COVID-19: GERMAN ACT TO MITIGATE THE CONSEQUENCES OF THE PANDEMIC

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Complex Commercial Litigation and Disputes Alert

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On March 25, 2020, the German Bundestag passed the "Act on Mitigation of the Consequences of the COVID-19 Pandemic in Civil, Insolvency and Criminal Proceedings" ("Act") as part of the so-called "Corona Package." The Act passed the German Federal States' Assembly ("Bundesrat") in a special session on March 27, 2020, and came into force on the same day.

In addition to regulations on criminal procedure law, the law contains regulations on general civil law, insolvency law and corporate law. For the newly created regulations on insolvency law and corporate law, please refer to the separate alerts of our corporate practice group.

This alert will outline general civil law aspects of the Act. As these are limited to consumers and micro-enterprises, the right to refuse performance or to adjust performance under the general statutory provisions will be examined.

EXTENSIVE LIMITATION TO CONSUMERS AND MICRO-ENTERPRISES

In contrast to the rules on corporate law and insolvency law, the rules on general civil law primarily focus on consumers and micro-enterprises within the meaning of Commission Recommendation 2003/361/EC of May 6, 2003, i.e., enterprises that employ fewer than 10 persons and whose annual turnover or annual balance sheet in total does not exceed EUR 2 million.

In the area of general civil law, the Introductory Act to the German Civil Code ("EGBGB") will be supplemented by an Article 240, which is to expire on September 30, 2022. The newly created Article 240 EGBGB provides for:

- a right to refuse performance until June 30, 2020, under a contract relating to "material continuing obligations" — according to the explanatory memorandum to the Act, these are continuing obligations that are necessary to cover services of general interest, e.g., compulsory insurance, contracts for the supply of electricity and gas or for telecommunications services — if an obstacle for performance results from COVID-19 (Article 240 § 1 EGBGB);
- a restriction of the lessor's right of termination under rental or lease agreements for land or premises if the tenant or lessee does not pay the rent or lease in the period from April 1, 2020, through June 30, 2020, and such nonperformance results from COVID-19 (Article 240 § 2 EGBGB);
- a suspension provision as well as an exclusion of termination under loan agreements if payment of interest and principal payments that will be due in the period from April 1, 2020, through June 30, 2020, is unreasonable for the borrower because the borrower has lost income as a result of COVID-19 (Article 240 § 3 EGBGB).

Article 240 § 1 EGBGB, which stipulates the right to refuse performance in the case of "material continuing obligations," applies only to consumers and micro-entrepreneurs. Correspondingly, Art. 240 § 3 EGBGB concerning the suspension and the exclusion of termination of loan agreements, in principle, only applies to consumer loan agreements. Art. 240 § 3 para. 8 EGBGB permits that the government may render a governmental order ("Rechtsverordnung") to extend the scope of application — such extension, however, may only be granted for micro-enterprises.

Only Art. 240 § 2 EGBGB, which stipulates the exclusion of the right of termination in the case of tenancies and leases, is not limited to a specific group of persons. For more information please visit our global Responding to COVID-19 resource center on K&L Gates Hub.

"FORCE MAJEURE" AND DEFAULTS IN PERFORMANCE UNDER GERMAN LAW

Thus, the Act on Mitigation of the Consequences of the COVID 19 Pandemic in Civil, Insolvency and Criminal Proceedings does not help companies that do not qualify as "micro-enterprises." The same applies — also to the group of persons mentioned in Art. 240 EGBGB — to "nonmaterial" continuing obligations as well as to other contracts.

For any contracting party, however, the right to refuse performance or to adjust performance may arise from the respective contractual agreements themselves as well as from the general statutory provisions.

Contractual Agreements ("Force Majeure")

In contracts that are governed by German law, so-called "force majeure" or "act of god" clauses, which are common in Anglo-American agreements, are the exception rather than the rule. If such a clause exists, the conditions for and the legal consequences of a "force majeure" are determined by the contractual agreements. Typically, epidemics are explicitly addressed in "force majeure" clauses. If this is not the case and the clause does not contain any comprehensive "catch-all" element, the scope of the clause must be determined by interpretation. The same applies to the question whether the general statutory provisions apply as a supplement.

Statutory Provisions

The German Civil Code ("Bürgerliches Gesetzbuch" — "BGB") does not provide for a general "force majeure" concept. Only in regard to specific types of contracts, the concept of "force majeure" can be occasionally found. In a judgment relating to travel agreements, the German Federal Court of Justice ("Bundesgerichtshof" — "BGH") held that "force majeure" is "an external event that cannot be averted, even by the utmost diligence that can reasonably be expected, and which cannot be attributed either to the operational sphere of the tour operator or the personal sphere of the traveler" (BGH, judgment dated May 16, 2017, docket no. X ZR 142/15). However, there is no provision under German law that provides for a general right to refuse to fulfil or to adjust contractual obligations in cases of "force majeure."

Consequently, contracting parties that wish to invoke an exclusion or an adjustment of their performance obligations as a result of COVID-19 have to rely on the general provisions of the BGB. In this respect, Sec. 275 BGB dealing with "impossibility" ("Unmöglichkeit") as well as on Sec. 313 BGB regarding the "discontinuation or adjustment of the basis of the transaction" ("Wegfall der Geschäftsgrundlage") may allow to suspend contractual obligations, or to — temporarily — adjust existing agreements.

Sec. 275 para. 1 BGB ("Impossibility")

Under Sec. 275 para. 1 BGB, the debtor is released from the obligation to perform if performance is impossible for the debtor or for anyone else. With regard to the cases of nonpayment of monetary debts, which have now been regulated by the legislator in Art. 240 EGBGB, however, it must be taken into account that Sec. 275 para. 1 BGB does not apply on monetary debts from the outset. In this respect, the BGH has repeatedly held that under the principle of unrestricted liability, everyone shall be liable for his or her financial capacity regardless of fault (BGH, judgment dated February 4, 2015, docket no. VIII ZR 175/14). Consequently, outside the scope of application of Article 240 EGBGB, the principle of "one has to have money" ("Geld hat man zu haben") continues to apply.

In contrast, a debtor can be released from a principal contractual obligation — e.g., the obligation to render a service or to deliver ordered goods — under Sec. 275 para. 1 BGB. If such release applies, as always, depends on the circumstances of the specific case. In this respect, "impossibility" may occur as so-called "personal impossibility" ("subjektive Unmöglichkeit"), i.e., the person that is obliged to perform under an agreement is unable to perform; furthermore, "impossibility" may occur in cases of so-called "absolute fixed transactions" ("absolutes Fixgeschäft"), in which punctual performance is so essential for fulfilment that a delay cannot constitute fulfilment.

The consequence of "impossibility" is that the debtor — for example a service provider or a supplier — is (temporarily) released from the obligation to perform. In this event, the contractual partner is likewise not obliged to provide the consideration — e.g. the remuneration for the service or the purchase price — under Sec. 326 para. 1 BGB. Furthermore, the contractual partner may terminate under Sec. 326 para. 5 BGB. Claims for damages remain unaffected. Such damage claims, however, require fault ("Verschulden"), which in cases of COVID-19 as "force majeure" is likely to be lacking.

Sec. 313 para. 1 BGB ("Discontinuation or Adjustment of the Basis of the Transaction")

Moreover, it is also possible that the effects of COVID-19 will have such a serious impact on the basis of a transaction that the contract will have to be adjusted — if necessary temporarily — in accordance with Sec. 313 para. 1 BGB. Under this provision, a contracting party can request the adaptation of a contract if the circumstances that have become the basis of the contract have changed seriously after the conclusion of the contract and if the parties would not have concluded the contract or would have concluded it with a different content if they had foreseen such change. If it is not possible to adapt the contract, a right of termination exists in accordance with Sec. 313 para. 3 BGB.

Moreover, an adaption under Sec. 313 para. 1 BGB requires that, taking into account all circumstances of the individual case, in particular the contractual or statutory distribution of risk, it cannot reasonably be expected of a party to the contract to adhere to the unchanged contract. The "basis of the transaction" within the meaning of Sec. 313 para. 1 BGB includes (aa) the expectations of one party (1) that have come to light at the time of the conclusion of a contract, (2) that have become apparent to the other party, and (3) that have not been objected to by the other party, or (bb) the common expectations of both parties about the existence or the future occurrence of certain circumstances, provided that the business intention of the parties is based on these expectations.

In principle, Sec. 313 para. 1 BGB applies on COVID-19-related hardship, although legal academic scholars have discussed that the distress caused by economic or social disasters and the problems arising from such disasters cannot be solved by means of Sec. 313, para. 1 BGB, and that it is necessary for the legislator to take action in this respect (Grüneberg, in: Palandt, BGB, 79th edition, 2020, Sec. 313, no. 5). However, health disasters with global effects such as COVID-19 have not (yet) been discussed in this context. Moreover, the legislative materials

on the Act on Mitigation of the Consequences of the COVID-19 in Civil, Insolvency and Criminal Proceedings neither indicate, nor even suggest that the legislator intended to deny protection by general provisions, such as Sec. 313 para. 1 BGB, for the group of persons that is not covered by Article 240 EGBGB.

Whether COVID-19-related hardship may cause "impossibility" within the meaning of Sec. 275 BGB, or may justify adaptation of a contract under Sec. 313 para. 1 BGB is subject of a legal examination taking into account all circumstances of the specific case. We will be happily available in this respect. K&L Gates has assisted numerous clients in evaluating contractual rights and obligations in connection with COVID-19.

DISCLAIMER

The situation created by the so-called COVID-19 crisis is unprecedented in Germany. No sound case law on the legal issues involved currently exists. Developments occurring in the period after March 26, 2020, are not considered in this alert. The statements in this alert are not intended to replace legal advice in any particular case, and K&L Gates assumes no liability for the statements and legal assessments contained therein.

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