

# **NO DEFECT OF THE PREMISES, NO LUMP-SUM RENT REDUCTION - UPDATE ON THE LEGAL CONSEQUENCES OF COVID-19- RELATED BUSINESS CLOSURES (FEDERAL COURT OF JUSTICE (BUNDESGERICHTSHOF, BGH), DECISION DATED JANUARY 12, 2022 - XII ZR 8/21**

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Legal Briefings

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## **BRIEF SUMMARY OF THE DECISION**

1. Covid-19 pandemic related measures do not constitute a defect of the leased property.
2. An adjustment of the contract on the basis of the doctrine of frustration of contract (Störung der Geschäftsgrundlage) is generally possible, However, this requires among other things that adherence to the originally concluded contract is unacceptable for the tenant.
3. There is no general legal principle to the effect that the risk of the pandemic-related restriction of use of the leased premises is to be shared equally between landlord and tenant and that the rent is therefore to be reduced by 50 %. Rather, all circumstances of the individual case must be taken into account for the decision of the specific case.
4. Relevant circumstances include inter alia corresponding financial benefits of the tenant such as government assistance and insurance benefits.

## **THE CASE**

A retailer located in Saxony, Germany, was forced to close from March 19, 2020 until April 19, 2020, due to orders of the relevant authority related to the Covid-19 pandemic. Landlord and tenant were in dispute whether or not the rent during the period of closure was payable. The court of lower instance OLG Dresden denied a defect of the leased premises, but ruled that the rent payable was reduced on the basis of the doctrine of frustration of contract, resulting in a reduction of the rent for the time of the closure by 50 % without the court considering the specific effects on the landlord or the tenant. This was based on the assumption of the court that risks associated with the Covid-19 pandemic are generally to be shared equally between landlord and tenant, since neither party had foreseen these risks nor had caused them to occur.

## **THE DECISION OF THE FEDERAL COURT OF JUSTICE**

The Federal Court of Justice overturned the judgment of the OLG Dresden and referred the case back to such court for a new hearing and decision.

As the Federal Court of Justice explained in detail, the officially ordered closure did not constitute a defect in the leased premises.

However, an adjustment of the rent on the basis of doctrine of frustration of contract is possible. The Federal Court of Justice affirmed that the Covid-19 pandemic had seriously changed the basis of the lease agreement. However, this does not automatically give rise to a claim for rent adjustment: Instead, it is still a prerequisite that it is unacceptable to expect the tenant to adhere to the unchanged contract under the circumstances of the individual case. Here, the Federal Court of Justice comes to the conclusion that, at least under the specific lease agreement concluded, the risks of the Covid-19 pandemic with the associated restriction on the use of the leased premises were not imposed unilaterally on the tenant, i.e. there is generally room for a rent adjustment. However, the Federal Court of Justice further emphasizes that not every severe effect on the tenants position entails a contractual adjustment, but rather that adherence to the contract must lead to results that are no longer acceptable, which requires an examination of all circumstances of the individual case. The court of lower instance had not carried out this examination, hence the Federal Court of Justice referred the case back.

## **IMPORTANT POINTS OF THE DECISION**

1. That the Federal Court of Justice negated a defect of the rental object is not a formality, but rather quite relevant. If there was a rental defect, the further assessment of the circumstance of the case would essentially relate to the question to which extent the rent would have to be reduced. By taking the route via the doctrine of frustration of contract, the Federal Court of Justice sets a high hurdle for rent adjustments with the requirement of it being unacceptable for the tenant to adhere to the original lease.

2. The tenant bears the burden of proof that it is unreasonable to adhere to the unchanged contract. It is on the tenant to state and prove what disadvantages it has suffered a loss as a result of the measure imposed (in this case, the company closure) that make unacceptable to pay the rent in full and also what measures the tenant has taken to compensate for the losses. Cost savings, insurances and governmental support are relevant in this respect, as well as omitted measures of the tenant, if they would have reduced the loss.

3. The Federal Court of Justice's comment that the interests of the landlord are also to be taken into consideration in the course of the consideration of the particularities of the case is noteworthy, although no further details are provided in this regard. Obviously, it is the landlord's interest to receive the rent in full. It is likely also relevant that the landlord regularly has to service a loan from the rent paid, whereas there is no right to reduce the instalments due to the Covid-19 pandemic.

## **OUTLOOK**

The decision of the Federal Court of Justice is well founded and understandable, but it does not provide the parties concerned or the courts of instance with such general blueprint for other cases which some may have hoped for. This was the approach taken by the lower court as it divided the risks associated with the pandemic on a 50/50 basis. The case on which the Federal Court of Justice ruled concerned a retailer and the period of closure of the business premises ordered by the authorities. For a restaurant operator and a period in which access to the restaurant was possible in principle but severely restricted, the relevant circumstances of the individual case may be completely different. When assessing the individual case, it will also be necessary to take into account which, if any, settlement arrangements regarding rental payment and lease adjustments have been made by the contracting parties during the period since the start of the Covid-19 pandemic, as this may significantly affect the evaluations whether the doctrine of frustration of contract is applicable. The issue of rent adjustments due to the Covid-19 pandemic is therefore likely to occupy landlords and tenants as well as legal courts for some time to come.



## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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