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## **Commercial tenancy law: Effects of the coronavirus crisis on rent payment claims**

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#### **I. Status quo**

The spread of the so-called coronavirus (SARS-CoV-2 or Covid-19 virus) and the government measures that have been or are being implemented in the short term in this context are leading to massive interference in economic life and its supply and service chains. The consequences are causing serious defaults in performance which are also affecting commercial leases to a significant extent including its contractual parties. On the tenant side, in addition to hotels, restaurants and entertainment businesses, all areas of the retail trade that do not serve the basic needs of the population, as well as service companies of all kinds are increasingly affected.

What applies to politics can initially also be applied to commercial tenancy law: there is no reliable experience, especially no established jurisprudence, when dealing with such a pandemic.

This raises a number of new questions for both, tenants and landlords. The following analysis of the legal situation is intended to provide initial assistance in answering core questions as well as in the practical management of the current crisis situation.

#### **1. Legal situation - landlord's claim to payment of rent**

A main question is, whether a landlord of business premises can (still) claim the contractually agreed upon rent from his tenant (Sec. 535, subsection 2, German Civil Code [BGB]).



The landlord's right to claim rent payments, which initially arose upon conclusion of an effective lease agreement, could have expired under various legal aspects due to the far-reaching consequences of the state crisis management. In particular, this could be (i) the so-called impossibility to perform under contract, (ii) a rent reduction by law, or (iii) an adjustment of agreement on the principles of the discontinuation or disruption concerning the principles of frustration of contract (principle of good faith).

**a) No impossibility of performance:**

Almost certainly it can be assumed that the landlord's claim to payment of the rent does not expire due to impossibility of performance. The fact that a tenant will be facing liquidity difficulties as a result of a loss of revenue does not, according to the statutory provisions, in principle lead to the tenant being released from his obligation to pay rent. Cases of so-called economic impossibility of the tenant are to be resolved, if necessary, by the legal consequences of applying the principles of the discontinuation or disturbance of the basis of principles of frustration of contract; as the Federal Court of Justice (Bundesgerichtshof) decided in several cases.

**b) No reduction of rent**

In terms of a statutory rent reduction (Sec. 536 subsection 2, Sentence 1 German Civil Code), on the other hand, it depends largely on the definition of the contractual risk spheres and the corresponding allocation of the currently realized risk in the course of the coronavirus pandemic.

**a. General distribution of risk**

In general, and unless otherwise stipulated in a lease agreement (see below), the landlord bears the risk of the usability of the leased premises. In contrast, it is usually subject to the tenant's business risk whether the leased object can be used to generate sales or to earn profits (so-called **use risk** or **profitability risk**).

With regard to the existence of a rental defect - as being a legal prerequisite for warranty rights under tenancy law such as a rent reduction - there are a large number of court decisions. In addition to the contractual distribution of risk, it is particularly important whether the impairment in question directly or indirectly affects the use of the leased premises.

In order to assess direct impairments in terms of usage, it is, according to the jurisprudence of the Federal Court of Justice (Bundesgerichtshof) mandatory to examine whether the impairment is **property-related** / **building-related**, as the risk allocation is based on such determination e.g. based on public construction law (Higher Regional Court [OLG] Brandenburg, decision of 4 April 2019 - 3 W 95/18).



In case of applying said criteria it is likely to expect that government measures which are ranging from mere recommendations provided to citizens, to executive or legislative closure orders are deemed to be within the tenant's use or profitability risk, what leads to the consequence that a landlord is being entitled to claim rent payments. The landlord is remaining unaffected in his position to fulfil his main obligations under contract by providing unrestricted (property-related) use of the lease premises during the lease term. Within the meaning of the jurisdiction, it is therefore unlikely to be considered a direct impairment of use regarding the leased premises.

**b. Special features due to contractual regulations**

However, the legal assessment of contractual risk spheres depends largely on the individual case. In addition to the specific type of impairment, i.e. in particular the type and intensity of the government measure, a variety of contractual arrangements are conceivable, whereby the parties deviate from the general distribution of risk under tenancy law in favor of the tenant.

Nevertheless, such regulations are to be reviewed and interpreted in accordance with the applicable GTC law. It is unlikely that the contracting parties were considering nor aware that any of those measures that they are currently facing is about to happen at the time they had entered into a lease agreement and hence, in the absence of such considerations the parties did not stipulate which side shall bear the risk of such external circumstances, e.g. outbreak of a pandemic is leading to administrative orders which are forcing entire business industries to close business, the isolation of entire geographical regions (e.g. German islands) and a lockdown of the entire national economies. In view of said facts, it might be difficult to interpret what the parties would have intended to do in case of such adverse effects, if they had only known at the time of entering into the lease agreement. For this reason, one will finally have to resort to solutions in doubt, which in turn will correspond to the general distribution of risk in lease agreement and the delimitation criteria of case law.

Even then, only in exceptional cases (for example, if the rent is completely dependent on revenue without agreeing on a minimum base rent) impairments are subject to the landlord's sphere of risk



### c) Principles of frustration of contract ?

Whether the tenant can demand a reduction or even suspension of the rent also depends on whether the economic effects of the government measures to fight pandemics are seen as a unbearable situation for the tenant with the consequence that the underlying contract must be adjusted (Sec. 313 BGB or in good faith, Sec. 242 BGB).

The event that has occurred - such as, for example, alleged losses of revenue due to the coronavirus - must be so exceptional that it cannot be attributed to the risk area of either the tenant or the landlord. According to jurisprudence, as a general rule it is seen as a responsibility of the tenant to estimate the prospects of success of his business for the future, so that an adjustment of the contract due to good faith is rather difficult to claim (see BGH, ruling of 3 March 2010 - XII ZR 131/08). It is always important to comprehensively balance the interests of all parties by way of taking into account all circumstances of the individual case.

The fact that several epidemics and pandemics (e.g. H1N1 virus, H5N1 virus, SARS-CoV etc.) have occurred worldwide since the year 2000 is opposing contractual adjustments on grounds of unbearableness, so that comparable events should not be classified as completely exceptional or completely unforeseeable. However, due to the particular extent of the currently rampant coronavirus and the government measures taken to combat, it could be argued in favor of unbearableness. As any further spread of the virus and any related economic effects on the tenant's business cannot be foreseen at present, the question of unbearableness cannot yet be ultimately answered. Depending on the extent of the crisis, a right of the tenant to adjust the rent by means of evaluating correction mechanisms cannot be completely ruled out. However, when examining the question of unbearableness, the question of the extent to which a tenant has resources which he must, at least partly use up first, before he intervenes in his landlord's revenue also plays a role. After all, a reduction, suspension or a final loss of rent and any associated loss of financing can also threaten the landlord's economic existence and thus be unbearable.

## 2. Up-to-date: Law to mitigate the consequences of the COVID 19 pandemic in civil, insolvency and criminal proceedings law

The German government passed a law to mitigate the consequences of the COVID 19 pandemic in civil, insolvency and criminal proceedings law. This draft law, has been passed and resolved through the entire legislative process and contains important regulations which also concern commercial tenancy law.

According to the passed laws the landlord's right to terminate the contract in the event of late payment is subject to limitations. As background serves the legal situation, that tenancies can be terminated for good cause without notice if the tenant is in default of payment of the rent or a substantial part of the rent for two consecutive dates or, in a period extending over more than two dates, is in default of payment of the rent in an amount equal to the rent for two months (Sec 543 subsection 1, 2 sentence 1 no. 3 German Civil Code).



According to the draft law, the landlord may not give notice to the tenant for delay in paying the rent in the period from 1 April to 30 June 2020, if the non-payment of the rent is caused by effects of the coronavirus pandemic. The tenant must merely make this fact plausible; in the event of a dispute, the landlord is obliged to prove the contrary to the satisfaction of the court. However, this **does not** mean that the tenant's obligation to pay the rent does not apply.

Apart from tenancy law, further regulations are to be passed which are also relevant for landlords and tenants of business premises. In particular, the intended suspension of the obligation to file for insolvency and personal liability privileges for managing directors are to be mentioned. In the area of company law, the holding of general meetings, shareholders' assemblies and members' meetings is to be facilitated. In condominium property law, for example, organs should remain in office until new ones have been appointed.

## **II. Reconciliation of interests in reality**

In view of the legal situation described above, the top priority by means of hands on measures should be to achieve an appropriate balance of interests by means of amicable solutions. This applies separately, no matter of a new law coming into force and can go beyond its regulatory content.

As a rule, it will ultimately also be in the interest of the landlord to protect the "good tenant" and his liquidity at least to the extent that he needs it for his own economic existence. On the other hand, in order to secure the landlord's own liquidity and the debt service to be rendered to the bank or other financiers, the tenant's available funds should be exhausted as much as possible.

### **The following measures are to be considered:**

- Agreement of rent-free periods or periods of reduced rental payments in connection with contract extensions and other contractual adjustments that may be necessary (which may also have a positive effect on the property valuation by banks on the landlord's side);
- Deferral agreements, if necessary also in connection with rental agreement supplements/extensions of terms;
- Instalment contracts together with acknowledgement of debt;
- Temporary conversion of the rented premises/change of permissible use (e.g. for storage and logistic purposes or similar);
- (Concerted) realization of security deposits;



- Possible participation in the tenant's company, provided that its business is profitable and sustainable outside the crisis;
- Assignment of third-party services to the landlord
  - o assignment of any insurance claims
  - o Assignment of claims under the German Protection against Infection Act (Infektionsschutzgesetz), if relevant;
- Assistance with the use of government support measures by tenants with the aim of ensuring ongoing rent payments
  - o KfW funding programs
  - o Use of services from funding programs of the states
  - o Use of tax reductions;

### III. Conclusion

In conclusion, it should be noted that the government is in the process of adopting measures to balance the interests of the parties to a commercial tenancy in order to correct the possible unequal distribution under current law for the period of the current crisis. However, from the landlord's point of view there is the threat of considerable liquidity losses!

If the tenant unilaterally reduces the rent or even announces to do so, the landlord shall still have the right to sue for payment of the rent in court, even if this concerns rent payments that become due in the future. Such an action, which should be brought as a legal action based on documentary evidence to accelerate the process (Urkundenprozess), may be necessary in individual cases because, for example, compensations out of security deposits require undisputed or judicially established claims.

**Attention: In the event amending rental agreements, it must be adhered to the written form requirement. Furthermore, any credit agreements must be checked to see whether rights and claims have been assigned to financiers and therefore the involvement of lenders/banks might become necessary.**

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