COVID-19: German Government Issues Draft Bill Suspending Tenants' Obligation to Pay Rent and Borrowers' Obligation to Repay Loans

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As countries around the world implement procedures to inhibit the spread of the COVID-19 coronavirus, many changes are obviously having increasingly adverse effects on the economy. With borders closed and free movement restricted, these adverse effects are especially acute in the hotel, travel and consumer industry and will certainly expand in the production and service industries generally. Economic difficulties may result in a person's inability to fulfil its obligation to pay rent or to repay its obligation to service its debt. Under German law, this will inevitably lead to insolvency.

The German government has responded to this unprecedented threat to individuals and small entities by issuing a draft bill essentially suspending rental payments and debt service until 30 June 2020. The Federal Government may extend this suspension period until 30 September 2020 (without the consent of the Federal Council) and beyond 30 September 2020 (with the Federal Council's consent).

To mitigate the impact of the COVID-19 pandemic in the areas of civil law, insolvency law and criminal procedures law (*Entwurf eines Gesetzes zur Abmilderung der Folgen der Covid-19 Pandemie im Zivil, Insolvenz- und Strafverfahrensrecht*), the draft bill (the "Bill") brings long awaited clarity to the intense discussion in Germany over the last few weeks (partially limited to consumer credit agreements). Spread of COVID-19 obviously being of general impact to all parts of society and economy, legal discussions have centred around Material Adverse Circumstance or Material Adverse Effects as well as lapse of inherent basis of a contract (*Wegfall der Geschäftsgrundlage*). These discussions focused on determining whether one party has a right against its counterpart (landlord or tenant with regard to termination of a lease, and creditor or borrower with regard to drawdown of commitments or termination of loans) but with dramatically decreasing cash flows there was no certainty whether management of a company would be able to avoid filing for insolvency in case it is not able to pay rent or debt service on its (upcoming) due date.

The Bill adds article 240 to the Introductory Act to the German Civil Code (see article 5 of the Bill). It, amongst others, introduces a new section 2 (dealing with lease agreements) and a new section 3 (dealing with (for the time being) consumer credit agreements).

The effect of the Bill on lease agreements:

- A landlord will not be able to terminate occupational lease agreements for residential or commercial real estate for the reason the tenant has not paid its rent in the period from 1 April to 30 June 2020 if and to the extent such non-payment is due to COVID-19. The termination right is excluded until 30 June 2022.

The effect of the Bill on consumer credit agreements with:

- It applies only to loans entered into prior to 15 March 2020;
- In principle, subject to the caveats below,
  - Interest and repayment installments becoming due in the period from 1 April to 30 June 2020 are suspended for three months from their due date, in case it is unacceptable for the consumer to pay debt service to the lender due to lost revenues which are caused by the COVID-19 Pandemie. It is the case if either the reasonable living costs of the borrower or the reasonable living costs of persons dependent to

the borrower are at risk. The consumer is still entitled to make payments in accordance with the respective credit agreement;
- the lender's termination right because of (i) a payment default; or (ii) a material adverse effect to the financial status of the consumer or the value of the security has occurred in situations set out above, is suspended until 30 June 2020;
- lender and borrower are free to find alternative agreements for debt service if they are for the benefit of the consumer;
- the lender shall discuss with the borrower about possibilities to support the borrower. The lender must document the changes, as agreed or as a result of the Bill;
- if the lender and borrower are not able to agree to a solution for debt service by the borrower for the period of 30 June 2020 onwards interest or repayment installments are suspended for another three months from their due date;

- the aforementioned provisions do not apply if it is unacceptable to the lender taking into account the circumstances of the individual case including the COVID-19 pandemic and general circumstances;
- the Federal Government may declare to apply the aforementioned provisions to very small entities, i.e. entities with (i) less than 10 employees; and (ii) an annual turnover respectively a balance sheet not exceeding EUR 2 million.

This Bill is an interference by the German government with contractual autonomy. It is a strong indication that the German legislator expects that neither lease agreements nor credit agreements are per se affected by COVID-19. This is in line with the decisions of the Federal High Court ruling on effects of extraordinary circumstances to credit agreements. In conjunction with the deferral of the obligation to file for insolvency also contained in the Bill, the Bill will create important headroom for tenants and borrowers to “breathe” during the challenging times of the COVID-19 pandemic. This Bill is a contribution by the German government aiming to keep the German economy going, out of insolvency state, and to protect tenants from losing their properties.;

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Goodwin's team of real estate industry lawyers, Stephan Kock, Andreas Mallin, Marc Bohne and Peter Junghänel along with our dedicated finance lawyers Stephan Kock and Andreas Mallin can help clients navigate the economic and legal uncertainty posed by the COVID-19 coronavirus. Please contact us to review or continue the discussion.

Please also visit Goodwin’s **Coronavirus Knowledge Center**, where firm lawyers from across the globe are issuing new guidance and insights to help clients fully understand and assess the ramifications of COVID-19 and navigate the potential effects of the outbreak on their businesses.

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