

## COVID-19: Impact on Legal Positions of Landlords in Germany

### ***What actions are available to the landlord in the event of COVID-19-based rent payment defaults?***

As a result of the legal amendments on German tenancy law that were passed in March 2020 in connection with the COVID-19 pandemic, landlords are not allowed to terminate lease agreements for default of rental payments occurring in the period from April 1 to June 30, 2020, until June 30, 2022, if those defaults result from the COVID-19 pandemic. Soon, there will be an increasing need for commercial landlords to deal with the fact that either rental payments for the abovementioned three-month period are outstanding for a longer period of time than initially expected or that insolvency proceedings will be initiated against the tenant's assets if its financial situation gets worse.

As for the outstanding rent for the three-month period, the landlord's lien and existing rent deposits provide legal instruments to secure the landlord's payment claims. At the same time, an insolvency filing with respect to the tenant's assets implicates certain restrictions on the landlord's ability to terminate the relevant lease agreement.

### **Landlord's lien (*Vermieterpfandrecht*)**

Pursuant to Sec. 578 para. 1, 562 para. 1 of the German Civil Code (BGB), the landlord is entitled to a lien on the tenant's movable assets placed in the leased area for its claims arising out of the lease. This includes any claim for outstanding rent payments for the period from April 1 to June 30, 2020. An enforcement of the landlord's lien to secure the payment claims from the abovementioned period was not restricted by the legal amendments made in March 2020. However, the landlord's lien can only be claimed for outstanding rent for the current and following rental year (not calendar year). This means that the landlord's lien, which is asserted for claims for payment of outstanding rent for the period from April 1 to June 30, 2020, cannot be maintained until June 30, 2022 (the date from which the suspension of the right of termination ceases). Even if the lease period started on April 1, 2020, a claim could be asserted by the landlord's lien only until March 30, 2022. A termination due to rental arrears would only be possible after the expiry of the possibility to enforce the landlord's lien. In order to obtain satisfaction from the landlord's lien for the current period, the abovementioned timeline needs to be observed. However, waiting for outstanding rent to be paid by June 30, 2022, can lead to the exclusion of enforcing the landlord's lien.

The landlord's lien is applicable to objects of the tenant that were brought into the leased area and that were owned by the tenant at the time of the assertion of the lien. Such items must have been deliberately brought onto the relevant premises on a non-temporary basis. If an object or an entire stock of goods was transferred as security for claims to a third party after it was brought into the leased area, the security ownership of the third party is encumbered with the landlord's lien. In the event that such security transfer and the creation of the landlord's lien coincide in time (e.g., regularly in the case of security transfers of a changing warehouse), the landlord's lien resulting from an existing rental agreement takes priority in rank over such security transfer. Therefore, banks usually demand a waiver of the landlord's lien when such a security transfer is concluded.

As a result of the landlord's lien, the landlord is entitled to object to any removal of items brought into the leased property if and to the extent that such removal does not qualify as an ordinary business operation (see Sec. 562a BGB).

### **Enforcement of landlord's lien (*Vermieterpfandrecht*)**

The landlord can also request the return of a removed encumbered object by the tenant (Sec. 1231 BGB). A corresponding enforcement is possible as soon as the claim becomes due (cf. Sec. 1228 para. 2 BGB).

### **Satisfaction from rent deposit**

Sec. 551 BGB states the legal provision for rent deposits in relation to residential tenancies. For tenancies that are non-residential, German courts have applied those principles accordingly in the past. As for the non-payment of rent in the period from April 1 to June 30, 2020, landlords will not likely be able to satisfy their claims by offsetting them against a rent deposit easily. In the absence of an explicit agreement between the parties of the lease agreement, such payment claims during an ongoing rental relationship may be offset only if they are undisputed or have been legally valid as determined by court. Therefore, the relevant circumstances of each individual case must be evaluated. In connection with non-payment of rent for the aforementioned period, the tenant's obligation to pay rent should be undisputed (for details, see Latham & Watkins' *Client Alert* [Legal Implications for German Real Estate](#)). After the lease agreement is terminated, the landlord is entitled to withhold the rent deposit due to rent arrears or claims for damages or to declare an offset against the tenant's claim for repayment of the deposit, even if such payment claim is not undisputed or legally valid as determined by court.

### **Insolvency of the tenant / suspension of termination**

In the event of the tenant's insolvency, several legal effects relate to the outstanding rent payments. Any claims for the payment of rent that accrued up to the time of the insolvency proceedings qualify as part of the insolvency estate. The lease agreement itself continues, even though the insolvency administrator has a special right of termination (see Sec. 109 Insolvency Code (InsO)).

The landlord is affected by a suspension of its right of termination as of the moment of the application for insolvency (Sec. 112 InsO). This suspension prevents the landlord from terminating the relevant lease agreement after the application for insolvency is filed, if the termination is based on a delay in payment of rent that occurred in a period prior to such application for insolvency or upon a deterioration of the debtor's financial circumstances. In particular, the suspension of the landlord's right of termination concerns an extraordinary termination due to non-payment of rent before the application for insolvency was filed. Breaches of other contractual obligations that are not connected to the payment of rent may give rise to extraordinary termination without violation of Sec. 112 InsO. The landlord is still entitled to

regularly terminate the lease after filing for insolvency, if and to the extent that this possibility is contractually agreed or permitted by law.

The suspension of termination applies only to payment arrears before the application for insolvency is submitted. A termination due to possible payment defaults between the application for insolvency and the opening of insolvency proceedings is not excluded, but the relevant payments that are outstanding must have become due after the application has been made, and the tenant must be in default of this payments.

The landlord's lien has a special position in a potential insolvency of the tenant. Such lien can also be enforced against an interim insolvency administrator after an insolvency application has been filed (but only until the opening of insolvency proceedings). After the insolvency proceedings are opened, the landlord is entitled to a separate satisfaction from potential proceeds of the objects encumbered with the landlord's lien. The relevant movables of the tenant are therefore not included in the insolvency estate. Such right of separation only comes into existence if the relevant objects were brought into the leased area before the opening of insolvency proceedings (cf. Sec. 91 para. 1 InsO). The right of separate satisfaction can be enforced only in respect of rental payments for the period of the last 12 months prior to the opening of the insolvency proceedings.

After initiating the insolvency proceedings, the insolvency administrator may continue to bring items into the leased area as set out in Sec. 562 BGB. Such newly contributed objects are not liable for claims that arose before the opening of the insolvency proceedings, but they are liable for debt of the tenant (emerging after the insolvency opening) arising out of the lease agreement that was "continued" during the insolvency.

## Conclusion

Despite the restrictions on landlords' rights imposed by the legal amendments to German tenancy law made in March 2020, the enforcement of a landlord's lien remains unaffected.

Whether offsetting outstanding rent payments against rent deposits paid at the beginning of the rental period is possible needs to be examined for each individual case, but is generally not prohibited.

If an application for insolvency is filed in relation to the assets of a tenant, the suspension of termination set out in Sec. 112 InsO takes effect from the time the application is received by the insolvency court. Such suspension generally precludes the termination of an existing lease agreement due to pre-insolvency default on rent payments.

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