

Impact of the COVID-19 pandemic on energy supply and trading contracts under German law

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The German legislative package in reaction to the current COVID-19 situation gives consumers and microenterprises rights to refuse payment obligations under energy supply contracts. In addition, financial imbalances caused by the pandemic may also trigger material adverse change clauses under energy supply and trading contracts. This may result in a need for immediate action by energy companies and energy-intensive industries.

In order to stop the spread of the coronavirus, private and business life is currently experiencing strong restrictions. In particular, these restrictions have financial impacts on both consumers and companies and in some cases lead to considerable (temporary) deterioration of their economic situation.

For energy companies and energy-intensive industrial enterprises, this can affect existing energy supply and energy trading contracts. On the one hand, the relevant legislative package of the German Federal Government entitles individual customers as well as microenterprises to temporarily refuse the payment of power and gas supplies. On the other hand, obligations to provide performance assurance or, in the worst case, termination rights can be triggered under energy trade and energy supply contracts if the economic situation of a contractual partner deteriorates.

1. Energy supply contracts: Right to refuse payments of electricity and gas supply

Under the rules of the legislative package of the German Federal Government to mitigate the consequences of the COVID-19 pandemic (which is expected to pass the German Bundesrat on 27 March), consumers and microenterprises have a right to refuse payments in relation to all long-term contracts concerning services of general interest. According to the explanatory memorandum to the law, this explicitly applies to electricity and gas supply contracts.

Accordingly, consumers and microenterprises (i.e. companies employing less than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million) can suspend the payment of their energy supplies until 30 June 2020, if they are unable to meet their payment obligations due to the crisis caused by the coronavirus pandemic, unless exercising such right to refuse payment is unreasonable for the supplier.

Since the right to refuse payment excludes secondary rights, suppliers are in such cases especially unable to enforce an interruption of supply by the network operator in case of payment defaults.

Numerous energy suppliers have already announced that they will anyhow refrain from interruptions of supply in the current situation. However, based on such new legislation, they have to take into account that additional liquidity needs may arise on their part, since such right to refuse payment do neither apply with respect to the relationship between the supplier and its upstream supplier, nor with regard to the payment of network fees and charges.

Energy supply companies should therefore analyze their existing customer structure to determine how many of those consumers and microenterprises could be entitled to refuse payment. Based on this, strategies should be developed to mitigate the consequential (temporary) loss in revenue.

2. Energy trading and energy supply contracts: Obligation to provide performance assurance and consequential termination rights due material adverse change

Numerous energy trading contracts - especially those based on the EFET standard documentation, but also individually designed contracts used in the market - define legal consequences in the event of a so-called "Material Adverse Change" (MAC). The same applies to large-volume supply contracts of energy-intensive industrial customers.

In particular, the contracts include provisions which determine under which circumstances a Material Adverse Change shall have occurred. This can be triggered on the basis of objective evidence (e.g. a credit rating is withdrawn or downgraded or a decline in the tangible net worth has occurred). However, under some contracts, a Material Adverse Change shall already be occurred if in the reasonable and good faith opinion of one contract party, the ability of the other party to perform its obligations under the contract is materially impaired.

Therefore, if an energy trading company or an energy-intensive enterprise should suffer considerable economic impacts or already face financial problems as a result of the COVID-19 pandemic, corresponding MAC clauses under energy trading or energy supply contracts can be triggered.

As a consequence, performance assurance will likely have to be provided at short notice. If this is not provided in due time, also termination rights may apply. Other legal consequences are also possible.

Energy trading companies and energy-intensive industrial enterprises facing financial problems in the current situation should therefore analyze whether MAC-clauses are included in their trading respectively their supply contracts and assess whether obligations to provide performance assurance could be triggered.

Energy trading companies and suppliers whose contractual partners are in an economic imbalance should examine whether the provision of performance assurance can be requested in order to mitigate the risk of payment defaults.

Need help? Hogan Lovells' energy law team has extensive expertise in the field of energy supply and energy trading contracts and will be happy to assist you with the necessary review of your contracts.

Contacts



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