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# Dealing with supply interruptions and restrictions due to COVID-19 in German Law

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The coronavirus SARS-CoV-2 ("COVID-19") is a stress test for many supply chains. The associated restrictions have the potential to disrupt production processes and confront manufacturers and suppliers alike with considerable challenges. The virus and the reactions of governments, companies and society to it can disrupt individual production steps and thus paralyze the entire supply chain. Reconstructing the supply chain after normalization of the situation will also create challenges.

In this context, the question arises as to whether, according to German law, performance obligations under a supply contract will continue to exist or whether and how they may need to be adapted. The questions as to what efforts the parties are obliged to make and what transitional adjustments are to be made for the ramp-down and ramp-up of supply chains are also becoming increasingly relevant.

## Legal Situation under German law

COVID-19 is an extraordinary event that has never been experienced before in this form. It is therefore well suited to fall in the category of force majeure in principle or in individual cases. According to the German legal understanding, force majeure is an external event, introduced from the outside, which is unforeseeable and unusual, and which cannot be prevented or rendered harmless by economically bearable means, even by the utmost care that can be reasonably expected in the circumstances. However, there is no blanket term of force majeure, but it rather depends on the individual circumstances.

If, for example, there is no ongoing obligation to supply (or no obligation to accept supplies), the problem can be solved by not confirming orders/ call-offs (or not placing orders/ call-offs) when COVID-19 is affecting the performance.

In case of an existing supply obligation, German law provides several possibilities to deal with force majeure in exchange relationships. If a supply performance is "impossible", the German legislator excludes the claim for supply, at least as long as the hindrance to perform exists (Section 275 German Civil Code ("**GCC**")).

If the service can still be provided, but if the circumstances have changed from the supplier's point of view to such an extent that the provision of the service is not economically bearable for him anymore, the German law provides for the possibility of a contract adjustment in accordance

with Section 313 GCC and the doctrine of frustration of contract ("*Störung der Geschäftsgrundlage*").

Both of the aforementioned cases can occur in connection with COVID-19: If a production plant is closed by a public authority, a specified supply of owed goods, for example, could be assessed as (temporarily) impossible in the sense of Section 275 GCC for the duration of the closure; the obligation to supply is excluded in this case. Vis versa the consideration (payment for the supplies) cannot be demanded for the duration of the non- supply. Depending on the individual case, this can also be the case with regard to the obligation to accept supplies, e.g. if further production steps of the manufacturer cannot be carried out due to the ordered closure of the plant. If, on the other hand, the supplier can adapt his production in such a way that supply is still possible, his obligation to perform remains in force.

However, the aforementioned shall only apply to the extent that the obligation to supply is originally affected by the impossibility or not bearable in the aforementioned sense. If a company, however, gets into financial difficulties due to COVID-19, the obligation to pay for received goods in general can not be suspended or reduced by reference to the concept of impossibility. If a business partner sees signs of possible liquidity problems or over-indebtedness, the instrument of the so-called defense of uncertainty (section 321 GCC) is possibly suitable to avoid a potential payment in advance. In such cases, the customer who is obliged to make advance payments may refuse to perform until the business partner either effects his performance or provides security (e.g. advance payment).

## Force Majeure clauses in supply contracts

Some supply contracts contain explicit clauses on force majeure. These clauses often provide for an exemption from the parties' obligation to perform if they are prevented from doing so by force majeure. In those cases, the aforementioned statutory provisions of Section 275 GCC and Section 313 GCC generally have no relevance. Nevertheless, an adjustment of the contract according to the statutory provisions stays possible in addition, if the corresponding requirements are fulfilled. This applies in particular if the force majeure clause only provides for a termination and not for an adjustment of the contract.

In this case, however, the inability to perform must be based on force majeure. The virus hast to be causal for the supplier not being able to provide the service owed. Moreover, case law assumes that any fault on the part of the debtor means that he can no longer invoke force majeure. A supplier must take all reasonable measures to prevent an interruption of operations (e.g. caused by a plant closure). Which measures a supplier can reasonably be expected to take (e.g. alternative delivery routes) depends on the circumstances of the individual case.

A different assessment may apply with regard to supply obligations that only are established after the occurrence of COVID-19. Many force majeure clauses link to whether the respective event of force majeure was foreseeable. This characteristic will no longer be fulfilled for supply obligations which arose in a time when the respective effects of COVID-19 were already known or foreseeable. In such cases it is recommended that any effects of COVID-19 on the supply obligation to be established be expressly regulated (for example by including a provision that the supply obligation is suspended for as long as the impairment caused by COVID-19 continues).

## Production reduction and stop as Force Majeure?

If the operation of the business has been prohibited by a public authority, it must regularly be assumed that the non-performance is due to force majeure. In this case, the characteristic of "externality", which is part of the definition of force majeure, is decisive. An administrative order can be classified  an external event if it aims not only to protect the workers but also the general public.

If, on the other hand, the supplier closes the plant without an official order for the voluntary protection of the employees, he, in principle, does not face an external risk. This is because it is the supplier's responsibility to organize his business in such a way that it remains performance-capable. Thus, the closure can basically be attributed to the risk sphere of the respective employer. In this case an exclusion or an adjustment of the obligation to perform according to the statutory provisions described above is possible.

In individual cases, German case law has ruled in connection with cholera and SARS that epidemics cannot be unilaterally assigned to the risk sphere of one party. Depending on the circumstances of the individual case, it appears possible to apply this interpretation to pandemic-related closures that are taken to prevent the further spread of the virus. Whether this is the case must be assessed on a case-by-case basis.

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