

FAQ – Insolvency of Commercial Tenants

Introduction

In the context of the Covid-19 pandemic and the economic difficulties associated with it, the German legislator had enacted the Covid-19 Insolvency Suspension Act (*Covid-19-Insolvenzaussetzungsgesetz*). The Act temporarily suspends the statutory obligation to file for insolvency for cases of insolvency caused by the Covid-19 pandemic. As a result, the number of corporate insolvencies in Germany has decreased in 2020 compared to the previous year. However, following the expiry of the temporary suspension as of 1 May 2021 an increase of insolvency filings is to be expected.

This document focusses on FAQs relevant for commercial landlords in the event of an insolvency of commercial tenants and shall provide initial guidance to professional real estate investors.

1 Does the lease survive the opening of insolvency proceedings?

- In general, the lease remains in place, but with effect for the insolvent estate, Sec. 108 of the German Insolvency Code (*Insolvenzordnung*, "InsO"). However, only the insolvency administrator can act for and on behalf of the insolvent tenant.
- However, the insolvency administrator can in its discretion terminate the lease with 3 months' notice at the end of a calendar month (Sec. 109 InsO). If the insolvency administrator does not exercise the termination right, rent and other payment obligations under the lease remain unaffected and enjoy priority over other claims (see also FAQ No. 3).

2 Can the landlord terminate the lease?

- After **filing** for insolvency, the landlord is no longer entitled to terminate the lease on grounds of rent arrears which arose prior to the insolvency **filing** (Sec. 112 InsO).

- The landlord can terminate the lease due to rent arrears which arise after the insolvency **filing** in accordance with statutory provisions. Whether a termination of the lease makes sense from a commercial perspective should be evaluated with professional advisors (e.g., if re-letting of property proves to be difficult and part of the rent is still paid).

3 What happens to rent arrears and service charges?

- Rent arrears or service charges which became due prior to **opening** of the insolvency proceedings are treated as non-preferential insolvency claims (*Insolvenzforderungen*). These can be filed for registration with the insolvency administrator against the insolvent estate and will only be settled on a pro rata basis with all other non-preferential claims at the insolvency quota, if any.
- Rent arrears or service charges arising in the period after the **opening** of the insolvency proceedings are treated as priority claims (*Masseforderungen*). Such claims will be settled in priority to the non-preferential insolvency claims, to the extent that there are sufficient assets. Otherwise, the landlord will receive payment on a pro rata basis at the insolvency quota, if any.
- Service charge credits do not have to be paid to the insolvency administrator, but can be set-off against landlord's insolvency claims.

4 Can the landlord enforce rent security?

- As long as the lease is not terminated, the landlord can enforce any rent security (e.g., bank guarantee or deposit), to the extent the underlying claims are undisputed or determined by a binding judgement. In case of disputed claims, the rent security can only be enforced after expiry of the lease, unless the lease agreement explicitly provides otherwise.
- In case of enforcement of rent security, the rent security should be offset against the oldest claims first by way of a redemption notice (*Tilgungsbestimmung*) from

the landlord, thereby, reducing the non-preferential insolvency claims.

5 What other rights does the landlord have?

- The German Civil Code provides for a statutory lien on all assets of the tenant located on the premises in favour of the landlord securing any claims of the landlord under the lease.
- The landlord can and should exercise this lien vis-à-vis the insolvency administrator as soon as possible upon becoming aware of the insolvency. The landlord's lien may in particular be used to cover potential gaps between the rent security and the landlord's outstanding claims.
- The right of realization of the assets subject to the landlord's lien lies with the insolvency administrator. The insolvent estate is entitled to a cost lump sum of 9% of the gross proceeds of sale (Secs. 170, 171 InsO) plus any potential surplus following full satisfaction of the landlord's claims.

- The landlord's lien only covers rent arrears of up to 12 months (Sec. 50 para. 2 InsO).
- If the sales proceeds are not sufficient to cover all outstanding claims, non-preferential insolvency claims should be settled first (again, by way of a redemption notice (*Tilgungsbestimmung*)).

LPA-Guidance Note

Generally, landlords should contact the insolvency administrator immediately upon becoming aware of the insolvency in order to formally assert all rights of the landlord under the lease, in particular the landlord's lien. Depending on the situation, individual arrangements can be made with the insolvency administrator. In addition, it may be necessary to take action in relation to other property-related contracts (e.g., financing agreements) which often provide for notification/disclosure obligations in the event of the tenant's insolvency.



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