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COVID-19 and Its Impact on German Law Contracts

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The COVID-19 pandemic, related lockdowns and other preventive measures may make it difficult or even impossible for parties to perform certain contractual obligations. For affected businesses, important questions arise as to how these obligations are impacted. With regard to contracts governed by German law, the nonperformance of obligations would first have to be addressed on the basis of contractual provisions being broad enough to cover pandemic risks and their effects. Contracts may provide for clauses related to a material adverse change ("MAC") or a material adverse event ("MAE") as well as *force majeure*. In the absence of any such provisions, German law provides for statutory provisions on frustration of contracts or (temporary) impossibility to perform contractual obligations, which may give guidance on how to deal with situations arising from the COVID-19 outbreak.

On the Debevoise Coronavirus Resource Center webpage, you will also find guidance on the position under other governing laws including New York law, UK law and French law.

At the outset, we note that whether the principles of *force majeure*, frustration of contract or impossibility to perform will apply in any particular case is always highly sensitive to both the background facts and the actual terms of the relevant contract. While this update provides general observations on each area of the law, for parties considering the application of these principles to their own contracts, there is no substitute for having their situation reviewed by experienced lawyers. This is particularly true when a party that wrongly claims *force majeure*, frustration or impossibility to perform can expose itself to claims for breach of contract and significant liability. Should you wish to discuss any of these matters further with Debevoise, contact details are provided at the end of this bulletin.

Contractual *Force Majeure* Provisions

To determine whether an impairment of contractual obligations is attributable to the COVID-19 pandemic and considered as *force majeure* depends on the contractual agreement and the individual circumstances surrounding it. *Force majeure* clauses usually make provisions on the following points:

- definition of *force majeure*,
- release of the parties from their performance obligations,
- obligation of the parties to minimize and/or make up for the consequences of the *force majeure*, and
- contractual termination rights if *force majeure* exceeds a fixed period of time and exclusion of claims for damages.

If any such clause explicitly mentions epidemics, pandemics, diseases or quarantine measures as forms of *force majeure*, the COVID-19 pandemic falls under this category. Especially after the WHO officially declared it as a pandemic on 11 March 2020, if not already after the WHO's prior COVID-19 international crisis declaration on 30 January 2020.

What if the Provision Does Not Define *Force Majeure*?

If a contractual *force majeure* clause does not address epidemics or pandemics, it has to be assessed in light of the overall contractual provisions and factual circumstances, and on the basis of existing case law. In German jurisprudence, *force majeure* is understood as an external and unavoidable event caused without fault, has no link to a party's business operations and cannot be averted even by applying utmost care. Due to the national and international measures adopted to limit the effects of and contain the COVID-19 outbreak, there are good reasons to consider contractual impairments caused by the COVID-19 pandemic as a case of *force majeure*.

However, as a general rule, a party seeking to invoke a *force majeure* clause bears the burden of proof to show that the individual obligations of the party could not be met specifically because of the COVID-19 outbreak. This may be difficult for parties who signed contracts after the WHO declared COVID-19 as an international crisis on 30 January 2020 as a prudent party could have known by then that it might not be able to properly meet its contractual obligations.

What Process Needs to Be Followed?

If the *force majeure* clause can be invoked, the parties will need to consider what process is required by the contract to do so. Often, contracts will state that the affected party

must give notice in writing, using a particular address and form of communication. Contracts may also require that such notice is given within a particular time after the event which obstructs performance. Where the *force majeure* event is continuing, the clause may require the affected party to give regular updates to the other parties and may set deadlines for such updates.

MAC/MAE Clauses

MAC/MAE clauses may grant the right to rescind an agreement. This requires an event of a material adverse change (or effect) on a party's business operations or financial conditions. Triggering a MAC or MAE clause depends on

- the specific wording of an existing MAC/MAE clause, and
- the ability to prove that respective conditions are met.

For example, the wording of a MAC/MAE clause may especially exempt from the definition of a MAC/MAE changes in the general economic conditions or the general conditions of the industry in which the respective company operates. If this is the case, any party seeking to invoke a MAC/MAE clause would need to prove that the COVID-19 outbreak and its (economical) consequences solely result in a material adverse change (or effect) for the company's individual business — as opposed to a material adverse change (or effect) in the economy or industry in general.

In addition, a material adverse change (or effect) of a contract may be relatively easy to prove by the party invoking such clause, given the severe economic effects of COVID-19 already evident today.

However, it may be difficult to invoke a MAC/MAE clause for any contracts signed after the WHO's initial COVID-19 international crisis declaration on 30 January 2020. This is because most MAC/MAE clauses provide that the MAC /MAE needs to be unforeseeable and materially deviate from conditions known at signing.

Contracts without Force Majeure Provisions or MAC/MAE Clauses

In agreements governed by German law without a specific MAC/MAE clause or *force majeure* provision, in order to be relieved from contractual obligations, parties to an agreement may raise objections relating to the **impossibility of performance** (*Unmöglichkeit der Leistung*) or **frustration of contract** (*Störung der Geschäftsgrundlage*)

as outlined below. However, even in view of current developments and the severe measures taken worldwide to contain the pandemic, hurdles in making such objections are high under German law. Also, it may be difficult to gain relief from obligations for any contracts signed after the WHO's initial COVID-19 international crisis declaration on 30 January 2020

Impossibility of Performance (*Unmöglichkeit der Leistung*)

Under German statutory law, if it becomes impossible for a party to perform its contractual obligations, that party is released from its obligation to perform. The same applies if a party may be only temporarily unable to perform its contractual obligations, e.g. due to a disruption in supply chains caused by the COVID-19 outbreak and related shut-down measures.

Likewise, where a party may in principle perform its contractual obligations though only with grossly disproportionate expenses and efforts, such party may have a right to refuse performance. This may not release the party from all its obligations under the contract but merely exempt it from providing expenses and efforts which are disproportionate. The burden of proof lies with the party seeking to invoke the exemption or deferral of the contractual obligation. In providing the relevant proof (and avoiding any potential secondary damage claims of the counter-party), the invoking party must show (i) that any efforts in achieving (timely) performance would be grossly disproportionate under the circumstances, (ii) a lack of responsibility for the impossibility or delay of performance and (iii) that all reasonable efforts were undertaken in order to meet its performance obligations.

It is possible that courts might somewhat lower the historically high bar in granting a right to refuse performing contractual obligations given the COVID-19 pandemic and the overall disruption of society and the economy.

Frustration of Contracts (*Störung der Geschäftsgrundlage*)

If contractual circumstances have significantly changed since the conclusion of an agreement, parties may claim adaptation of the contract if a party cannot reasonably be expected to uphold the contract without adjustments. This is conditional upon the parties not having entered into the contract or having concluded it with different contents had they foreseen circumstances similar to the Covid-19 outbreak.

To assess whether it has become unreasonable for a party to perform its obligations, all circumstances of the specific case have to be taken into account, in particular the contractual or statutory risks allocation amongst the parties. If an adjustment is impossible or unreasonable, the contract may be terminated. An example may be an unpredicted general unavailability of certain products in the supply chain due to the COVID-19 pandemic, although German courts historically applied high standards.

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Finally, please bear in mind that the consequences of a wrongful attempt to exercise any of the above-mentioned rights may involve significant liability for the exercising party itself and may also affect the party's reputation. Parties should therefore consider their contract carefully, and they may wish to obtain external advice before exercising any of the above-mentioned rights.

To discuss any of the issues in this update further, please feel free to contact us through your regular Debevoise contact or using the contact details provided below and on the Debevoise Coronavirus Resource Centre.

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