

The effects of the military conflict in Ukraine are serious, far-reaching and, ultimately, unforeseeable at the present time. Supply relationships will not remain unaffected, and there are numerous questions regarding the consequences under contract law.

Force Majeure

The term *force majeure* gained enormous significance during the COVID-19 pandemic and will continue to be important in light of a military conflict on European soil – but what does this frequently used term actually mean?

German law does not define the term *force majeure*. However, the German Federal Court of Justice (*Bundesgerichtshof*) (e.g. in its judgment of 16 October 2007 – VI ZR 173/06) defines *force majeure* in line with the Imperial Court of Justice of the German Reich (*Reichsgericht*) as:

“an external event caused from outside the business by elemental forces or the actions of third parties, which is unforeseeable according to human insight and experience, cannot be prevented or rendered harmless by economically acceptable means, even with the utmost care that could reasonably be expected under the circumstances, and which the business establishment is also not prepared to accept due to its frequency.”

In short, *force majeure* requires an external, unavoidable event beyond the control of the parties. Supply contracts, in particular, contain additional *force majeure* events, which include not only natural disasters and, more recently, pandemics, but also war and military conflicts.

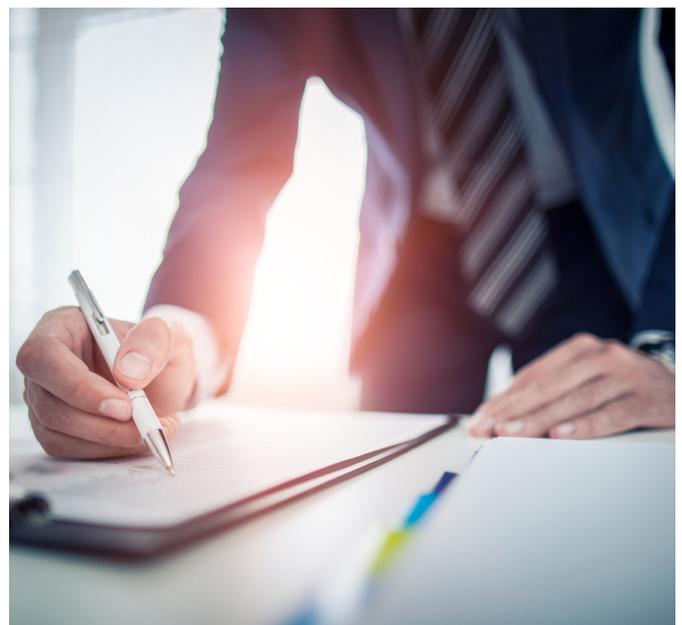
Military conflicts can, therefore, be qualified as acts of *force majeure*, subject to an examination of the individual case. However, the assessment is more difficult for contractual relationships that are established during a military conflict. In this case, the required “unforeseeability” of the event may not exist, which means that it does not qualify as a *force majeure* event.

A case of *force majeure* is likely to exist, for example, if a supplier’s production facilities are destroyed due to a military conflict, transport routes are cut off or trade relations are subject to an embargo, which, thus, legally prohibit the execution of the contractual relationship. However, if a Ukrainian or Russian supplier is able to deliver and the contractual relationship is not legally prohibited, *force majeure* does not yet exist.

Applicable Law

Particularly in the case of cross-border supply relationships, the question of applicable law arises. In order to ensure clarity in this regard, such contracts should always contain a choice of law clause.

Sales contracts with a German party without a choice of law clause are automatically subject to the applicability of the UN Convention on Contracts for the International Sale of Goods (CISG) under private international law. Art. 79 CISG contains a clear regulation regarding *force majeure* and exempts the supplier from liability for an impediment to performance caused by *force majeure*. The supplier must prove that the individual requirements of Art. 79 CISG are fulfilled. If German law applies, the applicability of the UN Convention on Contracts for the International Sale of Goods is often excluded. In this case, Art. 79 CISG is inapplicable. It is, of course, not possible to abstractly assess the legal situation in a specific case, which must be examined upon review of the respective contract.



Military Conflicts and Contract Law

Supply contracts often include *force majeure* clauses and – depending on the structure in the individual case – frequently allow for an adjustment of the contract, or even withdrawal from the contract. It is possible to include a *force majeure* clause not only in individual contractual agreements, but also in general terms and conditions, such as delivery or purchasing terms. Therefore, it may be worth reviewing the relevant documents.

The current conflict in Ukraine may also cause disruptions in the supply chain that cannot be classified as *force majeure*. If a supplier is not directly affected by the military conflict (e.g. because it is not located in either Russia or Ukraine), but (1) does not receive supplies as a result of the conflict (e.g. because of expected crop failures, particularly in the case of grain) or (2) is subject to significant price increases (e.g. due to increased energy costs), a case of *force majeure* does not exist if the supplier can meet its supply obligations by procuring replacements. In the first case, the supplier would be obliged to procure a replacement in order to fulfil its delivery obligations since it owes the delivery of a certain good. Any additional costs incurred would generally be borne by the supplier, unless otherwise agreed in the contract, since the procurement risk typically falls within the supplier's sphere of responsibility. The same applies in the case of price increases. This risk is also part of the procurement risk and must, therefore, generally be borne by the supplier. The general principle applies here that price increases and other impediments to performance do not constitute a case of *force majeure*.

The situation may be different if the supplier is a vicarious agent within the meaning of Section 278 of the German Civil Code (*Bürgerliches Gesetzbuch*, BGB). This is possible, for example, in the case of contracts for work and services if the upstream supplier is involved in producing the work. In such cases, the supplier may also be able to invoke *force majeure* as applicable to the upstream supplier. In the case of simple purchase agreements or contracts for work and materials where the supplier assigns the processing of an object to a third party, it generally cannot be assumed that the third party is a vicarious agent; therefore, the supplier normally cannot invoke *force majeure* that exists for the upstream supplier.

If neither individual contractual agreements nor general terms and conditions contain a *force majeure* clause and the applicability of the UN Convention on Contracts for the International Sale of Goods has also been excluded, any exemptions from the obligation to perform under a contract can only be achieved by applying the generally applicable principles of civil law.

Impossibility

Under German law, the term "impossibility" refers to a temporary or permanent exemption from the obligation to perform under a contract, according to Section 275 BGB, if the performance is impossible for the debtor or for anyone else. The cases of impossibility due to actual or legal circumstances correspond to the examples provided for *force majeure*: destruction of production facilities or transport routes, displacement of employees or legal embargoes. In principle, Section 275 BGB establishes an all-or-nothing principle. In the event of impossibility, whether actual, legal or economic (see below), the debtor is exempted from the obligation to perform under the contract. The creditor is then no longer obligated to render consideration (payment of the purchase price) according to Section 326 BGB.

The so-called "economic impossibility" in Section 275(2) BGB normally does not apply in the event of price increases because the law requires that the effort required of the debtor (supplier) is grossly disproportionate to the interest of the creditor (customer) in the performance of the contract. In the case of price increases, however, the creditor's interest in receiving the goods increases "parallel" to the debtor's effort, so a gross disproportion between the two usually does not exist.

Interference With the Basis of the Contract

Price increases may entitle a party to adjust the contract or to withdraw from it in accordance with the principles regarding interference with the basis of the contract (Section 313 BGB). However, German courts apply strict standards in this respect.

In principle, a party may demand an adjustment to the contract under Section 313 BGB if the circumstances that formed the basis of the contract have changed so significantly and unforeseeably that the parties can no longer reasonably be expected to adhere to it. Unlike Section 275(2) BGB, it is, therefore, not necessary that a gross disproportion exists, but rather that there is an undue hardship for one party, which makes it unreasonable for it to adhere to the contract. It is, therefore, possible to adjust a contract due to price changes, albeit only under extremely strict conditions.

An adjustment to a contract in the event of price increases is justified by the fact that an adjustment interferes with the natural distribution of risk in the contract. According to the jurisprudence of the German Federal Court of Justice, the contractor's basis of calculation does not become the basis of a contract concluded at a later date, which is why an adjustment to the contract is generally precluded. This also applies if the basis of calculation was disclosed to the customer (Federal Court of Justice, judgment of 10 September 2009 – VII ZR 82/08). Similarly, according to established jurisprudence, an adjustment of the contract is generally precluded if the parties have agreed on a fixed price because a conscious decision was made to distribute the risk in this case (cf. Federal Court of Justice, judgement of 23 January 2013 – VIII ZR 47/12; Higher Regional Court of Düsseldorf, judgement of 19 December 2008 – 23 U 48/08).

The Federal Court of Justice also rejects rigid limits, which, if exceeded, would automatically constitute an unreasonable price increase (Federal Court of Justice, judgment of 30 June 2011 – VII ZR 13/10). In individual cases, price increases of 60% (RGZ 102, 272) or even 100% have been deemed unreasonable by the courts. However, a concrete assessment can only be made on a case-by-case basis, whereby the chances of adjusting the contract due to price increases (e.g. in the form of rising energy costs in the production process) are likely to be relatively limited, so contracting parties are well advised to seek a mutually acceptable solution, which will enable them to continue working together in the future.

Defence of Uncertainty

Even if delivery and performance are still possible, the financial sanctions imposed and the partial exclusion of Russian banks from the SWIFT payment system may raise the question for companies as to whether they will still receive payment for their own deliveries to Russian or Ukrainian customers as contractually agreed.

According to the concept of the law, the seller or supplier is required to perform in advance. Delivery must, therefore, be made in order to trigger the obligation to pay the purchase price. The supplier may, in turn, refuse to perform its obligation to deliver in advance, in accordance with Section 321 BGB, if it becomes apparent after concluding the contract that the claim for consideration is at risk due to the debtor's inability to pay the purchase price.

However, the right to refuse performance does not exist if the contractual partner provides sufficient security for the consideration owed by it.

Proviso Regarding Punctual Delivery to the Supplier

The obligations assumed by the supplier shall be subject to the proviso that the supplier receives the goods on time. If, due to circumstances for which the supplier is not responsible, upstream suppliers fail to deliver the goods to the supplier on time despite the fact that the supplier ordered substitutes elsewhere to cover its needs in due time, the supplier shall not be obligated to deliver orders even if they have been confirmed.

Such circumstances shall include, for example, crop failures, shortages of harvest workers or freight forwarders, shortages of materials, lack of packaging materials, traffic restrictions, strikes, official measures, such as those taken to protect the population against the effects of pandemics or armed conflicts, and other cases of *force majeure*.

If the supplier can foresee that a delivery cannot be made on time or in full due to such circumstances, the supplier shall immediately inform the company concerned. In such cases, the supplier shall distribute the available goods and/or the goods delivered late among all customers concerned according to fair criteria, in particular based on the quantities purchased in the past. Claims due to delayed, cancelled or reduced deliveries shall not exist in such cases.

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