

Insights

FOCUS ON LANDLORDS AND LESSORS: READJUSTMENT OF CORONA RISK DISTRIBUTION

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Last Sunday, the prime ministers of the federal states and the chancellor of Germany decided on a number of measures reacting to the Covid-19 pandemic. The set of measures include, that commercial real estate lessees be supported in the negotiations with their landlords by the COVID-19 measures in the case of commercial real estate rent or lease being qualified as a potential frustration of contract (*Störung der Geschäftsgrundlage*), according to Section 313 of the German Civil Code (Bürgerliches Gesetzbuch). For the implementation of the resolution, the Federal Ministry of Justice and Consumer Protection (BMJV) has now submitted a draft bill (Drucksache 19/21981).

Lessors and lessees – those that at least are no lawyers – will not know the Section 313 of the German Civil Code. It covers cases in which the circumstances that have become the basis of a contract substantially change after its conclusion, and the parties would not have concluded that contract, or would have concluded it with a different content, had they foreseen this change. As a legal consequence, an adjustment of the contract can be requested if one party cannot reasonably be expected to adhere to the unchanged terms thereof. Thereby, the circumstances of the individual case and the contractual and legal distribution of risk must be taken into account. If an adjustment is not possible or unreasonable, it is possible to terminate or even withdraw from the contract.

Already prior to the government initiative there were discussions in German academic literature concerning if and to what extent lessees affected by the Covid-19 measures, can request an adjustment to their lease agreements based on Section 313 of the German Civil Code – specifically a rent reduction. This particularly affects those lessees that cannot use the rented premises at all, such as the operators of restaurants or businesses which are dependent upon public attendance of their premises to be able to offer them goods or services.

The proposed bill (“Draft law on the further shortening of the residual debt discharge procedure - Entwurf eines Gesetzes zur weiteren Verkürzung des Restschuldbefreiungsverfahrens – Drucksache 19/21981) is supposed to deal with the issues described above. According to the provisions of the draft bill presented, section 240 of the Introductory Law to the German Civil Code (Einführungsgesetz zum Bürgerlichen Gesetzbuch - EGBGB) is to be supplemented by a further

paragraph intended to make it easier for the lessees of commercial real estate to prove that the governmental Covid-19 measures indeed constitute a case of Section 313 of the German Civil Code.

In detail:

- The planned legislation is only applicable to commercial real estate lease/ rental agreements. It does not affect residential leases.
- Prerequisite is, that due to the Covid-19 restrictions, the lessee cannot use its facilities for the business at all or with substantial limitations.
- An example situation would be an operator of a restaurant that has to close their restaurant because of administrative orders (already in the jurisprudence of the Reichsgericht).

The main consequences and the statements of the submitted draft bill are as follows:

- In general, lessees can request an adjustment of their lease agreements, if they cannot use their facilities for the business pursued by them at all or with substantial limitations due to Covid-19 restrictions.
- Other legal remedies under rental contract law (reduction of rent, extraordinary termination rights, etc.) shall remain unaffected by the proposed changes.
- The statutory assumption that governmental Covid-19 measures leading to an inability to use the leased premises entitle the lessees to claim the frustration of contract does not apply to contracts that were concluded at a time when a pandemic-like spread of Covid-19 was already foreseeable among the general public.
- The basic division of risk spheres between the lessors and the lessees under the German Civil Code is not proposed to be changed.
- Indirect consequences of the government actions that cause a business, open to the public, to lose customers simply because of a decline in consumer demand **are not covered by the proposed changes;** an
- The governmental measures must significantly restrict the tenant's or lessee's business (for example, through closure, restrictions on the sales area or on entry). Measures that only concern the tenant or lessee themselves or their employees, such as quarantine orders against individual persons and not the business itself, **are not covered by the proposed legislation.**

Additionally, the bill introduces an amendment to the German Civil Procedure Code (*Zivilprozessordnung*) which will facilitate quicker court proceedings in relation to the legal disputes in connection with the requested adjustment or termination of the affected contracts. This ensures that such proceedings shall be handled with priority and on an expedient basis. A first oral hearing

should be held no later than one month after service of the respective legal action to make certain that pandemic-related disputes on commercial real estate rental and lease agreements will be resolved quickly. The general rule for quick and expedient proceedings shall be maintained for the entire duration of the proceedings in all court instances. This principle does not only apply to proceedings, in which the tenant or lessee sues the lessor or landlord for a rent adjustment according to Section 313 of the German Civil Code. It will also be applicable if the tenant or lessee raises the rent adjustment as a defence to the landlord's suing for payment of rent. The proposed legislation aims for a quick resolution of those disputes in court.

This plan of the federal government is contrary to the prevailing opinion in German jurisprudence and academic literature, which vests the risk of COVID-19 measures with the tenants/lessees and does not permit a termination or adjustment of the respective contracts for rent based on the frustration of contract doctrine. Specifically, this initiative of the BMJV means a new regulation of the distribution of risks primarily at the expense of lessors, and landlords, and indirectly their financing institutions which are dependent on an ongoing rental income to settle the interest and principal payments.

It also remains to be seen whether, despite statements to the contrary in the draft bill, the German courts will see the new provisions as an opportunity to interpret Section 313 of the German Civil Code differently in the case of other types of contracts or legal situations.

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