Distribution of risk in connection with coronavirus-related trade disruptions

Article by Philipp Reusch and Laura Kleiner

The spread of the SARS CoV-2 virus is having an impact on the economy as well, as plant closures in at-risk areas and disrupted supply routes have resulted in shipments being delayed or cancelled entirely. The companies affected by these problems face the question of how the content and scope of their duties should change as a result. In particular, the question of whether force majeure exists is frequently discussed. Whether an event of force majeure can be assumed depends on the circumstances of the individual case. This question is determined by the wording of the contract and the governing law, as well as by the extent of the disruption and the distribution of risk.

Contractual interpretation and stipulation of governing law

The starting point for the legal assessment in each case is the contractual relationship. Many (international) commercial agreements include force majeure clauses which specify when an event of force majeure exists and how such an event affects the duties of the individual parties. If this clause is unclear, or if the agreement does not include such a clause, further assessment of the situation is determined in accordance with the governing law. The governing law may be expressly stipulated in the contract or may be evident from the rules of international private law relating to the conflict of laws. As a result, the contract may be governed by German law, the UN Convention on Contracts for the International Sale of Goods (CISG) or the law of another state.

Force majeure in German law

The relevant provisions of German law are those relating to incapacity in accordance with § 275 of the Civil Code and frustration of contract in accordance with § 313 of the Civil Code. In case of incapacity, the duty of performance ceases to apply (temporarily). Frustration of contract establishes a right to adjustment of the contract or rescission.

Incapacity is assumed when performance is (temporarily) impossible or is possible only at a disproportionate expense. The former may be the case in connection with coronavirus, e.g. if a product (or component) is manufactured exclusively in a plant which is temporarily closed. The latter case is conceivable if obtaining a

substitute for the affected product (or component) is complicated by global supply shortages to such an extreme extent as to make it effectively impossible. This does not cover economic incapacity, i.e. if the performance would simply require higher costs or expenses. Frustration of contract may apply, but only in the rarest of cases. Frustration of contract applies if there is a serious change in circumstances of fundamental importance for conclusion of the contract. Procurement difficulties as a result of a pandemic may represent such a serious change. However, it is necessary to pay attention to the contractual or statutory distribution of risk. Typically, procurement risk is borne by the supplier vis-à-vis its customers. The standard for when a party can no longer be reasonably expected to perform the contract unchanged is high. The added cost or expense from obtaining a substitute product does not automatically result in frustration of contract.

Force majeure in accordance with the UN Convention on Contracts for the International Sale of Goods (CISG)

Obstacles to performance which are out of the debtor's control are addressed in Article 79 of the UN CISG. This includes cases which fall into the category of incapacity under German law as well as those which establish frustration of contract. In this case as well, the decisive criteria for determining when performance is impossible and unreasonable is the contractual distribution of risk and the scope of the additional cost and expense. The only legal consequence specified by Article 79 of the UN CISG is that the debtor is not liable for damages. However, it is generally assumed that the duty of performance ceases to apply as well, certainly in cases where performance is objectively impossible.

Issuance of "force majeure certificates" in China

Since companies based in China have thus far been most affected by the spread of coronavirus, it is worthwhile to take a look at legal conditions in China. The CCPIT (China Council for the Promotion of International Trade) is currently issuing "force majeure certificates" which are meant to serve as evidence for contracting parties and courts. Accordingly, the defense of force majeure should apply if the contractual relationship is governed by Chinese law. But if German law or the UN CISG applies, invoking such a certificate will not be sufficient.

Export prohibitions

Many countries have banned the export of certain products, as the German government has done for certain medical devices. Invoking force majeure in this case fails to address the problem. Rather, it will first be necessary to examine the contractual supply relationships, particularly in light of any Incoterms which may apply. This examination might reveal that the seller is obligated to deliver the product ex works, so that under the terms of the contract, the seller can deliver and charge for the affected product even if the buyer is unable to transport

the product from the seller's country into its own country. The relevant provisions in this case are clear in light of Incoterms.

Conclusion

The way in which the delay or cancelation of shipments due to coronavirus will affect the duties of manufacturers and suppliers must be assessed in each individual case based on the aforementioned criteria. The concept of force majeure is a legally tenable solution in only the rarest of cases.

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