LEGAL UPDATE
Real Estate Law
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GÖRG
YOUR BUSINESS LAWYERS

Act on Mitigating the Consequences of the COVID-19 Pandemic in Civil, Insolvency and Criminal Procedure Law – Important provisions for real estate investors

Alongside medical- and corporate-law related consequences, the COVID-19 pandemic and the state measures that have been introduced to mitigate it have already resulted in extraordinary economic effects. As a part of the package of measures introduced by the Federal Government, on 25 March 2020 the German Federal Parliament passed the Act on Mitigating the Consequences of the COVID-19 Pandemic in Civil, Insolvency and Criminal Procedure Law. The Federal Senate raised no objections to that legislation. This Act is a part of a package of measures approved by the Federal Government; along with providing liquidity assistance through KfW and support measures under the – concurrently-passed – Economic Stabilisation Fund Act, these measures and additional steps, such as tax deferrals, take further steps to allow time for businesses in economic distress to continue their business activities while making use of state aid and/or agreements with shareholders, capital investors and/or creditors. The following Legal Update provides an overview of essential provisions of the Act that may have special relevance for real estate investors. This Legal Update is not intended to be complete and comprehensive and does not substitute for individualised legal advice. If you have specific legal questions, please contact the authors of this Legal Update or your usual contacts at GÖRG. We look forward to assisting you.

The following insolvency law provisions have taken effect with retroactive effect as of 1 March 2020. The civil law amendments took effect on 1 April 2020.

Insolvency law - COVID-19 Insolvency Suspension Act ("COVInsAG")

Suspension of the duty to file for insolvency

The central insolvency law amendment is the suspension of the duty to file for insolvency under § 15a of the German Insolvency Act ("**InsO**") and § 42 para. 2 of the German Civil Code ("**BGB**"); this suspension is initially limited in time until 30 September 2020. The suspension does not apply (only) where grounds for insolvency are not based on the consequences of the COVID-19 pandemic or where there is no prospect that existing illiquidity can be remedied. Provided that the debtor was not illiquid on 31 December 2019, a presumption is raised that the grounds for insolvency are caused by the effects of the COVID-19 pandemic and that there is the prospect to remedy existing illiquidity.

In contrast to initial considerations in the legislative process, § 1 sentence 1 of the COVInsAG contains a fundamental suspension of the duty to file for insolvency during that period. Subject to the conditions referred to above, this general suspension lapses only on an exceptional basis. A strict burden of substantiation and proof is imposed (to the benefit of the potential applicant) to show that one of the suspension exceptions exists. An additional provision provides for a presumption with respect to the prospect of remedying existing illiquidity and amounts to additional relief for parties obliged to file.

Causal connection

The legislative reasoning does not define how broadly the term "based on" (COVID-19) should be interpreted. The purpose of the statute implies that a broad interpretation should be applied. Grounds for insolvency are not only "based on" the effects of COVID-19 where the business has immediate reductions in sales as a result of closures or supply chain interruptions; they can also be found where indirect effects of the COVID-19 pandemic result in grounds for insolvency. Tenants whose sales income has been diminished by business closures imposed by authorities, or landlords who do not receive rent payment as a result of that, will usually not be subject to the (reverse) exceptions to the general suspension. On the other hand, the necessary causal connection between COVID-19 and insolvency will be missing where the business was already required to apply for insolvency prior to the COVID-19 pandemic. In individual cases, a decision will have to be taken on how to deal with

cases where – in addition to the COVID-19 pandemic – other causes led to grounds for insolvency.

The exception to the suspension in the "absence of a prospect to remedy existing illiquidity" makes it relevant, among other things, whether and to what extent affected businesses have access to liquidity assistance provided by the state or guarantee support and seek to obtain that in the context of financial planning forecasting. State support measures are usually tied to certain criteria. For example, businesses that were already in "difficulties" on 31 December 2019 are usually excluded from accessing these. In such cases, serious financial planning needs recourse to alternative financing opportunities (e.g. shareholder loans or support from existing debt financers).

Duration

The suspension of the duty to file for insolvency is initially limited to 30 September 2020. It can be extended up until 31 March 2021 (at the latest) by way of a regulation, just like the other provisions of the COVInsAG.

Effects of the suspension

In § 2, the COVInsAG contains explicit effects of the suspension of the duty to file for insolvency that differ from the position at law without such a suspension. The motivation here as well was to create time for affected businesses to remedy grounds for insolvency that have arisen as a result of the COVID-19 pandemic and to allow the continuation of business until then.

In this Legal Update we note the following two aspects only as examples:

Exemption from corporate law payment prohibitions

Payments that are made in the ordinary course of business, and in particular payments that are made to maintain or re-commence business operations or to implement a restructuring plan, are compatible with the due care of a prudent and conscientious manager. This means that the liability risks for management in making payments during a period where the business is insolvent under relevant corporate law statutes (among others § 64 sentence 1 of the German Limited Liability Companies Act) is not entirely excluded, but is limited. Payments of rent that serve to maintain business operations should be privileged in this context.

Limitation of claw-back risks

Legal transactions that grant or make available to a counterparty collateral or payment fulfilment and that the counterparty is able to insist on (in that manner and at that time) may not be clawed back in a later insolvency proceeding; that principle does not apply where the counterparty knew that the restructuring and financing efforts on the part of the debtor were unsuitable to remedy the debtor's existing illiquidity. Provided that the (reverse) exemption does not apply here, payments made for proper consideration (congruent-coverage payments), including payments of rent in the amount legally owed and when these become due, are excluded from claw-back claims in a later tenant insolvency proceeding. Since the statutory provision does not exclude objective creditor prejudice (as a test for all insolvency claw-back provisions), but only refers in substance to the special claw-back tests for congruent-coverage payments - § 130 InsO), claw-back claims on the basis of other claw-back provisions remain possible (in particular claw-back for transactions made with an intent to prejudice creditors under § 133 InsO). It is only the claw-back of those incongruent coverage payments that are expressly referred to in the statute (including shortening payment deadlines and the grant of payment relief) that is intended to additionally be prevented.

Interim solutions in individual cases

Tenants whose businesses have been closed by the authorities may be unlikely to be able to make full payment of the rent that is contractually owed until further funding is granted to them. In individual cases, it should be reviewed whether and under what circumstances payment agreements can be agreed on, e.g. instalment payment plans, and whether the insolvency law claw-back exemptions will apply to these.

Exclusion of exemptions

As noted above, the exemption from claw-back lapses where the counterparty was aware that the restructuring and financing attempts of the debtor were unsuitable to remedy the debtor's existing illiquidity. According to the legislative reasoning, only positive knowledge of this is prejudicial. A duty to investigate this is not intended to be imposed.

Creditor applications

Applications for insolvency that are filed by creditors in the period of three months after the promulgation of the Act on Mitigating the Consequences of the CVID-19 Pandemic in Civil, Insolvency and Criminal Procedure Law require that, for insolvency proceedings to be commenced, grounds for insolvency already existed on 1 March 2020.

Civil Law – Amendment of the Introductory Act to the Civil Code

Moratorium

Scope of application

A right to refuse to perform under long-term contracts that were entered into prior to 8 March 2020 has been created (and extends until 30 June 2020) for consumers and very small businesses (up to nine employees and up to EUR 2 million in annual turnovers), provided that performance cannot be made due to the effects of the COVID-19 pandemic. This is especially intended to ensure that these individuals and businesses are not cut off from basic utilities. For very small businesses, the right to refrain from making payments (= performance) is available for all long-term contracts that are essential (i.e. are required to obtain goods and services necessary for the reasonable continuation of the business). These include e.g. mandatory insurance and contracts for the provision of energy or telecommunication services. However, it also applies with respect to claims that are not simply claims for payment, i.e. entitlements to services. Lease, loan and employment contracts – and hardship cases – are excluded from the provision. Where the right to refuse performance is unreasonable for the creditor, the debtor is entitled to terminate the contract vis-à-vis the creditor.

Exercise

The right to refuse performance must be exercised by way of an objection. The debtor (refusing performance) must therefore expressly rely on its right to refuse performance and is generally also required to prove that such performance cannot be provided due to the COVID-19 pandemic.

Legal consequences

The debtor is capable of avoiding the enforceability of the principal claim and that secondary claims arise. The scope of application also generally encompasses demands for the return of goods and funds (*Rückgewähransprüche*), contractual claims for damages and claims for reimbursement that arose prior to the amendment. The primary obligation to make performance remains in existence and must be satisfied after the moratorium expires. Where the debtor is already in default of performance, the tests for default lapse upon the exercise of the foregoing right.

Limitation on terminating leases

Termination right limitation

A lessor may not terminate a lease "*only on the grounds that the tenant failed to make payment of rent in the period from 1 April 2020 until 30 June 2020 in spite of rent becoming payable provided that this failure is based on the effects of the COVID-19 pandemic*". Lessors may no longer terminate leases due to rent owing for the period from 1 April 2020 to 30 June 2020 provided the rent payment debt is based on the effects of the COVID-19 pandemic. The statutory right to terminate lease agreements for good cause on exceptional grounds and without notice where the tenant is in default of making rent payments (or substantial parts of these) for two consecutive dates, or in any period extending beyond two rent payment dates and the default amounts to rent payable for two months' rent, is suspended for two years with respect to the next three months. This applies to lease agreements for residential and commercial premises, as well as to concession rental agreements (*Pachtverhältnisse*). Different application prejudicing tenants is not permitted.

No general right to refuse performance

The tenant's obligation to make payment of rent continues to exist. No general right to refuse performance is provided for and tenants can enter into payment default where they do not make payments on time. The general BGB provisions on rent becoming due payable and default arising remain unaffected. An unwillingness to make payment or other illiquidity that is not based on the COVID-19 pandemic does not result in a suspension of termination rights. Termina-

tions on other grounds (for example a serious breach of duties on the part of the tenant vis-à-vis the lessor) remain possible. To the extent that the termination of a lease without cause is possible at law, for example for commercial leases without a term, such termination possibilities remain unaffected.

Requirements of proof

"The connection between the COVID-19 pandemic and non-performance must be proven." The tenant must substantiate facts that show that it is highly probable that its non-performance is based on the COVID-19 pandemic. Commercial property tenants can usually provide such substantiation with reference to the fact that the operation of their businesses was prohibited or significantly restricted as a result of legal regulations or orders by authorities imposed to suppress the virus.

Duration

The limitation on terminations will end on 30 September 2022. That means that terminations may be issued after that date for outstanding payments that arose from 1 April 2020 to 30 June 2020 and which have not been paid by 30 June 2022. Accordingly, tenants and lessees have two years as of 30 June 2020 to resolve outstanding payments that would justify termination. The Federal Government is empowered to issue a regulation under which the period in which outstanding payments may accrue (without termination being possible) would be extended until 30 September 2020, provided that significant restrictions due to the COVID-19 pandemic continue to persist. All of the foregoing periods may be extended with the consent of Federal Parliament.

Provisions on loans

The amending legislation contains various provisions temporarily adjusting the rights and duties of parties to consumer loans that were entered into prior to 15 March 2020. These include an automatic three-month deferral of repayment, interest and principal payments which become due from 1 April 2020 to 30 June 2020 where the consumer has sustained losses in income as a result of the COVID-19 pandemic and these have made making payments owed unreasonable. Terminations on the part of the lender due to a material deterioration in the assets of the consumer or the intrinsic value of the collateral provided to secure the loan are also excluded for the period of the suspension.

Scope of application

The foregoing provisions (and other ones) on loan agreement laws apply only to consumer loan agreements that were entered into prior to 15 March 2020. However, the legislation contains authorising legislation for the Federal Government to expand the personal scope of application. Under the wording of the legislation and the legislative reasoning, this is intended to apply in particular for very small businesses in terms of Art. 2 para. 3 of the Annex to the EU Commission Recommendation 2003/361/EC dated 6 May 2003 relating to the definition of very small businesses and small and medium sized businesses. It is unclear whether the Federal Government will make use of this authorisation to offer a statutory suspension to other businesses (other than the very small businesses that are explicitly referred to). Up until any such regulations, affected businesses are able only to enter into agreements with their financing banks and/or to take advantage of liquidity and support assistance available from the state, provided that the necessary conditions for these are met.

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Note

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