



Commercial leases in the COVID-19 pandemic

The COVID-19 pandemic in Germany is significantly affecting commercial landlords and tenants. The German legislator has taken various measures to mitigate the consequences of officially ordered business closures during lockdown and other pandemic-related adverse effects.

Of particular relevance to commercial leasing law in this regard are the Act to Mitigate the Consequences of the COVID-19 Pandemic in Civil, Insolvency and Criminal Procedure Law (*COVID-19 Act*) and the Act to Further Shorten the Residual Debt Relief Procedure and to Adjust Pandemic-Related Provisions in Company, Cooperative, Association and Foundation Law and in Tenancy and Lease Law (*Adjustment Act*).

This document summarises the (new) statutory provisions and court rulings to date that are of relevance to commercial leasing law. In addition, it outlines government assistance programmes providing assistance to landlords and tenants for mitigating the impact of the pandemic.

Continuation of lease obligations

In general, contractual obligations entered into by landlords and tenants remain in effect during the COVID-19 pandemic. Tenants do not receive a separate right to reduce rent, defer or refuse performance under the *COVID-19 Act*. If tenants do not pay the rent on time and in full, they are in default as a matter of principle and must pay interest on arrears, as well as compensate any other default-induced damage.

No rent reduction in the event of business closures

Court rulings to date have predominantly rejected possible tenant warranty rights, particularly rent reduction. Although some of the decisions are inconsistent, a landlord-friendly approach is discernible: A defective rental property which results in a rent reduction is mostly rejected because government

measures to address the COVID-19 pandemic do not concern the specific condition, state, or location of the rental property.

Contractual adjustment claims only in specific cases

Commercial tenants may have a claim to a rent adjustment due to frustration of contract (*Störung der Geschäftsgrundlage*) according to section 313 of the German Civil Code (*BGB*). Whether such a claim exists – subsidiary to contractual and statutory provisions – must be assessed on a case-by-case basis and is subject to the following preconditions:

- (1) There has been a serious change in circumstances forming the basis of the contract,
- (2) the parties would not have concluded the contract, or would have concluded a different contract, if they had been aware of this change at the time of conclusion, and
- (3) at least one of the parties cannot be reasonably expected to adhere to an unamended contract in the specific circumstances of the given case.

So far, the courts have not considered the first two conditions to be problematic in relation to pandemic-related government measures. The legislator follows this line in the Adjustment Act by providing a statutory presumption that government action to combat the COVID-19 pandemic constitutes a serious change in the basis of commercial leases.

The key question for an adjustment claim is whether one of the parties can be reasonably expected to adhere to the unchanged contract. This is to be assessed by weighing interests in the specific case. The contractual or statutory distribution of risk plays a crucial role in this regard.

There are not yet any established court rulings in this regard. To date, the lower courts have predominantly ruled that it is reasonable for tenants to adhere to unamended commercial leases, despite government-ordered business closures. In the judgments relating to the first lockdown period in spring 2020, the courts

largely held that the risk of using a property for business purposes should be borne by the tenant. The rulings also stressed that tenants had had the opportunity to form reserves of at least one month's rent.

At present, there are two conflicting judgements by the higher courts: while Dresden Higher Regional Court has deemed a contractual adjustment to be appropriate (with a 50% rent reduction), Karlsruhe Higher Regional Court has adhered to the previous, rather landlord-friendly line taken by many courts and rejected a rent reduction.

The Federal Court of Justice will therefore definitively rule on the legal effects of the pandemic on commercial leases in scenarios created by various specific cases, with the legally mandated acceleration of corresponding judicial proceedings meaning this will also occur in the foreseeable future. Until then, both the requirements for a contractual adjustment and the possible content thereof will remain uncertain, as there is discretion available to court rulings in this respect.

In addition to a rent reduction (in a variable amount), deferrals or claims for damages should also be considered. However, only after clarification has been provided by the Federal Court of Justice will it be certain whether the *Adjustment Act*, which was intended to encourage the parties to negotiate solutions, will also have significant legal consequences.

In the field of procedural law, the *Adjustment Act* has partially reversed the apportionment of the burden of proof. In cases of doubt, the landlord must now prove that the new statutory presumption does not apply, i.e. that the government measures have not led to a serious change in material circumstances forming the basis of the contract. The tenant continues to bear the burden of presentation and proof for the other requirements for a contractual adjustment claim, in particular those for unreasonableness.

The court rulings on this to date are strict and require detailed evidence of the circumstances that supposedly cause unreasonableness.

Numerous criteria can play a role here (including sector affiliation; effects on specific business operations; government assistance received; possible cost reductions, etc.).

Temporary suspension of the landlord's right of termination

In general, the landlord is entitled to an extraordinary right of termination if the tenant is in arrears with two months' rent. This right of termination was temporarily suspended by the *COVID-19 Act* insofar as the tenant had failed to pay rent due during the period from 1 April to 30

June 2020, and the failure to pay was due to the effects of the COVID-19 pandemic. The connection between the COVID-19 pandemic and the failure to pay must be credibly demonstrated by the tenant.

The tenant has until 30 June 2022 to settle the rent arrears. Until then, termination cannot occur due to arrears arising in the period from 1 April to 30 June 2020. However, in the event of payment arrears, the landlord may continue to have recourse to the security deposit and also pursue its (payment) claims in court.

The option to extend the suspension period for the landlord's right to terminate the lease was not used.

Insolvency law aspects

The *COVID-19 Act* initially provided for a suspension of the insolvency filing requirement until 30 September 2020, if the company's insolvency or over indebtedness was based on the COVID-19 pandemic and there were prospects of recovery.

The suspension of the insolvency filing requirement was extended for the period from 1 October 2020 to 31 December 2020, albeit only for companies that were over-indebted but not insolvent.

In light of delayed payment of government aid, the legislator has now extended the suspension of the insolvency filing requirement due to insolvency or over-indebtedness in the period from 1 January 2021 to 30 April 2021 for companies, provided they filed an application for government aid to mitigate the consequences of the COVID-19 pandemic (particularly what are referred to as the November and December aid measures) in the period from 1 November 2020 to 28 February 2021. The insolvency filing requirement is also suspended if filing an application within the period was not possible for legal or factual reasons. However, the filing requirement remains in place if the company obviously has no prospect of being granted government aid or the assistance is insufficient to prevent insolvency.

The legislator has also extended protection against rescission for pandemic-related deferrals (e.g. of rent). This privileged status covers payments on deferred claims made until 31 March 2022, provided the deferral was agreed by 28 February 2021.

Under this privilege, receipt of contractual rent payments in the relevant periods are generally not contestable. In principle, the privileges do not apply if the landlord was aware that the tenant's restructuring and financing efforts were not capable of eliminating pre-existing insolvency.

Government assistance programmes

Commercial landlords and tenants can take advantage of a number of government assistance programmes.

KfW assistance programmes

All KfW assistance programmes follows the same basic principle: under certain conditions, a company that has run into temporary financing difficulties as a result of the COVID-19 pandemic may receive a loan which KfW or another government agency guarantees to the lender up to a certain percentage. This enables the lender to grant the loan to the company at a very low interest rate and without further collateral.

In principle, real estate companies domiciled in Germany may take advantage of the KfW assistance programmes, if they satisfy the relevant conditions.

Contractual payment reliefs such as rent deferrals may affect the existence of financing difficulties and thus eligibility for KfW assistance programmes.

In principle, it is possible for both companies with registered offices inside and outside of Germany to take advantage of the KfW assistance programmes (although it has not been definitively clarified whether the relevant registered office is that under company law or tax law).

However, foreign commercial enterprises are only eligible for assistance if they are majority private-owned and the assistance relates to projects in Germany (i.e. it is to be used, for example, for the purposes of subsidiaries, local offices, permanent establishments or branches in Germany). Companies in which private equity investors have a stake can receive assistance regardless of the size of the stake, but if the private equity investors exert significant influence, a loan can only be granted on condition that no distributions are made to the investors or withdrawals made by them during the term of the loan.

Companies must use the funds for investments. Simple debt rescheduling and the refinancing of completed projects are not covered.

November and December aid measures

The November and December aid measures are extraordinary economic aid benefiting undertakings, businesses, the self-employed, associations and other institutions that are affected directly, indirectly or via third parties by the pandemic-related government closure orders.

Up to 75% of the relevant comparative net turnover from the same month of the previous year is compensated. EU state aid rules set the disbursement limit, which is currently €4 million per undertaking. According to the EU Commission requirements, which still have to be transposed into German law, future aid of up to €12 million can presumably be disbursed per undertaking.

Other economic aid that relates to the same assistance period, and has the same purpose, is generally offset against the November and December aid measures – in contrast to KfW assistance.

Bridging Aid II and III

Bridging Aid (*Überbrückungshilfe*) II and III are intended to compensate for fixed costs for companies, the (solo) self-employed or members of the professions who have to cope with pandemic-related falls in turnover. The (partially) reimbursable fixed operating costs include, among other things, rent and costs of construction measures for implementing hygiene plans amounting to a maximum of €20,000 per month. Bridging Aid II covers the months of September to December 2020, while Bridging Aid III covers the period from November 2020 to June 2021.

For Bridging Aid II, there is a complex set of criteria that must be met in order to be eligible to apply. The criteria for receiving Bridging Aid III have been simplified to the effect that there must be a decline in turnover of at least 30% in the month in question compared with the same month in the previous year, and this drop must be attributable to the COVID-19 pandemic.

Until 2 March 2021, eligibility for Bridging Aid III was limited to companies with no more than €750 million in annual turnover. Since 3 March 2021, higher-turnover companies have also been able to apply for Bridging Aid III.

Bridging Aid II and III grant between 40% and 90% of fixed costs (taking into account the EU framework on state aid), depending on the decline in turnover. The maximum amount for Bridging Aid III was raised to €1.5 million per month of support, where not precluded by EU state aid law. Support of up to €3 million a month is possible for affiliated companies.

The principles for setting off other financial aid are the same as those for the November and December aid measures (see above).

Applications for Bridging Aid II will be accepted until 31 March 2021 and for Bridging Aid III until 31 August 2021.

Legally granted bridging aid does not have to be repaid.

Economic Stabilisation Fund

Based on the Act to Establish an Economic Stabilisation Fund (*Gesetz zur Errichtung eines Wirtschaftsstabilisierungsfonds*), a €600 billion federal fund known as the *Wirtschaftsstabilisierungsfonds* (*WSF*) has been created.

This federal fund provides €400 billion for guarantees for corporate debt instruments issued and liabilities incurred between 28 March 2020 and 31 December 2021.

An additional €100 billion is intended for recapitalisation measures (including silent participations, acquisition of subordinated debt instruments, hybrid bonds, profit participation rights, share acquisitions). A further €100 billion is available to support the KfW programmes mentioned above.

The *WSF* may be used if no other government assistance programmes are applicable or if they are insufficient.

In particular, companies of the real economy of a certain size that have fulfilled at least two of the following three criteria in the last two completed financial years are eligible to apply for guarantees and recapitalisation measures:

- (1) total assets of more than €43 million,
- (2) more than €50 million in revenue; and
- (3) more than 249 employees on an annual average.

In addition, the company must be so significant that its existence as a going concern has a considerable impact on the economy, technological sovereignty, security of supply and the labour market. In addition, there are other admission requirements, the fulfilment of which must be confirmed in any given case.

Tax payments

Taxpayers have until 31 March 2021 to submit applications for deferral of taxes due on or before 31 March 2021, setting forth their circumstances, if they suffer substantial, direct financial harm as a result of the COVID-19 crisis. Deferrals will be granted until 30 June 2021 at the latest; subsequent deferrals may be granted in connection with an appropriate instalment agreement lasting until 31 December 2021 at the latest. In such cases, the tax authorities may refrain from charging deferral interest, as is otherwise usual. In addition, advance payments of income or corporation tax can be reduced on application if tax liability is likely to be lower as a result of falling sales due to the COVID-19 pandemic. Any application for deferral or adjustment of an advance tax payment must show that the COVID-19 pandemic is having a serious adverse effect on the applicant's economic situation. The tax offices of the federal states can also, for example, reduce (potentially to €0) and refund special advance payments for the permanent turnover-tax extension for entrepreneurs affected by the COVID-19 crisis. In addition, upon notifying the tax office, affected taxpayers are to be exempted until 30 June 2021 from enforcement measures for taxes due by 31 March 2021.

Our real estate experts

Gerrit Beckhaus

T +49 40 36 90 61 68
E gerrit.beckhaus@freshfields.com

Johannes Conradi

T +49 40 36 90 61 68
E johannes.conradi@freshfields.com

Timo Elsner

T +49 69 27 30 81 68
E timo.elsner@freshfields.com

Julia Haas

T +49 69 27 30 81 58
E julia.haas@freshfields.com

Niko Schultz-Süchting

T +49 40 36 90 62 73
E niko.schultz-suechting@freshfields.com

freshfields.com

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