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# COVID-19 and commercial leases: Case-by-case contract adjustment – the new decision of the Federal Court of Justice

On 12 January 2022, the Federal Court of Justice *(Bundesgerichtshof, **BGH**)* ruled on the legal consequences of public closure orders to combat the COVID-19 pandemic for commercial leases, in this case for the first so-called lockdown in spring 2020 (BGH - XII ZR 8/21).

According to the BGH, lease agreements can in principle be adjusted due to a frustration of contract (*Störung der Geschäftsgrundlage*). In doing so, the court emphasised that a comprehensive consideration of all circumstances of the respective individual case was indispensable. A blanket adjustment of the rent payment obligation (e.g. in the sense of a 50/50 split between the parties) was legally erroneous.

The BGH overturned the decision of previous instance, the Higher Regional Court *(Oberlandesgericht, **OLG**)* of Dresden (5 U 1782/20) and referred it back for a new decision.

In this briefing, we provide an overview of the legal situation and analyse the new BGH ruling.

## Contractual obligations remain

In principle, contractual obligations of tenants and landlords remain in force even during the COVID-19 pandemic. Therefore, tenants are generally obliged to pay the rent in full. Due to the lack of other legal regulations, this also applies to the closure period imposed by the public authorities through closure orders for the protection of the population, even though this may cause businesses to suffer immense losses in turnover as a result.

Tenants also do not have any separate rights of rent reduction, deferment, or refusal of performance due to closure orders. If a tenant does not pay the rent on time and in full, he is in default - usually without a further reminder - and must pay interest on arrears (currently 8.12 % p.a. if tenant and landlord are entrepreneurs) as well as other damages caused by default. The landlord may still claim the rent security in case of non-payment of the rent due.

Thus, the economic consequences of the public closures first affect the commercial tenants, whereas commercial landlords who currently let their properties do not suffer any economic losses from a legal point of view.

## The decision of the BGH

The BGH has now addressed the question of whether this is inequitable in individual cases and must be corrected. It emphasised that the legal distribution of risk, according to which the tenant bears the risk of use or operation of the leased property, only applies to a limited extent in the case of public closure orders to combat the COVID-19 pandemic. After all, the pandemic had created such an extraordinary risk that it could not be assigned to one party alone. As a result, the business basis of the affected lease agreements was thus seriously impaired. Therefore, an adjustment of commercial leases may also be considered in individual cases. In detail:

### The facts

The defendant rented commercial premises from the plaintiff for the operation of a textile discounter store. This store was closed from 19 March 2020 up to and including 19 April 2020 due to official measures taken to combat the COVID-19 pandemic. The tenant then failed to pay the monthly rent for April 2020 in the amount of EUR 7,854.00.

In the first instance, the defendant was ordered by the Regional Court *(Landgericht)* of Chemnitz to pay the rent in full. The OLG Dresden partially overturned the judgement in the appeal proceedings and ruled that the rent for the period of the lockdown-related closure was to be divided in half across the board; the contract was to be adjusted accordingly in line with the principles of the frustration of contract.

#### No rent reduction due to lack of defect

The BGH first denied the tenant's warranty rights (in particular the right to reduce the rent) due to government shutdowns, since there was no defect in the leased property, i.e. no cancellation or substantial reduction of

the suitability of the leased property for the contractually agreed use.

In principle, a defect only exists if the restrictions on the rented object are based on the concrete condition, state, or location of the rented object (*object-related* circumstances) and do not lie in the personal or operational circumstances of the tenant (*personal* or *operational* circumstances).

According to the BGH, in the case of the pandemic-related public authority closure orders, there is no rental defect due to the lack of concrete object-related circumstances. The rental space continued to be available as agreed.

## Contractual adjustment claim

However, the BGH affirmed in principle the possibility of a contract adjustment due to a frustration of contract (section 313 of the German Civil Code - *Bürgerliches Gesetzbuch, **BGB**).*

Such a claim is in principle subsidiary to other contractual and statutory provisions, e.g. warranty rights. Under certain conditions, it allows for an adjustment of the content of the contract to changed actual circumstances in order to create a balance between one party's interest in continuance and fulfilment and the other party's interest in adjustment or termination. An adjustment of the contract due to a frustration of contract means in practice that the principle of contractual compliance *(pacta sunt servanda)* is restricted and can therefore only be applied in special exceptional cases.

A contract may be adjusted pursuant to section 313 (1) BGB if the following conditions are met:

1. there is a serious change in a circumstance which has become the basis of the contract;
2. the parties would not have concluded the contract or would have concluded it differently if they had foreseen this at the time of conclusion;
3. at least one of the parties cannot reasonably be expected to adhere to the unchanged contract in the specific individual case.

### Serious change in the basis of the contract

The COVID-19 pandemic and the subsequent public order to close the commercial space from 19 March 2020 to 19 April 2020 constitute a serious change in the inherent basis of the contract, according to the BGH. This is also supported by the newly adopted provision of Article 240 section 7 Introductory Act to the German Civil Code *(Einführungsgesetz zum Bürgerlichen Gesetzbuch, **EGBGB**)* after the second lockdown in 2020/2021, according to which it is presumed that there is a serious change in the inherent basis of the contract, if commercial premises are not usable or usable only with considerable restrictions by the tenants because of governmental measures to combat the COVID-19 pandemic.

### Hypothetical agreement of an adjustment clause

The BGH also assumed that the parties would have concluded the lease agreement with a different content if they had foreseen the possibility of the pandemic and the associated risk of a closure of the business by governmental order when concluding the lease in 2013. It had to be assumed that fair parties to the lease agreement would not have regulated the associated economic risk unilaterally to the detriment of the tenant for this case but would have provided for a possibility to adjust the rent in the agreement for this case.

### Adhering to the contract may not be reasonable

Finally, the BGH outlined the criteria to be considered for a possible adjustment of the contract. For here, a weighing of interests is required as to whether and to what extent the tenant cannot reasonably be expected to adhere to the unchanged contract, considering all circumstances of the individual case.

The BGH found that the closure of the business due to the authorities' order went beyond the usual risk of use. Due to the COVID-19 pandemic, a general risk of life had materialised, which was not covered by the distribution of risk under the lease agreement without a corresponding contractual provision. The associated risk could not normally be assigned to one contracting party alone. However, a general approach in the sense of splitting the rent in half - as assumed by the previous deciding court - did not fulfil the requirements of the reasonableness test. Rather, a comprehensive weighing of the individual case was required.

The disadvantages suffered by the tenant, due to the closure of the business and its duration, had to be factored in. The BGH essentially referred to the tenant's possible loss of turnover. However, only the specific rental object had to be considered in this regard, not the corporate group's turnover. Furthermore, the weighing had to include which measures the tenant had taken or could have taken in order to reduce impending losses. In principle, the financial advantages the tenant had received through state benefits to compensate for pandemic-related disadvantages had to be reflected. Furthermore, (expected) benefits from business insurance had to be considered. However, any loans are to be disregarded.

The BGH does not consider it a prerequisite for a claim for adjustment of the contract, that the tenant's existence is threatened (*Existenzgefährdung*). Finally, the landlord's interests were also to be considered in the balancing of interests.

**Legal consequence**

The BGH overturned the decision of the OLG Dresden and referred it back to the OLG for a new decision. The OLG now must examine which concrete economic effects the closure of the business had on the defendant during the period at issue, and whether these disadvantages have reached an extent that require an adjustment of the lease agreement. If this is the case, the OLG must also assess a possible reduction of the rent based on the concrete individual circumstances (and not by using generalised rates).

## Conclusion and outlook

Since the beginning of the pandemic, numerous courts have ruled on possible obligations of commercial tenants to pay the full rent despite the severe impact of the COVID-19 pandemic.

Previous case law has mostly denied tenants' warranty rights in the event of business closures/restrictions. The BGH has now confirmed this and - as explained above - also rejected a defect leading to a reduction in rent.

The previous judicial assessments diverge on the question of whether there is a claim for adjustment of the contract due to a frustration of contract.

While most recently the OLG Cologne (22 U 79/21), the Court of Appeal *(Kammergericht)* in Berlin (8 U 85/21; 8 U 1106/20) as well as the OLG Frankfurt a.M. (2 U 147/20; 2 U 18/21) did not assume any deviation from the previous legal situation and therefore neither reduced the rent nor adjusted the contract, the OLG Dresden (the judgement on which the BGH has now ruled), the OLG Nuremberg (13 U 3078/20) and the KG Berlin (8 U 1099/20) made a (blanket) adjustment of the obligation to pay rent.

Against this background, the decision of the BGH was eagerly awaited. Accordingly, the BGH's statements on the aspects that are to be considered in the context of the weighing decision, and that will now form the guideline for the clarification of further cases, are particularly welcome. It is correct and important, that both the interests of the tenants and those of the landlords as well as their different starting situations are to be considered in each individual case.

Should commercial tenants approach their landlords and demand a reduction of the rent by way of a contractual adjustment for the period of the lockdown, the criteria established by the BGH can help to come to an amicable agreement for the future or, if necessary, to a retroactive contractual adjustment. Tenants should abstain from reducing the rent or offsetting it themselves to avoid a potential reason for termination. Rather, amicable solutions should be sought with the landlord - also in order to quickly create clarity without lengthy and costly court proceedings and to be able to continue a trusting tenancy. Moreover, it is likely to be costly for a commercial tenant to prove the actual conditions for a rent adjustment in detail in court proceedings. If tenants were to demand a lease adjustment for the past without having promptly asserted such an adjustment for the period of one or both lockdowns or without having at least paid the rent with reservation, this could possibly argue against an adjustment of the rent. However, the BGH did not address these questions further in its ruling, so that further disputes in courts are likely to arise in this regard.

Overall, this first BGH decision does not conclusively provide legal certainty and clarity in this area.

Further appeal proceedings with similar facts and issues are pending before the BGH. Additional clarification of further questions is therefore to be expected soon.

It should be noted that not only the BGH, but also the legislator could provide more legal certainty and clarity. However, this is not to be expected at present. This is because the legislator has not seized previous opportunities to create clear solutions for a large number of cases, but has so far left it at selective interventions such as the temporary lock on lease termination in the first lockdown 2020 and the reversal of the burden of proof in favour of tenants (consequences of the COVID-19 pandemic as a serious impairment of the basis of the business) in the second lockdown 2020/2021 (cf. our briefings "COVID-19 real estate law aspects" of 16 March 2020 and "Commercial leases in the COVID-19 pandemic" of 15 March 2021). The legislator could - if it does not adopt a blanket regulation on the distribution of risk in the event of state ordered closures - at least regulate the criteria to be factored in the context of the contractual adjustment claim by way of example. This would be a welcome aid to assessment not only for the parties to the tenancy agreement concerned, but also for the courts now dealing with many of such cases.

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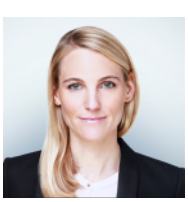

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