Corona Crisis and Lease Law in Germany

The Corona Crisis has hit the real estate market in general, but in particular it is impacting the retail and hospitality sectors. The scale and business relevance of the Corona Crisis is somehow unprecedented, and therefore there is little safe ground for the market players when it comes to the legal framework for their decision making. In commercial landlord and tenant law terms, the central question is whether the tenants' payment obligations remain unaffected or whether the tenants are entitled to reduce the rent or even stop payment altogether. The quick response of many retail and hospitality chains was to stop paying rent or to announce a rent payment stop for April and the following months. One may assume that in many cases this was more borne out of an urgent need to keep cash in the company or to level the field for negotiations, rather than based on the outcome of a detailed legal analysis. However, going forward the legal situation will become decisive where quick settlements cannot be found.

Defect of the Leased Premises

According to Section 536 German Civil Code (*BGB*) the rent is reduced by operation of law if a defect of the leased premises arises which affects or even prevents the contractually agreed use of the leased premises.

The Corona Crisis itself is not directly a defect of the leased premises. However, if due to the Corona Crisis the leased premises cannot be used as contractually agreed it has to be distinguished between the landlord's and the tenant's risk spheres. To draw the line between these two spheres is a delicate task. The courts have regularly relied on the general allocation of risk spheres under lease law as well as on the individual allocation of risk and the agreed lease purpose in making this decision.

Landlord's risk sphere

While having to ensure that the tenant is (legally) able to use the leased premises as contractually agreed (especially under public building law) is the landlord's risk, the risk of use is with the tenant (permits required for the tenant's business (*Betriebserlaubnis*)).

If the contractually agreed use requires actions by the landlord which the landlord cannot provide (e.g. to provide personnel, a facilities manager, centre management, security, etc.) failure to act constitutes a defect of the leased premises. The amount of rent reduction is a case by case decision and depends on the actual impairment of the contractually agreed use.

Tenant's risk sphere

To the contrary, if a tenant cannot use the leased premises e.g. as its own employees were infected by COVID-19 and therefore are unable to work, or given an impact to his business in general, this would not be the landlord's risk and would not be considered a defect of the leased premises. As a general landlord and tenant law principle, the operation of the tenant's business is his own risk. This also applies to the tenant's loss of sales and similar caused by the Corona Crisis. However, in particular in cases where the permitted lease use was more tightly defined than usual, in some individual cases the courts have taken the position that the risk of public law based interdiction is shifted into Landlord's sphere (for definition of leasehold defect or impossibility of performance purposes, see below).

Accounting of Savings due to non-usage of Leased Premises

In case a tenant voluntarily decides to temporarily close the operation of its business in the leased premises (for reasons that do not lie in the landlord's risk sphere) the tenant is, as stated above, not entitled to rent reductions as there is no defect of the leased premises. However, in such a case, Section 537 BGB applies stating that the landlord must give the tenant credit for the value of the expenses saved from the non-usage of the leased premises. Practically speaking, given that the tenant has not vacated the building, these are the saved costs for water, gas, power, maintenance and repair. Especially in multi-tenant objects it will hardly be possible to calculate the exact amount of such saved costs, but it will also be of little practical relevance since the lower consumption will be reflected in direct contracting or via service charge reconciliation anyway. A possible area of applicability could be all-inclusive rents, for which a reduction of the service charge element could be claimed.

General Civil Law Considerations

As outlined, in most cases the Corona Crisis does not seem to create a defect of the leasehold. However, it is intensively discussed if the shut-down ordered by the government might constitute a case of impossibility of performance (*Unmöglichkeit*) or if it fulfils the conditions of Section 313 BGB (interference with the basis of the transaction – *Störung der Geschäftsgrundlage*). Of course, in applying these legal principles, as with lease law in general, the review of the individual contracts, including lease use definition, force majeure and MAC clauses or other contents remains of paramount importance.

Impossibility of Performance (*Unmöglichkeit*)

The general impact of the Corona Crisis on tenants' businesses is not likely to cause impossibility in the meaning of the law. The lease use can be granted by the landlord, and the lack of interest in using the leasehold does not change this situation. The general decree of the government to close any business that is frequented by the public and which is not of systemic importance

(grocery stores, pharmacies, banks, etc.) might however constitute a case of impossibility of performance for which the landlord is responsible.

It has never happened before that the public authorities order by a general decree (*Allgemeinverfügung*) a shut-down of businesses frequented by the public. There is no specific law or case law dealing with a shut-down ordered by the state. Hence, general statutory law and case law for similar cases have to be reviewed as to whether or not they are applicable to the current situation.

If the agreed rental purpose, e.g. the use of a cinema, can no longer be achieved as a result of a general decree of the government, and this un-usability for the rent purpose is totally unrelated to the individual tenant, it is argued that this constitutes a (temporary) impossibility of the landlord to provide the leased premises for the agreed use. The legal consequence would be that the tenant would be released from paying the rent for the period of the impossibility.

Against this it is argued that there is no case of impossibility for the performance of the landlord's obligations, because the keys are still with the tenant, the use has been approved under building regulations (responsibility of the landlord) and the general decree of the government does not concern the structural conditions of the leased premises but the actual operation of the tenant's business. The consequence would be that the tenant (not the landlord) bears the risk for the latter (Section 537 para. 1 BGB), and the rent payment obligation would remain unaffected.

Interference with the Basis of the Transaction (*Störung der Geschäftsgrundlage*)

Under German law a claim for renegotiation of the rent and/or the lease may be established on Section 313 BGB (Interference with the basis of the transaction). However, the Corona Crisis itself is very unlikely to fulfil the conditions of Section 313 BGB, inter alia since the landlord would not have accepted a general hardship stipulation in the lease agreement. Hence, on the basis of the Corona Crisis only, there is no right in favour of the tenant to claim renegotiation of the rent and/or lease.

If a case of impossibility cannot be argued the general decree might interfere with the basis of the transaction. If circumstances which became the basis of a contract have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different content if they had foreseen this change, adaptation of the contract may be demanded to the extent that, taking account of all the circumstances of the specific case, in particular the contractual or statutory distribution of risk, one of the parties cannot reasonably be expected to uphold the contract without alteration.

If adaptation of the contract is not possible or one party cannot reasonably be expected to accept it, the disadvantaged party may revoke the contract. In the case of continuing obligations (as lease agreements), the right to terminate takes the place of the right to revoke.

Even though Section 313 BGB seems to fit to the Corona Crisis, in particular given the drastic restrictions implemented by the administration, it should be considered that the landlord would hardly have agreed to a rent free period in case of temporary circumstances not related to the premises. In general, together with the risk spheres described above, this is a strong argument against an adaptation claim based on Section 313 BGB. However, there have been individual court cases in which changes to relevant laws, loss of permits without relation to the individual tenant and similar circumstances affecting the lease use by the tenant severely and permanently were deemed an interference with the basis of the transaction, and corresponding relief was granted. Hence, it is not impossible that adaptation would be granted by an independent court in individual cases.

Changes to the Law

With the law published on 27th of March 2020, the federal government has enacted certain protection for tenants. The landlords' right to terminate the lease agreement solely on the basis of rent arrears during the time period from 1 April to 30 June is excluded until 30 June 2022, as far as the non-performance is caused by the effects of the COVID-19-Pandemic. This applies irrespective of the contractually agreed termination rights. The tenant has to evidence the Corona related circumstances.

This leaves all concerned parties with a number of open questions with respect to rent claims. However it seems clear that the legislature is of the opinion that the Corona Crisis does not generally suspend the payment obligations for the affected business, but there is obviously not a specific statement for businesses shut down by decree of the competent authorities. Further, despite the new law (and notwithstanding the considerations for shut down businesses above) the rent remains due, and therefore the default interest (approx. 8% p.a.) applies, the rent claim can be enforced in court and the rent security can be drawn for open rent claims (including rent from April through to June). The tenants cannot object to rent payments with the argument of an insolvency situation (unless they filed), since the new law permits payments even in a situation of over-indebtedness.

One of the most pressing questions is whether a termination right is only excluded if the tenant actually cannot pay due to the Crisis, or whether a general impact on the business or a foreseeable cash problem that will occur if payments are continued are sufficent. For a business pushed to the edge of insolvency by the Corona Crisis this makes no difference, but there are also beneficiaries of state-aid and cash-rich companies refusing rent payments at the moment. Judging by the language and the reasoning of the new law, we would not expect that a general impact of the Corona Crisis is sufficient to exclude the termination right if the tenant is able to pay. This seems to apply even more so in cases where a continued rent payment has no impact on the operations at all. But similar to the other outlined considerations, it remains to be seen what the courts will make out of the unprecedented situation, and all business decisions will entail a level of uncertainty.

Settlements

Given the uncertainties, the troubles of many tenants, the somehow lower risk profile with respect to default with rent and the long term business perspectives of the parties, in many cases there will be negotiations. If the parties agree a rent suspension or temporary waiver, any settlement agreement has to be drafted with caution. The landlord has to have an eye on the covenants under its financing agreements. Insolvency law has to be considered. And any agreement affecting the future performance under the lease has to comply with the written form requirement for long term leases. Otherwise an early termination right may become applicable.

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