COVID-19: CORONA-RELATED LEGAL ISSUES IN GERMAN CONSTRUCTION LAW

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The current corona virus (COVID-19) situation raises many questions relating to German building law that cannot be answered with legal certainty due to a lack of case law. This article will show how the "corona crisis" affects the execution of construction works and which claims contractors can assert with regard to the obligation to complete the commissioned construction work on time. The article also considers the claims of principals for forfeiture of contractual penalties and for further compensation of damages due to construction delays.

CONSTRUCTION CONTRACTS ACCORDING TO BGB

The German Civil Code (BGB) still contains no express provisions and definitions for cases of delays due to "force majeure" or "other circumstances unavoidable for the contractor" in the newly inserted regulations governing construction contracts as well as contracts of architects and engineers (Sec.650 BGB ff.).

Therefore, if the contractor is unable to perform the agreed construction works in accordance with the contractual agreements, he can only rely on the general statutory law relating to the disruption of performance, in particular due to the impossibility of performance pursuant to Sec. 275 et seq. BGB. The contractor is only entitled to discontinue the service if the impossibility exists through no fault of his own. The general default rules of Sec. 286 ff. BGB also require fault. It is therefore possible for the contractor to exonerate himself. Consequently, he does not have to pay for the damage caused by default. According to Sec. 286 para. 4 BGB, the contractor is not in default if he is not responsible for the delay in performance.

With regard to the remuneration of the contractor, the general law on contracts for work and services (Sec. 631 ff. BGB) contains an additional allocation of risk, which becomes particularly relevant if the parties have concluded a contract for work and materials. If the contractor is obliged to fabricate a product and then deliver it to the principal, the question arises as to who will be liable for additional costs of interim storage and later delivery if delivery is not made on the agreed date.

According to Sec. 644, 645 BGB (German Civil Code), the economic risk of accidental loss (damage, destruction) of the work prior to acceptance by the principal is initially borne by the contractor. Before acceptance, the contractor must repeat the work in the event of loss without being able to demand additional remuneration. However, this risk shall pass to the principal if the principal is in default of acceptance. This requires that the contractor offers his performance — provided that he is able to fulfil his performance obligations — and the principal does not accept the performance. If the principal does not accept the offer, the principal, though, may not invoke "force majeure" or the existence of an "unavoidable circumstance" in this respect. There is no basis in the law for this and according to Sec. 293 BGB (German Civil Code) default of acceptance occurs regardless of any fault on the part of the principal.

It is currently uncertain how difficulties occurring with supply chains or due to a lack of manpower as a result of quarantine measures in connection with the COVID-19 pandemic are to be assessed. It is also unclear whether the contractor is entitled to demand an extension of time without having to pay any agreed contractual penalties or compensate for other damage to the principal. There is no clear legal situation in the German Civil Code (BGB) or relevant case law on this issue.

The parties of construction contracts that are based on the rules of the BGB are therefore recommended to seek advice on the possibilities of alternative conflict solutions. In this way, the parties of the contract can hopefully reach a mutual solution with comparatively little time and expense and keep the damage caused to both parties at a minimum.

BUILDING CONTRACTS ACCORDING TO THE RULES OF VOB/B

The same advice should of course be given to the parties of construction contracts, which are based on the provisions of the German Construction Contract Procedures Part B (Vergabe — und Vertragsordnung für Bauleistungen — VOB/B). The above also applies to these construction contracts, and it may also be expected that both parties will probably be affected by the impact of the COVID-19 pandemic and that damage will occur on both sides due to the disruption of the construction process.

However, there are additional provisions and helpful case law with regard to the VOB/B construction contracts to answer the most pressing questions.

Extension of Time

Sec. 6 of the VOB/B generally assigns the risk of delay to the contractor. Sec. 6 (2) No. 1 VOB/B provides that contractors are only entitled to an extension of time if the delay was caused:

- by a circumstance caused by the principal;
- by strike or similar events caused by the employer; or
- by force majeure or other circumstances that are unavoidable for the contractor.

In view of the worldwide COVID-19 pandemic, the third alternative of Sec. 6 Para. 2 No. 1 VOB/B comes into consideration with regard to the possible extension of the completion deadlines. The prerequisite for a cost-neutral claim of the contractor for an extension of time is that the current "corona crisis" constitutes a case of force majeure or another unavoidable circumstance. No case law that explicitly deals with the case of a pandemic like this yet exists. It is therefore necessary to refer to comparable cases.

Whether the contractor is entitled to an extension of time also depends on whose decision the construction work is not performed as contractually agreed. Can workers not be deployed because the contractor follows an official instruction (e.g. under the German Protection Against Infection Act) and is prohibited to work on construction sites? Or has the contractor, because of his duty of care towards his employees, decided to arrange the work on the construction site differently in the current situation with the consequence that the work cannot be carried out as quickly as planned? In any case, as long as there are no official instructions on the basic lockdown of construction sites, the contractor must do everything reasonable to fulfil his contractual obligations in accordance with the contract.

In 1952, the German Federal Court of Justice (BGH) defines force majeure as an "external event, caused from the outside by elementary natural forces or by the actions of third parties, which is unforeseeable according to human insight and experience, cannot be prevented or rendered harmless by economically justifiable means, even by the utmost care reasonably to be expected according to the circumstances, and is also not to be accepted by the operating company due to its frequency." In 1997, the BGH clarified that even the slightest fault of the injured party excludes the existence of "force majeure." According to the BGH in a ruling from 1961, an unavoidable circumstance is a circumstance that, according to human insight and experience, is unforeseeable in the sense that, despite the use of economically bearable means, it or its effects cannot be prevented by the utmost care to be expected in the circumstances and its effects can be rendered harmless to a tolerable degree. In 1981, the BGH determined that any fault on the part of the contractor also means that a claim for an extension of time due to the existence of an unavoidable circumstance must be denied.

The event shall therefore be objectively unforeseeable and unavoidable for the contractor, both in the case of force majeure and in the case of an unavoidable circumstance. However, since in the case of an unavoidable circumstance it is not necessary for the disturbance to come from outside and to be non-company related, such a circumstance can also lie in the fact that there is a sudden, completely unforeseeable shortage of materials or personnel that cannot be eliminated even by more expensive procurement. Surely, the contractor will not be expected to "stockpile" building materials or constantly keep another construction crew on standby.

It is therefore essential for contractors — as always — to document as precisely as possible that a disturbance of the supply chain, a lack of employees or other disruptions are the cause of the Corona crisis and are not due to their own fault. In particular, communication with suppliers and authorities should be documented and secured.

In addition, the contractor must immediately report the existence of a disturbance in writing (i.e. by means of a signed document) in accordance with Sec. 6 Para. 1 VOB/B. If no notice of obstruction is verifiably sent, the obstructive circumstances shall not be taken into account in favor of the extension of time requested by the contractor. In accordance with Sec. 6 Para. 3 VOB/B, the contractor must do everything that can reasonably be expected of him to continue the work on the construction site. This may also mean that material has to be purchased at significantly higher prices or additional personnel has to be provided. If an interruption of the construction work lasts longer than three months, Sec. 6 Para. 7 VOB/B allows both contracting parties to terminate the construction contract.

The current pandemic may be considered a case of force majeure or an unavoidable circumstance, depending on the specific circumstances — at least for contracts concluded before the beginning of March 2020 (see below under C.). According to a recent report of the Federal Ministry of Building in Germany, the authorities should — if their contractors request a delay of execution or extension of time — "handle the requests of the contractors in individual cases with a sense of proportion, pragmatism and with a view to the overall situation." In addition, the letter also refers to a second demand of the construction industry, i.e. that the contractors' fees be paid and thus their liquidity secured. According to the Federal Ministry of Building, invoices are to be reviewed and settled immediately.

Contractual Penalties

Principals may demand the payment of contractual penalties if these were effectively agreed in the construction contract in accordance with Sec. 11 VOB/B. Subject to a corresponding agreement in the contract, the provision on the forfeiture of contractual penalties also applies to the extended, i.e. new, completion deadlines.

As explained above, the current COVID-19 situation — unless there is additional fault on the part of the contractor — is likely to lead to an extension of the execution deadlines with the consequence that contractual penalties will not be payable.

This is because the forfeiture of contractual penalties according to the VOB/B generally requires that the contractor is in default of performance. However, the contractor shall not be in default if the performance is not caused by circumstances for which he is not responsible. The necessary fault presupposes at least negligence on the part of the contractor. Since the VOB/B generally assigns the risk of delay to the contractor, this fault is initially assumed; the contractor bears the burden of proof that he is not responsible for the delay. According to a decision of the BGH dated January 14, 1999, it is sufficient that he can prove that the entire construction process was disrupted by circumstances for which he is not responsible.

In this respect, too, the contractor must carefully document exactly where, when and for what period of time concrete disruptions occurred and what he did to eliminate the disruption.

The courts call the submission required "construction-sequence-related submission," i.e. the undisturbed and disturbed progress of the construction work must be compared. This submission is often very difficult and for this reason alone, complaints by the contractor, which are aimed at a claim for extension of time and — often associated with this — additional compensation due to a delay of the construction work, often remain without success.

In some contracts — especially international ones — individual contractual regulations deviate from the above-mentioned legal rule — liability only in case of fault — and a liability of the contractor independent of fault is sometimes agreed upon. A corresponding regulation is not valid as a so-called "general term and condition" in contracts that are subject to German law and if it has been provided and used by the principal. Only if it is verifiable that the clause was individually negotiated in the concrete case would the contractor be liable without fault. Should such a clause be found in a contract, it is recommended to have it first examined specifically for its legal validity.

Liability for Damages in Case of Non-Compliance with the Agreed Completion Date

The principal may claim damages from the contractor if the contractor is responsible for a delay in the agreed schedule for the construction work. Claims for damages according to Sec. 6 Para. 6 VOB/B also require fault on the part of the damaging party. Such fault will not be supported if delays are caused exclusively by force majeure or unavoidable circumstances.

RECOMMENDATIONS FOR NEW CONTRACTS

With regard to construction contracts, there are currently three situations to consider:

- Existing contracts are to be treated according to the principles outlined above.
- Contracts that were and will be concluded during the acute crisis are to be treated differently. The entitlement to a penalty-free or cost-neutral extension of time is probably out of the question, as it is not possible to exercise force majeure or unavoidable circumstances because the pandemic is no longer a sudden and completely unforeseeable event. There will certainly be (legal) disputes as to when exactly the relevant point in time has been. However, the risk for the parties of the construction contract was recognizable and expectable at the latest at the beginning of March, when the first restrictions on public

life were announced in Germany. All draft contracts that are currently being negotiated should therefore reflect the special situation caused by the corona pandemic. Corresponding and concrete clauses shall be negotiated and agreed.

- Even after the current situation has hopefully been reasonably overcome in the near future, it is recommended to include a provision in future (model) contracts that ensures or at least regulates a clear distribution of risk in similar situations. After this "corona situation," nobody will be able to say that such circumstances do not need to be considered. Since the VOB/B imposes the risk of punctual construction work on the contractor, it is particularly in the interest of the contractors to agree appropriate provisions in this regard. However, despite the current Corona situation, principals cannot expect contractors to make precautionary measures for any comparable pandemic without stipulation.

The situation created by the so-called COVID-19 crisis is unprecedented in Germany, and there is no well-founded case law on the subject. Further developments occurring in the period after March 31, 2020, are not considered in this memo. The statements in this memo are not intended to replace legal advice in any particular case and K&L Gates LLP assumes no liability for the statements and legal assessments contained herein. The information may not be disclosed to third parties without our express prior consent.

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