, for example due to a lack of storage capacity for goods to be delivered or due to a closure of its own business, he or she may be deemed in default of acceptance (§ 293 BGB). The legal consequences of default of acceptance can be substantial and do not require any fault of the creditor for the reason of not being able to accept. In particular, (1) the risk of loss is transferred to the creditor, (2) the liability of the party obliged to perform becomes limited to intent and gross negligence, and (3) the party obliged to perform may demand compensation for expenses, including inter alia, for storage. In order to avoid default in acceptance caused by the Coronavirus crisis, proactive contract management should be initiated at an early stage.

4. UN Convention on Contracts for the International Sale of Goods

If the contract is subject to German law and the UN Convention on Contracts for the International Sale of Goods (CISG) applies, Art. 79 CISG provides for an "impediment beyond the debtor's control". According to Art. 79 CISG, the party breaching contractual obligations is not liable to the other party if they can prove that the non-performance was caused by impediments beyond their control. Pandemics, epidemics, diseases or quarantine measures are, in principle, regarded as impediments within the meaning of Art. 79 CISG.

An additional requirement for an impediment pursuant to Art. 79 CISG is that it was not taken into consideration by the parties at the time of entering into the contract and, therefore, it cannot be expected that the affected party will bear the respective consequences. If performance becomes objectively impossible due to the impediment, the obligation to perform ceases. Otherwise, the contractual obligation to perform remains in force, and the affected party has to continue performance after the impediment (or unreasonableness) has ceased. However, Art. 79 CISG excludes a further liability for damages.
V. Individual risk and contract management required

The current situation shows that no business or sector is equally affected by the COVID-19 pandemic. The assessment of liability risks and the corresponding options for action depend on the individual case, rather than the general legal framework. Therefore, individually tailored risk and contract management is required.

We would be happy to support you in your individual risk analysis, in drafting amendments to existing contracts or new contracts, as well as in negotiations with your contractual partners. Please do not hesitate to contact us.

You can find more insights related to COVID-19 in our Germany-related and global COVID-19 hub.

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