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Legislation to mitigate the consequences of the COVID-19 pandemic

General contract law & loan agreements

The spread of the SARS CoV-2 virus (COVID 19 pandemic) and the measures taken by the authorities to prevent the rise in virus infections have led to significant restrictions in all areas of private and business life. Numerous facilities have been closed, events have been banned and the activities of manufacturing companies have been restricted or suspended.

The aim of the law is to mitigate the losses of income. With the section changing the Introductory Act to the German Civil Code (EGBGB), the Federal Government is not aiming at protecting commercial transactions as a whole, but at securing the livelihood of consumers and the economic basis of particularly vulnerable enterprises against the economic impact of the coronavirus. The primary **aim** is to **protect** consumers and micro-enterprises if they cannot fulfil their contractual obligations in relation to "substantial continuing obligations".

Article 5 of the legislation intends to redraft Article 240 of the Introductory Act to the Civil Code. The following description is based on the draft law adopted by the Bundestag on 25 March 2020, printed matter 19/18110.

- **General contract law**

In the area of civil law, the new law introduces a moratorium on the fulfilment of contractual claims arising from continuing obligations, granting a deferral to affected consumers and micro-enterprises that are unable to provide their contractually owed obligations due to the pandemic. There is concern, however, that - at least with regard to the general contract law - the regulation will only delay the difficulties. Due to the expiry of the regulations' temporal scope of application on 30 June 2020, the obligations are due immediately afterwards. The financial difficulties described at the beginning will likely reappear.

The moratorium refers to **consumers** (§ 13 BGB) in the context of consumer contracts (§ 310 (3) BGB); a right to refuse performance is also granted to **micro-enterprises** within the definition of European Commission Recommendation 2003/361/EC - i.e. companies employing less than 10 persons and whose annual turnover or annual balance sheet does not exceed EUR 2 million (**personal scope of application**).

The right to refuse performance applies to all **essential continuing obligations**. For consumers, these are continuing obligations which are essential to provide for their adequate basic needs – for example in relation to contracts dealing with electricity, gas, water or telecommunication. In respect to micro-enterprises, the regulation covers continuing obligations if they are essential for the reasonable continuation of the business. As the explanatory memorandum shows, this essentially includes the aforementioned group of contracts. Legal scholars note that these may also include important supplier relationships, provided that they are structured as continuing obligations.

A further condition of the right to refuse performance is that the consumers cannot – due to circumstances that are caused by the COVID-19 pandemic – fulfil their obligations without endangering their adequate means for living or, those of their dependents. For micro-entrepreneurs, a similar condition exists. The new regulations do not apply if the refusal to pay is **unreasonable** for the creditor.

When exercised by the debtor, the right to refuse performance means that the debtor cannot be in default with his performance. The right to refuse performance is intended to prevent the enforcement of claims linked to the non-performance of performance obligations (e.g. damages for delay, § 286 (1) BGB, as well as default interest; damages in lieu of performance, § 281 (1) BGB; withdrawal, § 323 (1) BGB). Furthermore, the refusal to perform does not *per se* constitute a breach of duty which would justify an extraordinary termination of the contract by the contractual partner (§ 314 BGB). The primary obligation to perform remains, it needs to be fulfilled after the moratorium has expired.

The regulation applies until 30 June 2020 for all contracts concluded before 8 March 2020 (**temporal scope**). The regulation authorizes the Federal Government to extend moratorium until 30 September 2020 and even allows an extension beyond this period.

- **Consumer loan agreements**

With regard to consumer loan agreements, a **deferral provision** for repayment, amortization and interest payments as well as the option of a **contract adjustment** after the deferment period has expired is to be introduced. These measures intend to enable the contracting parties to discuss a potential agreement. This will be accompanied by **protection against termination**.

The new regulation affects all consumer loan agreements within the meaning of § 491 BGB that were concluded before 15 March 2020. All claims which become due between April 1, 2020 and June 30, 2020 are postponed by three months from their respective due date if and to the extent the consumer suffers a decline of income due to circumstances caused by the COVID-19 pandemic. Due to these declines of income, the fulfilment of the relevant obligations must be unreasonable for the consumer. If necessary, the borrower must prove these circumstances. The consumer's default is thus prevented.

Until the expiry of the deferment period, termination by the lender due to default in payment, significant deterioration in the financial circumstances of the consumer or the deterioration of the realizable value of any security granted for such loan is also excluded. This significantly extends the protection against termination in view of the expected economic losses. In turn, the deferment and termination provisions do not apply if they are unreasonable for the lender.

The creditor is also called upon to discuss a potential agreement and conceivable measures of support for the future of the loan with the consumer. If the creditor and consumer cannot agree on an arrangement for the time period after 30 June 2020, the term of the contract will be extended by a total of three months. The law also provides for the authorization of the Federal Government to extend the rules to other groups, in particular **micro-enterprises**. With regard to the temporal scope of application of the regulation, the protective provision may be extended.

- **Conclusion**

Overall, the legislation introduces well-meant innovations to support consumers and micro-enterprises affected by the COVID-19 pandemic. However, the implementation of the legislation already indicates potential for tension; in particular, because - as explained

above - only a delay of the problem is to be expected. Moreover, the legislation introduces a number of undefined legal terms, especially the sections dealing with the right to refuse performance by micro-enterprises. These undefined terms complicate the necessary differentiation and are problematic on the grounds that the prerequisites of the right to refuse performance are thus unclear. This can have serious consequences for the contracting parties.

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