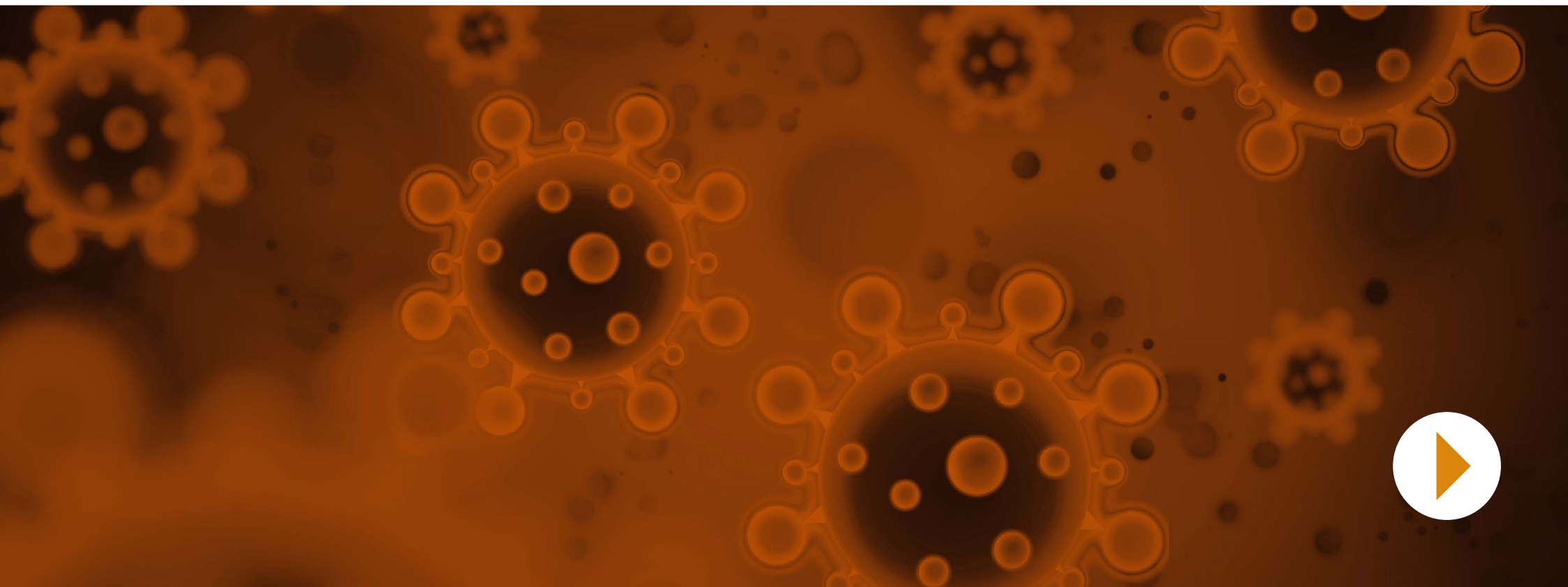
Bird & Bird

COVID-19 & Your Global Renewables Supply Chain

A Ten Step Guide - Germany



COVID-19 and the Renewables Sector

The renewables sector is feeling the impact as COVID-19 begins to cause huge global disruption to supply chains. The renewables sector is heavily reliant on global supply chains for raw materials and components, as well as an available workforce to physically build, operate & maintain the power plants.

Whilst we note that Chinese factories are now at various stages of restarting and ramping back up capacity, production across the rest of the globe is currently being hindered and disrupted. Examples of the practical impacts COVID-19 is having in the renewables sector supply chain are:

- *Imports/Exports stopped* - countries are enacting different measures concerning import of goods and services from COVID-19 high risk countries. The European Commission has allowed each Member State to adopt measures (proportionate and not prejudicial) aimed at safeguarding the health of its citizens and to prevent the spread of the virus COVID-19.
- *Factories and test facilities closing/reducing output* - countries are adopting differing approaches as to whether or not production must halt, which precaution measures needs to be taken (e.g. distance regulations for workers), and this is changing almost daily.
- *Reduced workforce* - employees not coming to work due to self-isolation, sickness or fear of risks.
- *Travel bans* - many countries have closed borders. Certain work in the sector (such as transport (on- and offshore), specialist installation or operation and maintenance) may require overseas-based specialists who are unable to get to the location of work due to travel restrictions.

Renewables is also a sector packed with tight contractual deadlines and liquidated damages ("pauschalierter Schadensersatz") and/or penalties ("Vertragsstrafen") for delay. Some project developers as well as utilities/generators need to grant a relief to their EPC and O&M Contractors, having no or little chance to mitigate the loss or damages. There are also often deployment deadlines in countries' auction systems, however there has been a positive note by the German Federal Network Agency ("BNetzA" - see in German).

The above all means that customers and suppliers are keen to understand their liabilities under their contracts should COVID-19 cause delay, and to work collaboratively to find solutions. Of particular interest is on which remedies a party may rely on in case of COVID-19 (such as suspension, termination or entitlement to increased costs under the change in law clause).

This note looks at how German contract law on force majeure applies to the COVID-19 pandemic and highlights other contractual hints and tips that both customers and suppliers should be aware of.

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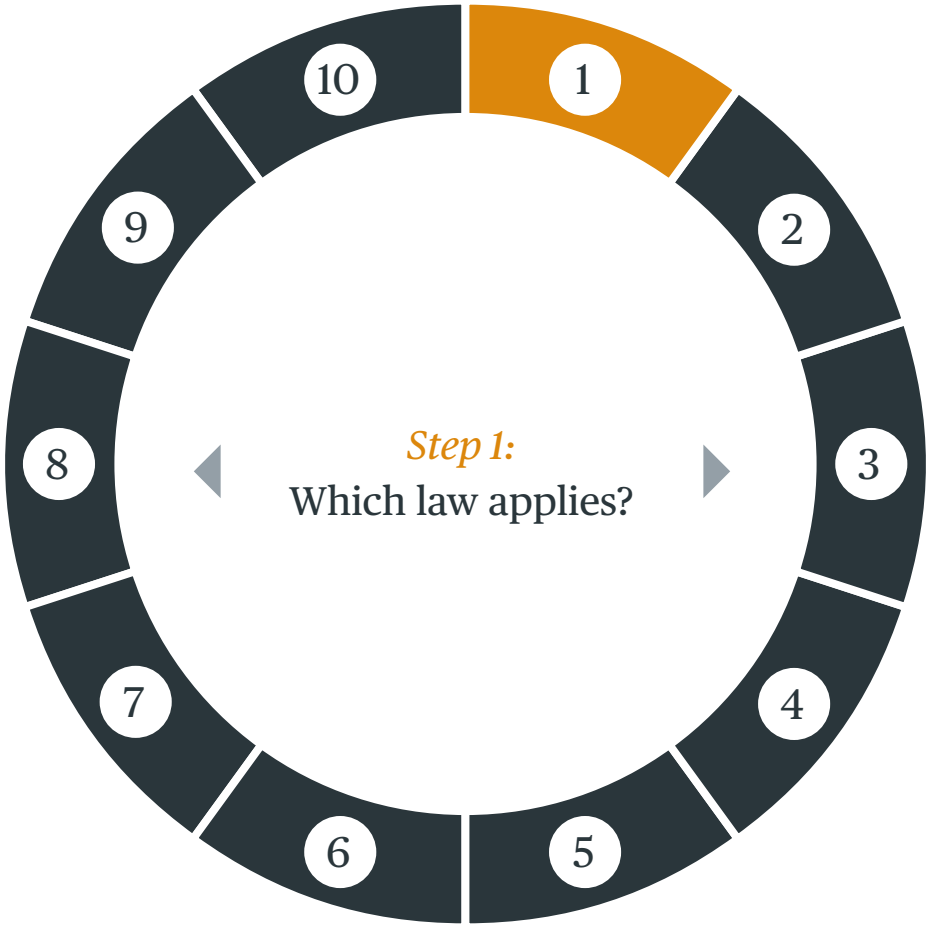

In assessing whether or not a party is entitled to a relief from its obligations, it is important to check both:

1. the governing law of the applicable contract; and
2. the laws in the jurisdiction where the obligations are being performed (particularly with regards to any mandatory restrictions in place regarding imports/exports, production and travel bans).

For example, the contract may be governed by German law, meaning the wording of the con-tract will be interpreted under German law interpretation principles and will be subject to German mandatory law. If the contracting parties have agreed on “German law” for an international contract, please be aware that in addition to German law, the UN Convention on Contracts for the International Sale of Goods (CISG) may apply - unless CISG has been expressly excluded, which is the case in most project contracts as well as in most general sales / purchase terms and conditions. However, the obligations under the contract may physically be performed elsewhere, such as Italy (e.g., at a factory or testing site), meaning Italian law and regulation is relevant for the question whether or not production must be suspended and needs to be taken into account to assess if the event in question qualifies as a force majeure event and to test its the impact (see Steps 4 & 5 below).

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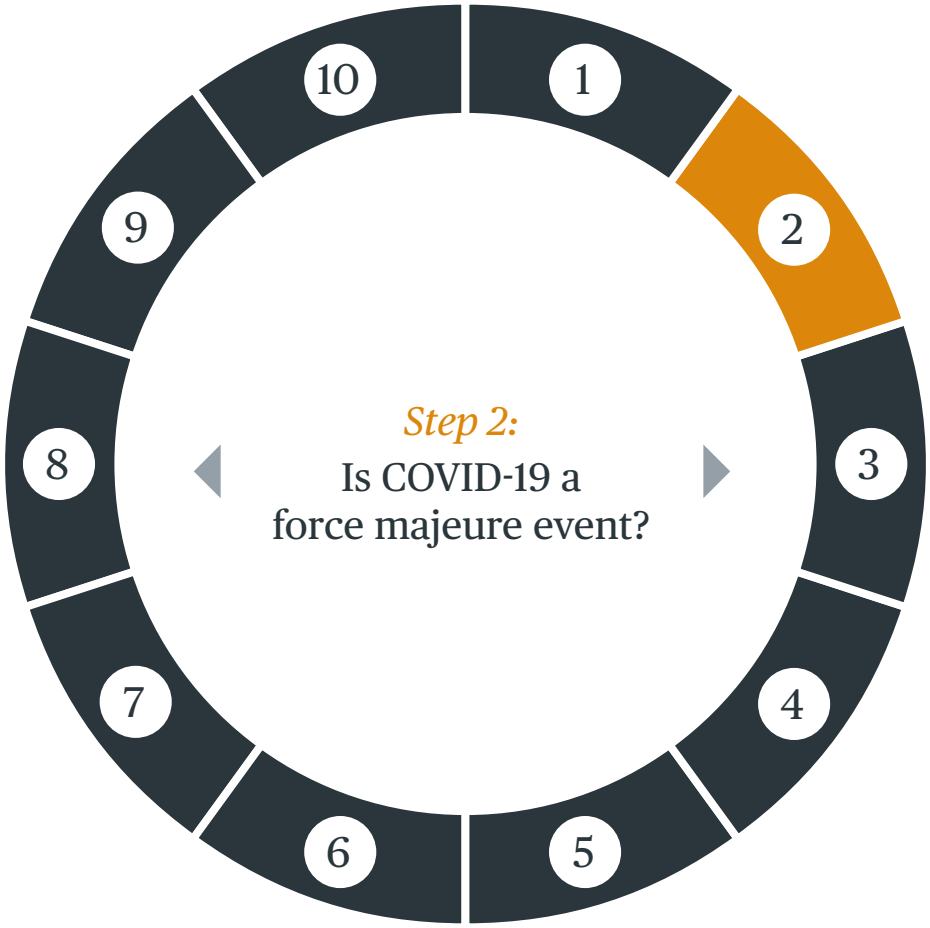

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Force majeure is a contractual mechanism that is only available if expressly set out in the contract. German law has no statutory provisions governing force majeure, nor will force majeure be implied into contracts under German law. However, should the parties neither have agreed on a force majeure clause, nor on another clause that may grant a relief (e.g. change in law clause, see step 8 below), there are non-contractual remedies a party can rely on following from German statutory law (see step 9 below).

Therefore, it should first be checked whether the specific contract contains provisions on force majeure. The language of a force majeure provision will be interpreted in line with existing interpretation principles under German law.

Force majeure clauses tend to follow two different formats:

- *Option 1* - A statement that a force majeure event is any event which is unforeseeable for the affected party at the date of entering into the contract or concluding the purchase order, beyond the reasonable control of the affected party and not attributable to the parties, followed by a non-exhaustive list of events which shall be considered to be force majeure.
- *Option 2* - An exhaustive list of events.

Option 1 is far more often seen in contracts governed by German law. Option 2 may be ineffective if such clause is part of general purchase/sales terms and conditions or if the force majeure clause of a contract is qualified as a general term and condition.

It should be noted that under German civil law also B2B contracts and consequently their clauses on force majeure ("Höhere Gewalt") and on (liquidated) damages or penalties in the event of delivery delays as part of general sales / purchase terms and conditions are subject to the control of the very strict German law on General Terms and Conditions ("German GTC Law"). It is important to check whether the clause in question is effective.

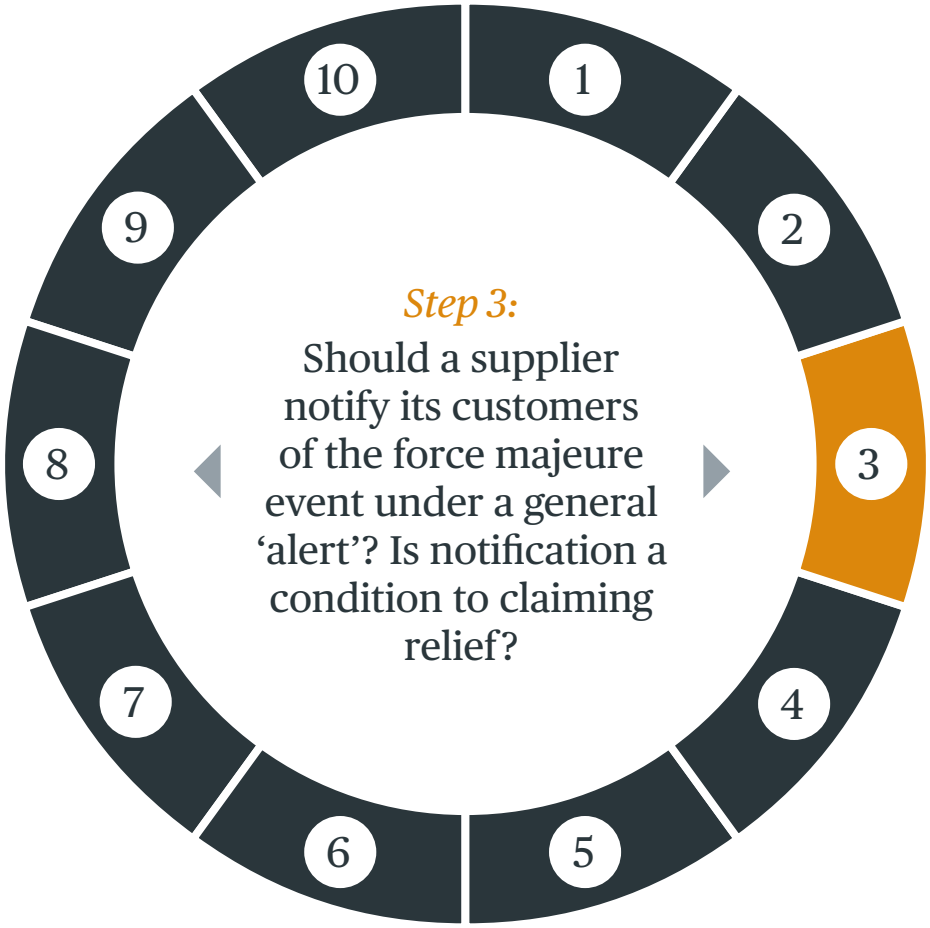
If the contractual content provides for a case of force majeure in the event of epidemics, pandemics, diseases or quarantine, there is a good chance that the party to the contract who does not deliver or only delivers with a delay as a result of COVID-19 can invoke force majeure. The same applies if a force majeure clause covers official orders and warnings. In addition, a company based in China can present a force majeure certificate, which will be provided by the China Council for the Promotion of International Trade (CCPIT) upon request. This paper constitutes evidence for the existence of the event, i.e. the background of the omitted or delayed delivery, but not for the fact that a case of force majeure exists.

However, if pandemic is not expressly listed, other events that may be applied to COVID-19 include:

- "shortage of supplies or raw materials" - where the downstream impact of COVID-19 is limited availability of supplies/raw materials in the market as a whole, not just from a party's contractual or preferred supplier;
- "labour shortages" - where workers are unable to man factories because they are off work due to sickness or self-isolation; and
- "Act of Government" - where an act by the Government or a government agency in a country has caused the disruption.

If the contract follows option 1, then the following aspects should be considered:

- Even if COVID-19 appears as a force majeure event under the contract, it does not automatically follow that the impact on business is beyond reasonable control, and the affected party will still need to comply with the remaining steps below in order to claim relief.
- Is the affected party claiming COVID-19 as the force majeure event, or another event that may have arisen as a result of COVID-19 (e.g. factory closure, lack of workforce)? This could be important for when notice obligations are triggered and how long the force majeure event is set to continue (COVID-19 may continue for months, whereas supply shortage may be shorter term).



In order to prevent direct liability based on contractual provisions, these should be checked for specific information requirements.

Even if there are no specific contractual requirements, the affected party may try to prevent any inconsistencies by informing the other party of the circumstances. However, the following principles should be observed:

- A general ‘alert’ may not satisfy the force majeure notification requirements in the contract as more factual detail is likely to be required.
- A general alert may ‘set the clock ticking’ that the affected party considers the event to be a force majeure event, meaning formal notice should be served under the contract within the specified time period.

As far as force majeure clauses are concerned, they are likely to require that the affected party serves notice of the force majeure event within a specified period. This may be drafted as a contractual obligation to serve notice, or as a condition to claiming relief. Look out for words/phrases such as “provided that” or “conditional upon” - these may indicate that if the affected party fails to serve notice within the required time period it loses its right to claim relief. The affected party must follow the requirements of the notice provision meticulously including who the notice should be addressed to, how it should be sent and information it needs to contain.

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Step 4:

What does an affected party need to do to prove that it has undertaken “due diligence” while performing its obligations?

Once a force majeure event has been established, the steps an affected party has to follow to claim relief will depend on what the contract says.

Nevertheless, one of the most important things is always to document the concrete facts in de-tail in order to be able to prove any effects on delivery and production possibilities.

In principle, the company must prove that the event causing the impossibility occurred and that it is precisely this event that makes the contract unfulfillable. So the key is the existence of a causal link between the non-performance of the contract (or improper performance) and this occurrence of force majeure and proving it.

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The affected party must show that it has taken “all reasonable steps” to mitigate the consequences of COVID-19. This is an implied duty which applies, in all apart from exceptional situations, even if the contract contains no express clause requiring the affected party to mitigate the impact of the force majeure event.

It will be a question of fact as to whether an affected party has taken steps to mitigate the impact, but relevant factors could be:

- Assuming the stop in production has not been mandated by law in the applicable jurisdiction, what could the affected party have done to keep producing during COVID-19 (e.g. protective measures, redeploying staff, recruiting additional staff)?
- Could the affected party have conceivably switched suppliers - e.g. used an alternative shipping company that was still running?
- Could the affected party have reasonable relocated the production to another production site?
- Have reasonable measures been followed to store (partial) products or vendor parts?
- Could the transport have been reorganized in a reasonable manner?

Whether such a step is reasonable must be examined in each individual case. This applies in particular to significantly more expensive transport options (e.g. air freight instead of ship freight). Often the actual contractual terms offer starting points; however, an obligation to bear excessively high (“unreasonable”) transport costs must be rejected.

There is a lack of German case law relevant legal literature that defines the legal term of “reasonableness” in the context of a force majeure situation. For the individual case examination, however, the concept of reasonableness in the provisions on force majeure in the UN Convention on Contracts for the International Sale of Goods (Art. 79 CISG) and on the doctrine of frustration in § 313 BGB may pro-vide guidance. However, such guidance can only be supplementary and subject to the interpretation of the relevant contractual provisions.

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Step 6:

If I am entitled to force majeure ‘relief’, what does this actually mean un-der the contract?

An entitlement to force majeure relief generally means that the contract is still binding, but the affected party is exempted from its performance obligations as long as the force majeure event exists. Most contracts grant the affected party a right to claim an adaption of the program, however no compensation of additional costs.

Which legal consequence a force majeure clause has, needs to be assessed in the individual case. This entails the contractual rights (expiration of the contract, termination, withdrawal), the way of proceeding (e.g., the need to notify the other party), or the consequences of the actions taken (e.g., payment of a contractual penalty).

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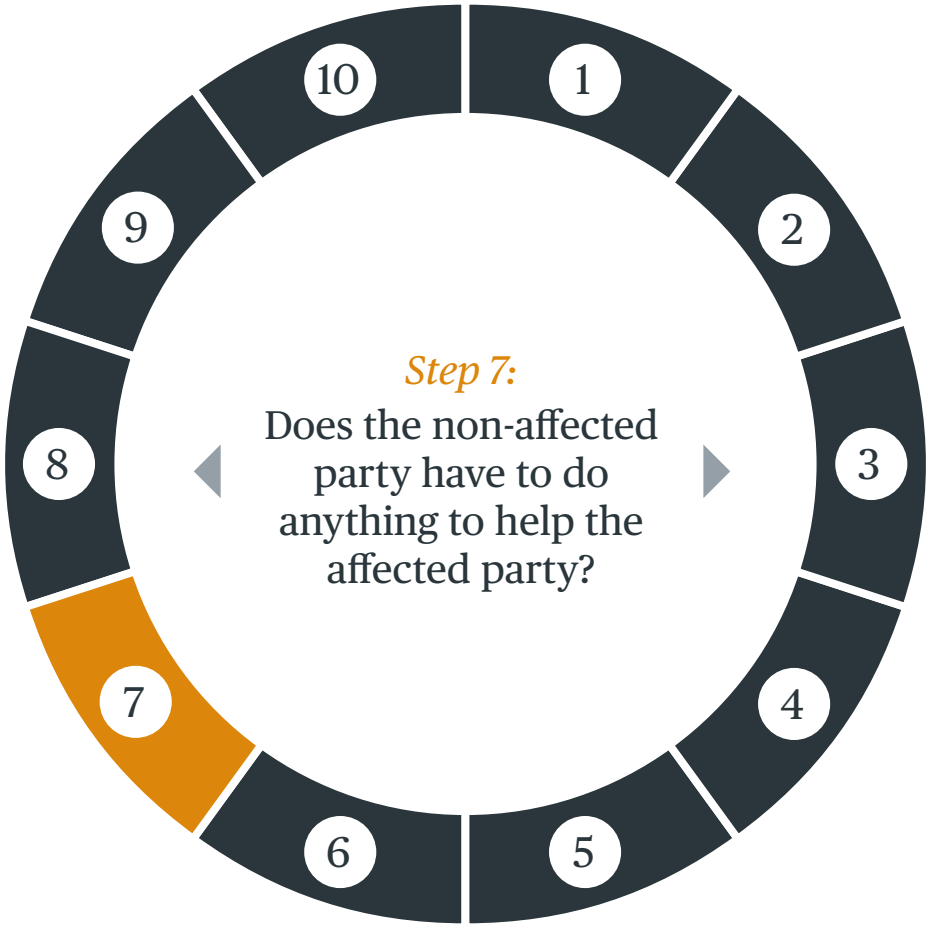

Step 7:

Does the non-affected party have to do anything to help the affected party?

This will depend on the contract. The non-affected party may have a contractual obligation to help the affected party to mitigate the impact of the force majeure event. Possible obligations may also arise from German statutory law, e.g. from the principle of good faith according to § 242 BGB.

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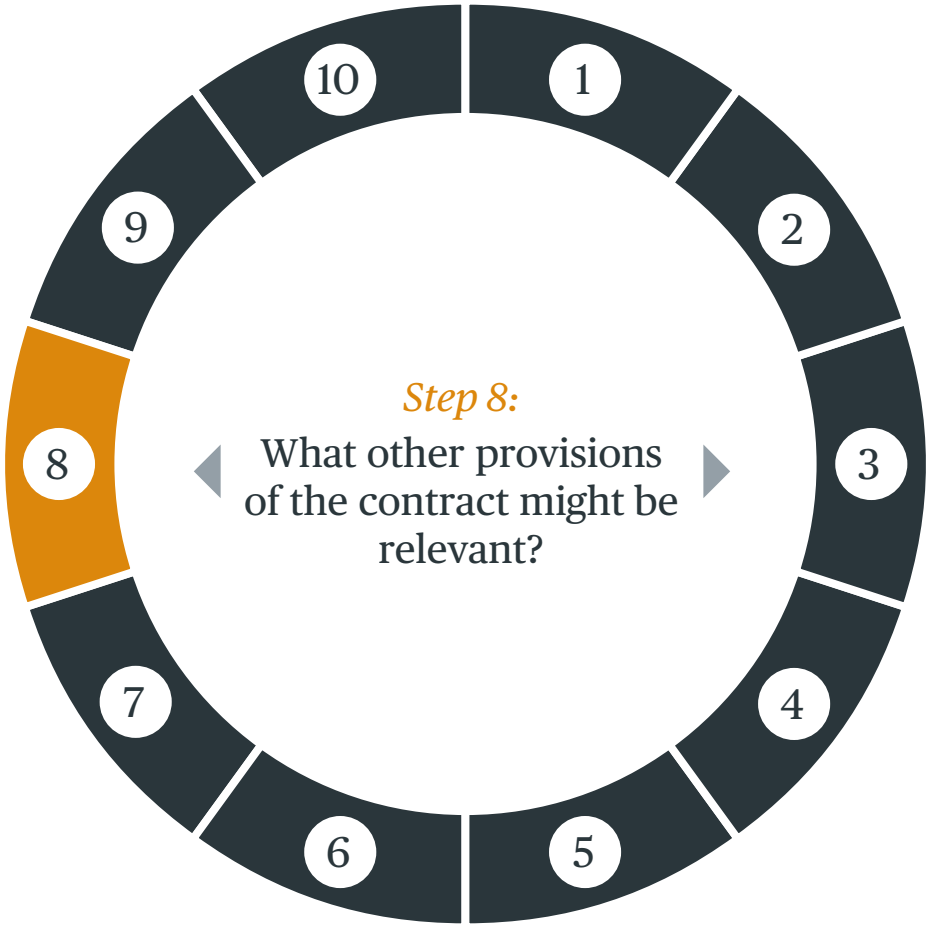

Step 8:

What other provisions of the contract might be relevant?

We suggest taking a holistic view of the entire contract. The following clauses may be particularly relevant:

- *Payment* - any rights for the customer to withhold payments if obligations are not performed (even if due to force majeure)?
- *Suspension/hardship* - any rights for the affected party to suspend its performance (for example due to economic change or under an express 'hardship' clause)?
- *Termination* - any compensation payable for termination for force majeure?
- *Change in Law* - many countries are introducing new laws or regulation to deal with COVID-19 which could make performance of obligations more expensive. How is this risk dealt with? How is "applicable law" defined for the change in law clause and does this cover guidance and legislation? For example, if factory is in France and French law impacts costs of performance, does this still trigger a change in law price adjustment if the contract is governed by German law?
- *Availability/take or pay service credits* - do service credits still apply even if the reason the supplier has not supplied is force majeure?
- *Material adverse effect* - are there any clauses entitling a party to terminate the con-tract if there is an event that has material adverse consequences or means that the con-tract would be loss making?
- *Health & safety* - can the supplier still comply with health & safety regulations and guidance that it may be contractually bound to comply with?
- *Key personnel* - are specified people earmarked for particular obligations?
- *Notice clause* - ensure compliance in order to ensure that notices are valid and can be relied upon.
- *Guaranteed delivery dates and other provisions of an unforeseeable impairment of the supply relationship* - to ensure that you protect your rights and comply with your obligations, these provisions should be legally evaluated in time and, if necessary, subsequently amended.
- *Variations* - any amendments agreed due to COVID-19 will need to be made in accordance with the "variations clause" (which may require variations to be in writing).
- *No waiver* - a "no waiver clause" does not necessarily protect a party from post-breach inaction. A non-breaching party should still reserve its rights and remedies and notify the party in breach by formal contractual notice.
- Dispute resolution which may include an "escalation clause" which includes parties' agreement to resolve any dispute on a staged basis.

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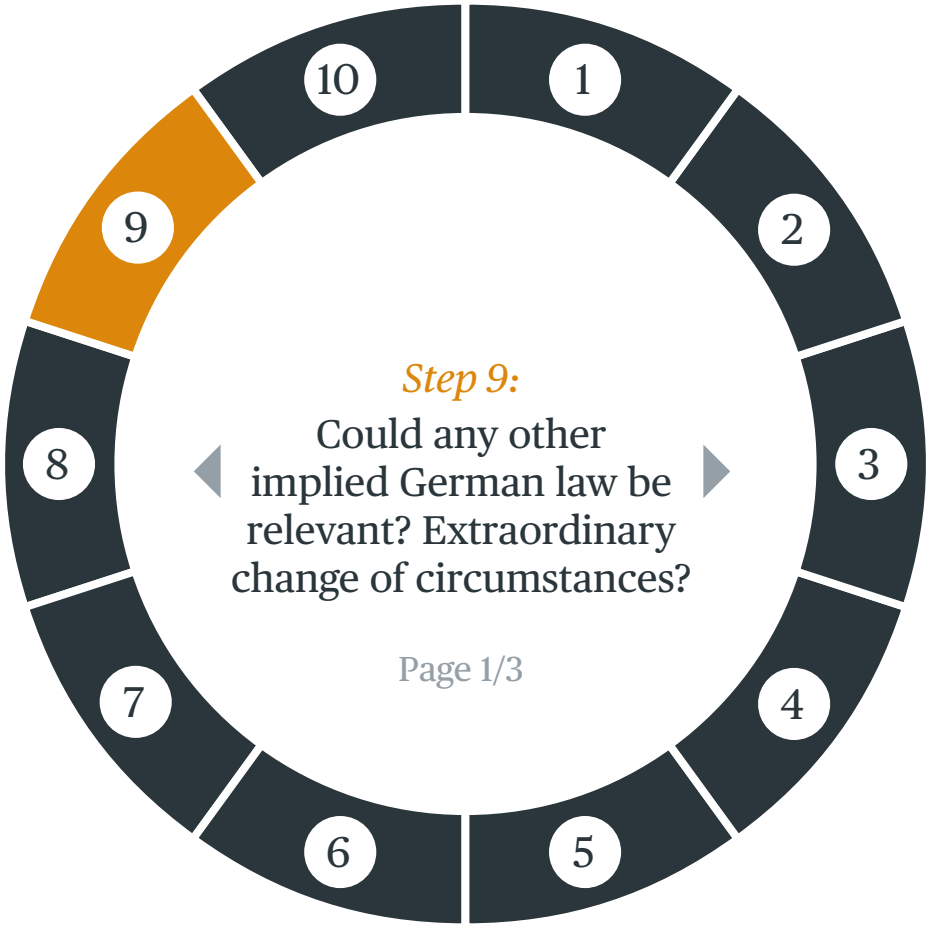

Step 9:

Could any other implied German law be relevant? Extraordinary change of circumstances?

In the absence of any contractual force majeure clause or any other clause which may grant relief (e.g. a change in law clause, see step 8 below), a party would have to rely on the statutory provisions. These can also partly apply in addition to a force majeure clause, if the force majeure clause is not conclusive by way of exception.

The remedies a party can rely on or the legal arguments a party can draw out of the German Civil Code ("BGB") in this context are as follows:

- Right to adapt or revoke the contract based on the doctrine of frustration: The effects of COVID-19 may in individual cases interfere with the economic basis of the con-tract/ transaction (doctrine of frustration, § 313 BGB).

  An interference with the economic basis of the contract/transaction exists if

  - circumstances which became the basis of a contract have significantly changed since the contract was entered into; and
  - the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change.

  In case the effects of COVID-19 interfere with the economic basis of the contract/ transaction, the affected party may be entitled to adapt the contract, if such party cannot reasonably be expected to uphold the contract without alteration, taking account of all the circumstances of the specific case, in particular the contractual or statutory distribution of risk.

  A comprehensive analysis of the entire contractual relationship is necessary to assess if the doctrine of frustration may apply. In this context, it is also crucial whether the disruptive event falls within the risk sphere of a party who has contractually assumed this risk or must bear it according to the agreed provisions of the contract. If this is the case, the courts often do not grant a right to adapt or revoke the contract.

  From this point of view, a right to adjust the contract price due to an interference with the economic basis of the contract/transaction does regularly not exist, e.g. if a "fixed price" or "lump sum price" has been agreed.

  Exceptionally, the party concerned may also demand the dissolution of the contract (withdrawal or, in the case of continuing obligations, termination).

- Obligation to pay delay (liquidated) damages or penalties: Often contracts and sales/ purchasing conditions or general terms and conditions provide for delay (liquidated) damages or delay penalties. However, even without contractual provisions, there is a basic obligation to pay damages in the event of delays, unless this has been effectively excluded by contract.

Continuation of step 9

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Step 9:

Could any other implied German law be relevant? Extraordinary change of circumstances?

In principle, COVID-19 can lead to the fact that you or your contractual partner are not responsible for the delay (should you or your contractual partner not already be entitled to adapt contract, to refuse performance or to exempted from the obligations). If you or your contractual partner are not responsible for the delay, there is also no obligation to pay (liquidated) damages or penalties. Something different may apply if a no-fault obligation to pay (liquidated) damages or penalties has been agreed upon in a permissible manner (i.e. usually outside of the terms of sale/purchase or general terms and conditions).

As already mentioned (see step 2 above), please note that under German civil law also B2B contracts and consequently their clauses on on (liquidated) damages or penalties in the event of delivery delays as part of general sales / purchase terms and conditions are subject to the control of the very strict German law on General Terms and Conditions ("German GTC Law" - for details see step 2 above).

- Right to terminate the contract: Even without a force majeure clause, your affected contracts could be terminable. In addition to the already mentioned termination due to the doctrine of frustration (§ 313 BGB), termination for good cause is also conceivable here. This right of termination can be based on contract or German civil law (§§ 314, 648a BGB). A termination according to §§ 314, 648a BGB has even stricter requirements than a termination due to disturbance of the business basis according to § 313 BGB. The right of termination for good cause cannot be effectively excluded by contract.

  Therefore, it is primarily necessary to check whether important reasons for termination are explicitly mentioned in the contract and whether one of these reasons could cover the consequences of COVID-19.

  However, even if this is not the case, an important reason for termination may exist according to §§ 314, 648a BGB: Namely, if the situation caused by COVID-19 for you or your contractual partners leads to the fact that under consideration of all circumstances of the individual case as well as the interests of both parties, the continuation of the contractual relationship until its scheduled end or - if not excluded - until the effectiveness of an ordinary termination is not reasonable. The contractual distribution of risk can also be decisive in this context.

- Right to refuse performance due to economic impossibility of performance: A right to refuse performance may exceptionally exist if the effects of COVID-19 lead to a gross disproportion between the cost of performance and the benefit of the performance (§ 275 para. 2 BGB). Such a right to refuse performance will, however, also be rather difficult to justify in the context of COVID-19. In particular, it must be taken into account that the creditor's interest in performance may also increase.

Continuation of step 9

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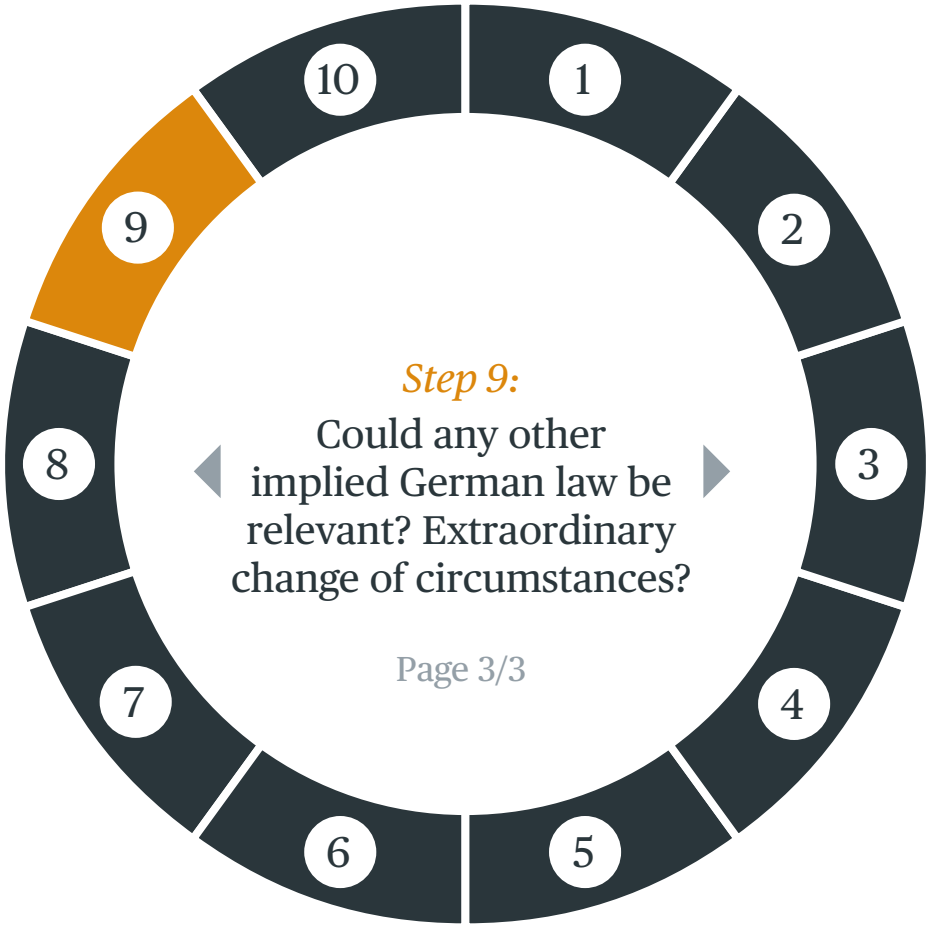

Step 9:

Could any other implied German law be relevant? Extraordinary change of circumstances?

- Exemption from the obligation to perform or from the consideration obligation due to impossibility of performance: In very rare exceptional cases you are not obliged to perform if the performance is impossible for you (or in general - § 275 para. 1 BGB). In this case, the consideration obligation of your contractual partner also does not apply (§ 326 para. 1 sentence 1 BGB).

  The effects of COVID-19 can, for example, lead to an exemption from the obligation to perform or from the consideration obligation,

  1. if the service can only be provided at a very specific time or within a very specific period of time from the outset, as it would miss its purpose at any other time and would therefore be a completely different work/service (so-called absolute fixed deal ("absolutes Fixgeschäft"); or
  2. if the service can also be performed later, but the purpose of the work service is missed and the usability of the work/service is part of the agreed obligation (which, however, will be extremely rare).

  However, the hurdle of achieving an exemption from the obligation to perform or from the consideration obligation is high. In principle, each party bears the risk of the usability of the service. In this case as well, the actual content of the contractual provisions is crucial.

- Set of measures by German Federal Government: It should also be noted that the "Act on Mitigation of the Consequences of the COVID 19 Pandemic in Civil, Insolvency and Criminal Proceedings Law" of 27 March 2020 grants

  - rights to refuse performance for micro enterprises (i.e. enterprises with fewer than 10 employees and with an annual turnover or balance below EUR 2 million); and
  - an exclusion of termination of rental and lease contracts in the event of late payment due to the effects of COVID-19,

  each of the above limited in time until 30 June 2020. This period may be extended by ordinance until 30 September 2020.

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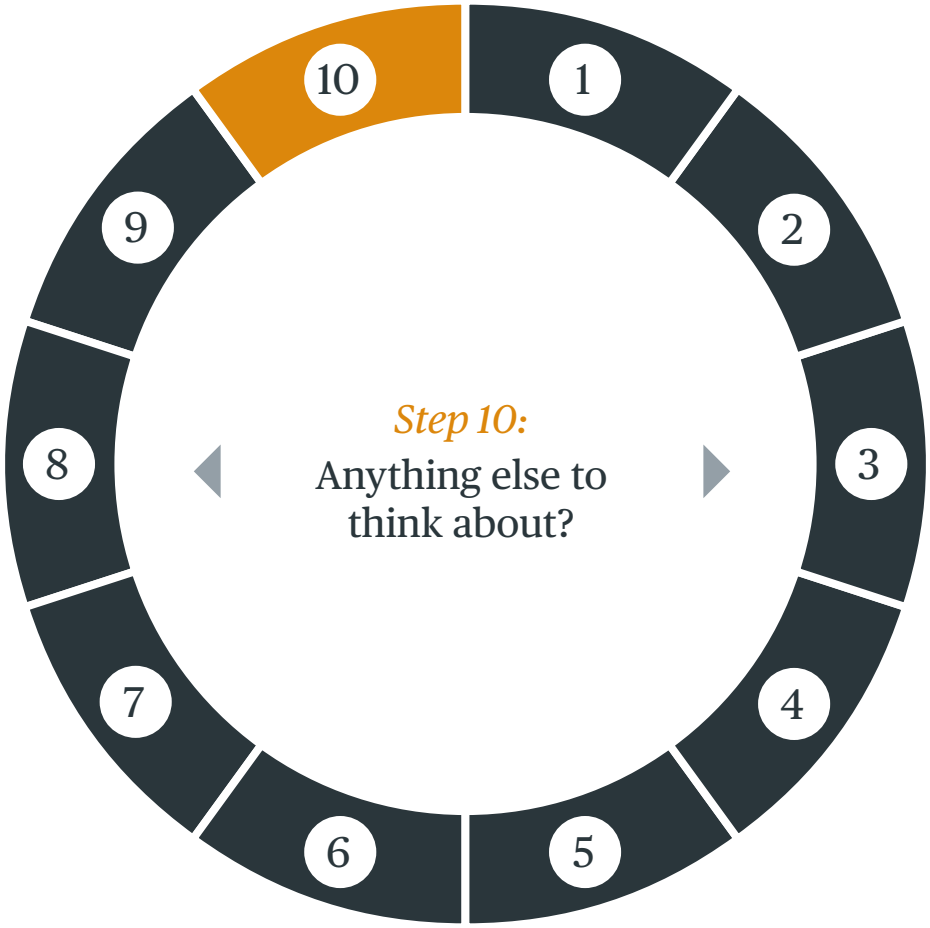

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1. Please pay attention to new legislation issued from time to time in order to timely undertake any necessary step.

2. Take a holistic view of the contract's analysis - consider what clauses may help/hinder and do not forget to look at the boilerplate.

3. Retain documented evidence of steps you are taking, the reasons surrounding those steps and steps taken to mitigate (and also steps counterparties may be taking if they are the ones invoking force majeure). This could include credible records - including trustworthy public domain information where available - which set out the factual context for the decision in question. It is important to document the alternative options available at the time of performance (or lack of them!).

4. Consider whether you wish to adopt a collaborative/non-adversarial approach to resolve the issue. Early engagement with contract counterparties and a collaborative resolution of issues may be preferable to an adversarial approach.

5. Resource supply wholly or partially - risks can be reduced or removed if you have a viable alternative which can be implemented quickly. Consideration should be given to the lead times for re-supply and how these fit with existing inventory. Be careful as re-sourcing may be in breach of existing supply contracts.

6. Recover assets - you may have supplied tools or certain assets may be used under licence. Equally, there may be stock or other materials on site which belong to you. The terms of any applicable contract will strongly influence your ability to recover these items. However, in case the difficulties the counterparty is undergoing end up by causing the commencement of insolvency proceedings, such recovery might become exponentially more difficult.

7. Ensure you make all required third party notifications in timely fashion (including insurance, industry regulators, etc.). Regular and timely information of your contractual partners on the extent of the delays or failures in your performance is essential. Relevant contractual provisions often contain an information period. If such a deadline is not included, your contractual partners must generally be informed of delays and failures in your performance without undue delay. At the same time, however, you should inform carefully, because too much information or information that later turns out to be incorrect can weaken your position vis-à-vis your contractual partner.

8. Be careful when entering into new contracts or issuing/accepting new purchase orders:

9. We recommend explicitly including COVID-19 and its effects in your future contracts. We also recommend concluding supplementary agreements for existing (framework) contracts, if further individual contracts are to be concluded.

10. The current COVID-19 situation is now generally known. However, it cannot be ruled out that - even if the current wave of infection flattens out - further waves of infection may occur in the future. It will then be much more difficult - if not impossible - to justify the fact that delivery delays and failures in performance were unforeseeable or unavoidable in the future. There is thus a high liability risk in the event of future delays and failures in performance. Contractual precautions should definitely be taken here.

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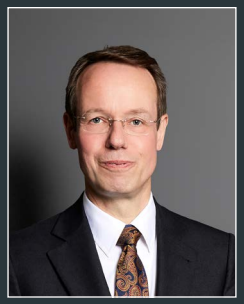

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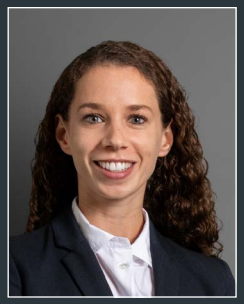

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