Update

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„Corona“-related Disruptions of Contracts

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RECHTSANWÄLTE

At a Glance

1. **SARS-CoV-2, COVID 19 – We explain the legal consequences of “Corona”-related Disruptions of Contracts**

   The corona virus brings with it massive economic consequences. Events and business trips have to be cancelled, deliveries fail and the exchange of services and contractual performances comes to a standstill. We explain the essential legal consequences of "Corona"-related delays and failures in typical case constellations.

2. **What Options exist for currently pending transactions and contracts?**

   We explain to what extent special contractual agreements are possible and sensible in the current situation, and what other options and reactions exist.

1. SARS-CoV-2, COVID-19 – We explain the legal consequences of “Corona”-related Disruptions of Contracts

The pathogen known as SARS-CoV-2, which triggers the lung disease COVID-19 (short: "Corona"), is a major concern for medicine, society, politics and industry worldwide. The number of confirmed infections is increasing exponentially. This prompted the WHO to classify the virus as a pandemic on 12 March 2020. In the meantime, serious economic effects are also becoming apparent. The stock market is talking about the "Black March", government aid in the billions has been approved and measures to stem the spread of the virus are being decided and implemented every hour.

Many people are wondering **what the legal consequences actually are if contracts and business are disrupted, delayed or even made impossible** due to "Corona". In this newsletter we would therefore like to explain briefly and compactly the applicable legal principles and legal consequences - and of course give the **practical tips** typical of our "UPDATES" on how companies can deal correctly with the legal consequences of the "Corona" crisis.

a) Basically contracts must be fulfilled – even during “Corona” periods

The principle that contracts must be performed ("*pacta sunt servanda*") also applies in "Corona" periods. However, external circumstances may well cause the performance obligations to lapse if the performance of the contract is no longer possible or unreasonable. There are several ways in which such an omission of the performance obligations can occur.

b) Lapse of Performance Obligations due to Impossibility (§ 275 Civil Code - BGB)

If the provision of a contractually agreed service is no longer legally or factually possible, not only the obligation to perform (§ 275 of the German Civil Code – the “BGB”) but also the obligation to pay the remuneration (§ 326 (1) sentence 1 Hs. 1 BGB) is no longer applicable.

Legal impossibility (§ 275 Para. 1 BGB) exists, among other things, in the case of a legal or official prohibition (examples: official prohibition of events with at least 1000 participants; official closures due to quarantine).

Actual impossibility (§ 275 Para. 1 BGB) is defined as a situation where the provision of services is not prohibited, but is in fact simply no longer possible (example: contractually agreed obligation of a trade fair constructor to erect a stand at a trade fair which has been cancelled by the organiser).

Objective impossibility (nobody can render the service) and subjective impossibility (only the debtor cannot render the service, but another can) are both covered by § 275 BGB. However, subjective impossibility has strict requirements: The debtor must primarily do everything reasonable to be able to render performance.

In addition, there is a principle of so-called **de facto impossibility** (§ 275 para. 2 BGB). This exists if the service owed can only be provided at a considerable additional expense which is out of proportion to the interest of the contractual partner in the provision of the service (example: the holding of a trade fair despite the cancellation of a large number of exhibitors would probably be a case of § 275 Para. 2 BGB in view of the high costs and the failure to achieve the trade fair objective).

Practical Tip:

In the event of legal or factual impossibility of performance (§ 275 para. 1 BGB), the obligations to perform and to pay remuneration in return automatically cease to apply - in the event of de facto impossibility (§ 275 para. 2 BGB), the affected party must expressly invoke such impossibility. Impossibility should therefore always be asserted in text form (e.g. by e-mail), in important cases better in writing by registered mail.

Legal consequences: In the event of impossibility, both parties to the contract are no longer obliged to perform their originally owed services. Any services already rendered (e.g. down payments/advance payments, participation fees etc.) must be fully refunded in accordance with the rules of the laws of unjust enrichment (§§ 812 et seq. BGB).

General Terms and Conditions (GTC): Clauses in GTC, according to which e.g. the reimbursement of down payments, participation fees etc. is generally excluded, are regularly classified as inappropriately disadvantageous and therefore invalid according to § 307 para. 1 BGB. This applies regardless of whether the contractual partner is a consumer (B2C) or an entrepreneur (B2B).

c) Right to Extraordinary Termination

It is **no case of impossibility** if the service is still possible, but one of the contractual partners **no longer wishes** to provide or make use of it merely because of the "corona" situation. Without a concrete risk situation, the abstract risk of contagion alone does not normally result in the lapse of the obligation to perform and to pay the remuneration (examples: A traveller cancels the booked hotel at a location that is not a risk area, for which there is no travel warning and no official entry ban; an event is cancelled although its execution is still permitted and the threshold of de facto impossibility has not yet been reached).

In such cases, however, **it may be possible to terminate the contractual relationship for good cause**. Concrete legal provisions exist in the law governing service contracts (§ 626 para. 1 BGB), works contracts (§ 648a para. 1 BGB) or rental and tenancy contracts (§ 543 para. 1 BGB). For contracts containing continuing obligations § 314 BGB contains special statutory provisions on extraordinary termination as well.

Such extraordinary termination requires the existence of good cause. This is always very dependent on the concrete circumstances and must always be examined individually for each case. Ultimately, the continuation of the contractual relationship must be **unreasonable** for the terminating contractual partner. The **mutual interests of both parties** are of particular importance and the **contractual distribution of risk** (which may also result from general terms and conditions) must also be taken into account. If force majeure - e.g. the "Corona" pandemic - persistently disrupts the exchange of services, it will often be possible to assume that there is an important reason.

Legal consequences: After (valid) termination, all obligations to perform cease to apply. Any performance already rendered but not yet completed must usually be

returned and reversed. Special provisions apply for works contracts (e.g. contracts with exhibition stand construction companies), according to which a pro-rata remuneration is still owed if part of the work has already been performed. In addition, at least a part of the remuneration (e.g. minus saved expenses) may be demanded on account of failure to cooperate on the part of the customer (§ 642 Para. 1 BGB) or general risk liability (§ 645 Para. 1 analogous to BGB); this also depends on the circumstances of the case and must be assessed individually.

GTC: The possibility of extraordinary termination can neither be effectively excluded by individual contracts nor by general terms and conditions. Such clauses would be ineffective due for being inappropriately disadvantageous according to § 307 para. 1 BGB.

d) Disruption of the Basis of the Transaction: Right to Adaptation or Termination of the Contract

Difficulties are caused by cases in which the provision of services is still possible in principle, but no longer makes sense due to "Corona". This question arises, for example, in case of **rental of venues for events** if the organiser cancels or has to cancel the event due to "Corona". The provision of the location by the landlord or hotel is still possible and the good reason which would entitle extraordinary termination does not usually relate to the isolated contractual relationship with the provider of the venue. The situation is similar for **already booked travel services** (airline tickets, hotel rooms etc.) if the journey as such is still possible.

§ 313 BGB may help at least in some of these cases. Should a circumstance not have been made the content of the contract but have been an **identifiable basis of the agreement for both parties** at the time of the conclusion of the contract nevertheless, each party can demand an adjustment of the contract (para. 1), if necessary even the cancellation of the contract (para. 3) under the legal conditions of this statutory provision. However, this only applies if adherence to the contract is **unreasonable** and the disruption **cannot be attributed to the contractual risks accepted by the party** who wishes to make use of this right.

In the case of **contracts concluded before the "Corona crisis"**, it can be assumed that the absence of a pandemic and related restrictions is such a contractual basis within the meaning of § 313 BGB (example: In autumn 2019 an event location was booked for a specific event, which now has to be cancelled due to "Corona", and the landlord was aware of this purpose). Then, however, it must still be assessed individually on the basis of the concrete contract whether the “Corona”-related prevention can be attributed to the accepted risks of one party. If a common basis of the transaction cannot be established or if the risk lies with the service recipient, there is at most the possibility of general cancellation (then possibly with associated cancellation costs and fees).

However, **if contracts were entered into in the awareness of "Corona" or are even concluded now**, the application of § 313 BGB will most likely not apply any longer with regard to “Corona” due to the general awareness of the virus and its effects on business.

e) Damages and Reimbursement of Costs

Whether a contractual partner owes compensation for additional costs and damages incurred in the event of "Corona"-related disruptions beyond the reimbursement of fees and down payments is a **question of attribution of liability for such disruptions to the contractual partner**. If the other party is **responsible** for the performance disruption, it is liable to pay compensation; if the other party cannot be held responsible for the disruption, there is no legal basis for such liability and the aggrieved party in principle has to bear its own costs and damages arising from the failed contract.

If an event **has to be cancelled mandatorily**, e.g. due to an official order, the organiser is **not responsible** for the impossibility of fulfilling its performance obligations. In this case, the organiser must refund participation fees, but not the cancellation fees for flights and hotels that participants have already booked for themselves.

If a **cancellation is made on a party’s own initiative**, it must be checked whether in the individual case the threshold of force majeure has been reached or whether it was unreasonable to carry out the event. In these cases, attribution of liability to the cancelling party may also be excluded. However, if a company or an organizer decides not to render its services out of fear or caution due to an abstract general risk of infection in the absence

of any concrete risk situation, any damages caused by cancellation may be attributable to the cancelling party and a liability to pay compensation for costs and damages of the contractual partners may generally arise.

These principles also apply in the event of delays in performance. If the debtor is not responsible for the delay, no default occurs (§ 286 para. 4 BGB). In this case there is also no obligation to pay damages. If the transaction is a transaction at a fixed date, performance becomes impossible as soon as the deadline is exceeded (see b). Even then, however, there is no obligation to pay damages if the missing of the deadline is not attributable to the debtor.

GTC: In individual cases, contractual agreements and general terms and conditions clauses must be taken into account, especially with regard to questions of risk allocation, and their validity must be examined (e.g. force majeure clauses, see f) below).

Practical Tip:

It is advisable to document official recommendations and authority decisions even if they are not directly addressed to the company itself. If necessary, this can be important in order to be able to demonstrate the lack of responsibility for contract disruptions.

f) Force Majeure

At the moment, many companies frequently invoke "force majeure" with the purpose of trying to soften the consequences of "Corona"-related performance disruptions for themselves. **But what exactly is "force majeure" and what does it mean as a legal term?**

In general, force majeure is understood to be any unforeseen external event that has no connection with the company and could not have been averted even with the utmost care that could reasonably be expected. Typical examples are natural disasters, wars, government and trade restrictions, but also epidemics and pandemics. There is, of course, as yet no judicial assessment of the new corona virus. However, in view of the overall circumstances, such as spread, risk of infection, response measures and WHO's classification as a pandemic, a characterisation of “Corona” as force majeure is highly likely.

Legal consequences/GTC: Force majeure regularly concerns the interpretation and effectiveness of the corresponding contractual clauses. It is not uncommon for GTC to attempt not only to define but also to extend the scope and legal consequences of force majeure in favour of the user of the clause. There is extensive case law on what is permissible and what is not; in case of doubt, however, an individual case examination must always be carried out on the basis of the concrete clause and the individual circumstances of the "force majeure" case.

Insofar as force majeure clauses provide for a transparent, clearly time-limited **right to postpone performance** without consequences of default, this is usually valid. A typical case would be a delay in delivery due to a "Corona"-related interruption of production or supply chain (unless a transaction with a fixed date or the acceptance of the procurement risk by one of the parties has been agreed). However, it must then always be checked whether impossibility (see b) above) has already occurred; in this case the mutual obligations to perform cease to apply).

If clauses of force majeure provide for **a right of withdrawal or termination** if the performance is merely delayed, such clauses may, however, be invalid (especially in GTC, cf. § 308 No. 3 BGB for consumer contracts or § 307 para. 2 No. 1 BGB in the B2B sector). Conversely, force majeure clauses may not exclude mandatory rights of withdrawal or termination on the part of the other party to the contract, as such exclusions are not permissible even in cases of force majeure.

Likewise, it is generally **not permissible to retain advance payments or fees** with reference to "force majeure" if the obligation to perform ceases to apply (e.g. due to impossibility). In GTC, such clauses regularly violate § 308 No. 8 b) BGB (in consumer contracts) or § 307 Para. 2 No. 1 BGB (in B2B contracts). However, special regulations, e.g. from the law on works contracts, must be observed. For example, the contractor's claim for remuneration according to § 645 BGB may not be excluded in GTC (violation of § 307 para. 2 no. 1 BGB).

Exemptions from liability in force majeure clauses are generally permissible, but are usually superfluous: If force majeure is present, there is naturally no responsibility of either party and thus claims for damages are regularly

excluded from the outset (see above e)). However, the party using GTC may not invoke such clauses if it was already aware of the obstacle to performance at the time the contract was concluded. Therefore, especially in the case of contracts which have recently been concluded or are planned to be concluded soon, force majeure clauses may no longer be sufficient as a legal precaution with regard to "Corona"-related disruptions (for tips on how to deal with this, see below under 2.).

Practical Tip:

"Force majeure" is not a precise legal principle that triggers clearly defined legal consequences. If someone invokes "force majeure", he usually means either one of the above-mentioned legal regulations (e.g. impossibility) or a force majeure clause in the contract. These must then be examined individually on the basis of the respective case for their prerequisites and legal consequences.

g) Compensation Claims against the State?

State liability claims for official measures are generally ruled out, as SARS-CoV-2 is not a circumstance for which the State (Federal Republic of Germany or its States, the *Bundesländer*) is responsible. However, claims based on **§ 65 of the Infection Protection Act** may exist. According to this law, compensation can be claimed if official measures for infection protection lead to significant financial disadvantages. As far as we are aware, it has not yet been decided to what extent the regulation can also be applied to "Corona"-related contractual disturbances (e.g. cancellation of events).

2. What Options exist for currently pending Transactions and Contracts?

Now that "Corona" is omnipresent, no one can invoke the fact that "Corona"-related failures are surprising or unforeseeable when contracts are about to be concluded. The question therefore arises how the currently existing, typical "Corona" risks can be adequately taken into account when concluding new contracts.

a) Standard Contract Templates / GTC

Anyone who enters into contractual obligations today which he then cannot meet due to "Corona" will no longer be able to invoke an unforeseeable disturbance of the basis of the transaction (§ 313 BGB). A non-contractual business basis of the absence of a pandemic, which is taken for granted by the parties, can no longer be argued for currently pending transactions.

Similarly, "force majeure" can no longer be invoked in relation to "Corona" for contracts which are about to be concluded. Force majeure presupposes unpredictability, and "Corona" is no longer unpredictable, but omnipresent reality.

Practical Tip:

Therefore, in the current situation, it is no longer sufficient to rely on standard contract templates and general terms and conditions with regard to possible future "Corona"-related obstacles to performance. Anyone who enters into contractual obligations today and is then unable to perform them due to "Corona" has consciously accepted this risk and can then also be held responsible and liable, e.g. for compensation of damages or reimbursement of costs.

b) Use of special „Corona” Conditions

One possible solution is to conclude contracts, individual clauses or certain performance obligations only under a **condition precedent or condition subsequent covering typical “Corona” risks**. In this way, the contractual performance can be made dependent on certain external framework conditions. If this condition then occurs, there is no breach of duty because the duty is limited accordingly from the outset. Further consequences, such as risk sharing, can be agreed according to the needs and interests of the parties. For example, delivery obligations can be expressly placed under the condition subsequent of a closure of business (forced by authority action or by a precautionary decision by the proprietor) or failure of suppliers to deliver certain raw materials.

However, such conditions should always be negotiated and agreed individually. In GTC, "Corona conditions" could, in particular if they are relatively far-reaching, intransparent or unclear, violate the prohibition of surprise clauses, the transparency requirements or be inappropriately disadvantageous and could therefore be void.

c) Agreements on alternative Dates and Multi-Step Plans

Since it is not yet possible to predict when the situation will ease again, it is also conceivable to provide for alternative dates for deliveries or events from the outset if the initial deadline cannot be met. Alternatively, contracts could provide for multi-step plans in case of delays or cancellations.

The advantage of this approach is that the prerequisites, consequences and the risk distribution of "Corona"-related disruptions can be discussed from the outset and agreed upon in a way that leads to calculability and thus feasibility of the business even in "Corona times".

d) Claiming State Aids

Now that it has become known that the EU Member States have decided to grant billions of Euros in aid, there are also opportunities for companies to at least partially compensate for the losses and economic damage by making use of such state aids. The details and procedures for this will become apparent in the course of the coming weeks and months and can then be examined and discussed individually.

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