GIBSON DUNN

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"... WHATEVER IT TAKES" – GERMAN PARLIAMENT PASSES FAR-REACHING LEGAL MEASURES IN RESPONSE TO THE COVID-19 PANDEMIC

To Our Clients and Friends:

On March 25, 2020, the German Parliament (*Bundestag*) passed a far reaching rescue package to respond to the COVID-19 pandemic and its dramatic economic effects. The full text of the package can be found here.[1]

The package is a combination of significant changes on different levels: (i) Temporary changes in the German civil code to protect individual tenants, debtors, and obligors under continuous obligations; (ii) the relaxation of provisions for businesses that are otherwise threatened by insolvency, (iii) practical solutions for companies to handle their corporate affairs in a virtual or remote setting, and – a bit out of step with the other context - (iv) extending strict court deadlines in a criminal proceedings to ensure criminal hearings keep pending during the COVID-19 crisis.

Below are the specific elements of the comprehensive package that are each discussed in more detail below:

I. Protect Individual Consumers, Micro-Businesses and Tenants Affected by COVID-19

For cases in which consumers or micro-enterprises are no longer able to meet their obligations under continuing obligations due to the COVID-19 pandemic, the temporary (non-waivable) *moratorium* should enable them to cover liquidity losses due to their loss of income through June 2020.

With the "Act on Mitigation of the Consequences of the COVID-19 Pandemic in Civil, Insolvency and Criminal Procedure Law" (the "Act"), the German legislator has adopted a new temporary right to refuse performance under these contracts (*See* Article 240 of the Introductory Act to the German Civil Code).

The new regulation not only raises substantial questions of economic policy and constitutional law, but will also lead to substantial legal uncertainties due to the large number of legal "blanket terms" used and the required weighing of interests.

1. *Temporal scope of application*

The moratorium is initially limited to June 30, 2020, but can subsequently be extended by directive - if the *Bundestag* does not object - through September 30, 2020. The short period reflects that the moratorium is intended to bridge short-term liquidity constraints of those affected until the start of government aid measures (*ultima ratio* function).

2. *Personal scope of application*

Consumers and micro-enterprises are supposed to be the beneficiaries of the *moratorium*. Section 13 of the German Civil Code (BGB) defines the term "consumer" as an individual that concludes a transaction for primarily private purposes. The definition of a micro-enterprise can be found in the EU Commission' Recommendation 2003/361/EC of May 6, 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.5.2003, p. 36). Therein, a micro-enterprise is defined in particular as an enterprise which employs fewer than ten employees.

3. *Substantive scope of application*

Specifically, the legislator provides that the beneficiaries of the moratorium can refuse to fulfill obligations arising from "*substantial continuing obligations*". Rental and property lease agreements are specifically regulated in Section 2, and loan relationships specifically in Section 3 (for more details, see below). Employment contracts are exempted from the scope of application. With regard to the term "*continuing obligation"*, the legislator apparently uses the long-established definition from civil law. For consumers, substantial continuing obligations are those which serve to provide goods/services of general interest (e.g. the supply of electricity and water), and for micro-entrepreneurs those which are "*necessary for the appropriate continuation of their business*". Thus, the scope of application for micro-entrepreneurs appears to be wider and includes regular supplies of goods to the micro-entrepreneur based on agreements with continuing obligations, and services that the micro-entrepreneur has to provide himself under such agreements. With regard to insurance contracts, for example, it will be necessary to differentiate based on their relevance.

4. *Standards to be met to refuse performance*

In order to be entitled to refuse performance, it is necessary that, due to circumstances caused by the COVID-19 pandemic, the beneficiary is not able to provide the service without risking its "reasonable standard of living" (consumers) or the "economic basis of its business" (micro-enterprises). What this means will have to be clarified on a case-by-case basis.

In particular, the legislator has not clarified, to what extent the use of one's own assets - in the case of micro-entrepreneurs also of *private* assets - can be demanded. It is also open to what extent the use of state aid, if available, will be required first. It is also unclear from the wording of the law who will bear the burden of proof. For property lease agreements, the legislator allows an affidavit to prove a connection between the COVID-19 pandemic and the difficulty of performance. In view of the fact that this is found in the provisions dealing with property lease agreements, it is doubtful whether this applies accordingly to other continuing obligations.

5. *Legal consequence*

The *moratorium* postpones the obligation to fulfil the primary performance obligations. Once the *moratorium* ends, these obligations must be fulfilled if the other prerequisites are met. In addition, the *moratorium* prevents damage claims caused by default, in particular default interest, coming into existence for a period of three months.

6. *Exclusion*

The right to rely on the *moratorium* is excluded if the *moratorium* puts an unreasonable burden on the creditor because failure to perform "would threaten his [own] reasonable standard of living or the reasonable standard of living of his dependent relatives or the economic basis of his business". In this case, the debtor has the unilateral right to terminate the contract. Obviously, questions similar to those regarding reasonableness naturally arise on the debtor side.

7. *The moratorium's objection character*

If the affected person decides to claim the moratorium, he or she must raise the objection (it is not recognized *ex officio*). This bears substantial risks when applying the law. In particular, it will be up to the courts to interpret the legal "blanket terms", and to clarify the relevant questions of fact. Considering the current delays in the courts, this could take years in some cases.

8. *Recommendations*

Going forward, companies should scrutinize their contractual portfolio to identify which contracts vis-a-vis consumer and micro-enterprises qualify as governing "*substantial continuing obligations*". In this context, it will be particularly important to distinguish contracts on „*continuing obligations*" from such which only stipulate subsequent delivery instalments (*Sukzessivlieferverträge*).

Once such contractual relationships which are subject to the new law are identified, the accounting department should be notified where the relevant collection processes need to be amended. In this context, a standard letter should be prepared confirming receipt of a notice by the respective consumers or micro-enterprises claiming rights under the moratorium.

The standard letter should not go beyond acknowledging the difficult economic situation in general, but also include language reserving the right to scrutinize whether the legal requirements under the law are in fact met, and reminding the consumer or micro-enterprise that the payment obligation becomes due after the moratorium has expired.

II. Protect Debtors under Consumer Loans and Relax Filing Requirements for Insolvency

The *Bundestag* has furthermore made significant changes in the laws of consumer loans and insolvency:

1. *Changes to the law of consumer loan agreements*

A temporary waiver of rights relating to consumer loans has been implemented. Specifically, for any consumer loans that were executed prior to March 15, 2020, claims of the lender for the payment of principal or interest which fall due between April 1, 2020 and June 30, 2020 will be deferred by three months if the borrower claims that performing on such claims would be unreasonable for him due to loss of income caused by the COVID-19 pandemic. Where the borrower can establish that it has suffered a loss of income, it will be assumed that such loss is actually due to the COVID-19 pandemic.

In addition, the right of the lender to terminate the consumer loan for payment default, deterioration of the financial condition or value of any collateral granted will be temporarily suspended in these cases.

If by the end of the suspension period the lender and the borrower have not agreed to amend the loan agreement otherwise, the term of the loan will automatically be extended by three months and any due dates for performance under the loan agreement, including for any payments due during the suspension period, will be extended by three months as well.

No deferral of payments or temporary suspension of termination rights applies where this would not be reasonably acceptable for the lender taking into account all relevant circumstances, including the changes in living conditions generally caused by the COVID-19 pandemic.

Note that the Federal Government may, by way of regulation, extend the personal scope of the new rules. The law sets out that it may particularly include micro-enterprises but it appears that it may even go beyond.

2. *Changes to German insolvency law*

The German legislator has also passed a law to make certain temporary adjustments to German insolvency laws. Previous obstacles and pitfalls for lenders granting bridge loans or rescue financings to distressed companies shall be eliminated to a large extent. This can be an effective way to support (dis)stressed companies in Germany. The obligation on directors to file for insolvency will be suspended for scenarios caused by COVID-19.

a. Filing requirement

With effect from 1 March 2020 until September 30, 2020 German companies do not have to file for insolvency in case of cash flow insolvency unless it is not caused by the COVID-19 pandemic or there is no prospect that the cash flow insolvency will be remedied. To give directors comfort that there is no obligation on them to file, it will be assumed that an illiquidity is caused by the COVID-19 pandemic where the company was not already cash flow insolvent on December 31, 2019.

b. Payments by companies in a crisis

As a consequence the company can make payments in the ordinary course of business without management risking personal liability. This shall stabilize stressed companies and enable them to continue business with its contractual partners.

c. Lender liability

The new law also eliminates legal risks in connection with the provision of financing in a crisis. Potential lender liability due to a delayed filing for insolvency is suspended. Also, claw-back risks relating to loans granted between March 1 and September 1, 2020 and repaid until September 30, 2023 or the granting of security for such financing have been minimized for all customary scenarios of financing in a crisis. This shall assist lenders in quickly making a decision to support stressed borrowers.

d. Shareholder financing

Last but not least, also shareholders can benefit from this new law. A shareholder shall be able to may make available financing to its subsidiary between March 1 and September 30, 2020 without running the risk of legal subordination of such a loan in insolvency proceedings of the debtor until September 30, 2023. Legal subordination of shareholder loans had in the past often been an obstacle in many rescue financings attempted by shareholders.

3. What am I supposed to do?

The wider economic impacts of the amendments now introduced cannot be predicted and will also depend on how debtors and creditors will sort out their affairs under the new regime. While hurry does hardly ever make good law, businesses need to adapt to these changes, particularly if they or their close business partners significantly lend consumer loans.

With regard to the changes to insolvency law, the German legislator has significantly released the burden on directors of companies to promptly file for insolvency. The assumption that a business that was not cash flow insolvent on December 31, 2019 has been affected by COVID-19 allows the management – without the threat of criminal prosecution and personal liability - to use the additional time granted to find reasonable arrangements with its creditors to hopefully avoid insolvency altogether.

However, as this is only a temporary relaxation through September 30, 2020, due care should be taken to get a crystal clear understanding of the prospects of the business before that date to avoid criminal and individual liability if a deadline to file for insolvency would be missed after September

III. Keep the Germany AG Running – Facilitate Virtual and Remote General Shareholders' Meetings, Allow for Advance Dividends

Due to the COVID-19 related restrictions of gatherings of people numerous German blue-chip stock corporations have canceled their scheduled annual shareholders meetings causing uncertainty when the necessary resolutions can be passed, in particular on the distribution of dividends.

The German legislator reacted quickly. It has passed legislation significantly simplifying shareholders meetings in 2020: In particular virtual-only-meetings may be held with limited rights of shareholders (regarding questions, motions, appeals), convocation periods may be shortened and advance payments on dividends (up to 50%) can be granted without authorization in the company's articles.

The respective rules are expected to take effect at the beginning of next week and apply to the year 2020, only. The key regulations are:

1. ***Purely virtual shareholders' meeting possible for the first time***

The management board may (with consent of the supervisory board) hold the annual shareholders meetings without physical presence of shareholders, provided (i) the entire meeting is broadcasted by audio and video, (ii) voting rights can be exercised by way of electronic communication (iii) shareholders

are granted a „possibility to ask questions“ and (iv) shareholders may electronically raise objections until the end of the meeting (provided they have also exercised their voting right electronically).

a. No “information right”, “possibility to ask questions” (only)

The possibility to ask questions does not give a right to request information. Rather the management board may select and decide - in its best lawful judgment - which questions to answer and in what way. The management board may privilege questions of investors with major shareholdings. It may also require shareholders to electronically turn in their questions (up to) 2 days before the meeting.

b. Motions DURING meeting don’t need to be permitted

No possibility to file motions during the meeting needs to be provided. If this applies only requests for additional agenda items prior to the meeting are possible.

c. Appeals against resolutions extremely limited

Appeals against resolutions in a virtual general meeting – in particular with respect to appropriate answers to questions – are limited to cases of intentional breach on the side of the company, which has to be proven by the appealing party.

2. *Reduction of convocation period*

The management board (with consent of the supervisory board) may reduce the convocation period to 21 days (for virtual and physical shareholders’ meetings). If this is applied, the record date (date for proof of shareholding in case of bearer shares) and the timeline for notifications of shareholders are reduced accordingly. This leads to an extremely tight window between notification of the shareholders and the registration deadline which makes it extremely difficult to register in time, in particular for foreign investors.

3. *Advance payment on dividend*

For virtual and physical shareholders’ meetings alike, the management board (with consent of the supervisory board) may grant advance payments on the expected net profit (irrespective of a respective authorization in the AoA). This allows, once (preliminary) annual accounts 2019 are available, a payment of up to 50% of the annual profit 2019 (less statutory reserves), however, limited to a maximum of 50% of the net profit of the preceding financial year (2018).

4. *Deadline for holding the annual meeting extended from 8 to 12 months (after end of fiscal year)*

This does, however, not apply to companies in the form SE (*Societas Europaea*) which is subject to European law (requiring the meeting to be held within 6 months after the end of the fiscal year).

The new law opens most unusual ways to conduct shareholders' meetings in 2020. Whilst the new rules enable companies to pass necessary resolutions, in particular on the distribution of dividends, despite the COVID-19 restrictions, this comes at the price of limited participation rights of the shareholders. Investors, therefore, need to monitor carefully how to exercise their rights in this year's AGM season.

IV. Termination for Cause of German Property Leases Restricted

The public health crisis caused by the COVID-19 pandemic increases the risk that residential and commercial tenants alike may no longer be in a position to pay their rent when due. A temporary *moratorium* has put a halt to this risk for the tenant.

1. *Landlord's termination for cause temporarily restricted*

German lease agreements usually allow the landlords to terminate the lease for cause, if the tenants are in default with their rent payments for at least two months. To mitigate the termination risks for tenants, the Act now temporarily restricts the landlords' termination right concerning German property lease agreements (*Miet- und Pachtverträge*).

According to the Act, a landlord is not entitled to terminate such a lease agreement based on the argument that the tenant is in default with payment of the rent for the period April 1, 2020 – June 30, 2020 if the tenant provides credible evidence (*glaubhaft machen*) that the payment default is based on the impacts of the COVID-19 pandemic.

2. *All other contractual and statutory provisions remain unaffected*

All other contractual and statutory termination rights, however, remain unaffected. Consequently, the landlord remains entitled to terminate the lease for payment defaults that occurred before or after this period or based on other defaults of the tenant.

The temporary *moratorium* also does not waive in any way all of the landlord's right to the payments due under the property lease. As of July 1, 2022, the landlord retrieves its termination right with regard to the rental payments for the period April to June 2020, if the respective amounts are still outstanding at that time.

By way of a separate regulation (*Rechtsverordnung*) to be issued by the Federal Government, the respective restriction to terminate the lease for cause may be extended to backlogs in tenant's payments for the period between July 1, 2020 through September 30, 2020 if it is to be expected that the social life, economic activity of a multitude of enterprises or the work of many continues to be significantly affected by the COVID-19-pandemic.

3. *Many things to talk about…*

The Act is silent on the question whether and under which circumstances a tenant may request an abatement (in whole or partly) of rent (*Mietminderung*) due to the impacts of the COVID-19 pandemic, *e.g.*, due to a shutdown of the tenant's business by public authorities. An abatement, if the abatement is

the result of a defect of the property, would reduce the respective obligation of the tenant to pay the rent (in full or partly).

Absent of any stipulations in the lease agreement to the contrary, German statutory and case law provides for an allocation of risks between the landlord and the tenant. As a general rule, the landlord is responsible for the compliance of the leased object with the agreed and/or common use.

Therefore, any defect related to the constructional status of the lease object (*e.g.*, public order to close the leased object due to constructional related issues (*objektbezogene Mängel*) and/or its location (*e.g.*, limitation of access due to works)) is within the scope of responsibility of the landlord. Instead, everything related to the operation of the leased object without having any impact on its constructional status is generally within the scope of responsibility of the tenant.

Therefore, in case of a shutdown of the activity of the tenant due to a public order related to the activity of the tenant, the shutdown would typically – absent *force major* events - be considered as in the tenant's responsibility and, therefore, the tenant would not be entitled to an abatement of rent.

4. *What already happens in the marketplace and what can be done*

We see that in cases where the tenant's operations are temporarily shut down by public orders following the COVID-19 pandemic, many tenants turn to the landlord with an (unspecified) notification of non-payment.

The risks for the tenant to doing so are now quite low as the tenant will likely be able to provide credible evidence that that the inability to pay the rent was caused by the COVID- 19 pandemic. If, at a later stage, the tenant will advance the argument that his notification was an abatement, the landlord may be at risk, to not only losing the liquidity provided by the rent through the relevant time period for which the *moratorium* lasted, but to lose part or all of its claims for the period in which his tenant was subject to the restriction order.

Therefore, it might be advisable, in order to respond to the tenant's notification of non-payment of a lease with a reference to the COVID-19 pandemic, to understand whether the non-payment is based on the *moratorium* or a request for abatement, and further seek a discussion about mutually acceptable contractual provisions to address the specific needs of the landlord and the tenant.

In this context, it is important to keep in mind that the mutually agreed provisions may not provide for less favorable provisions for the tenant than provided in the *moratorium*. However, finding a mutually acceptable solution will definitely be preferable to ensure stability and a clear path forward.

All those of you that have lived through prior crises have seen, *ad hoc* legislative measures prepared under stress and without extensive public debate come with many uncertainties caused by inconsistent terminology, sloppy drafting, or well-intentioned programs that ultimately fail to address the core of the problem. Clearly, this package demonstrates the Federal Government's determination to be bold in face

of the crisis. The next weeks and months will show whether this approach represented the right strategy. We hope for the best.

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[1] http://dip21.bundestag.de/dip21/btd/19/181/1918110.pdf

Gibson Dunn's lawyers are available to assist with any questions you may have regarding developments related to the COVID-19 outbreak. For additional information, please contact any member of the firm's ***Coronavirus (COVID-19) Response Team****.*

The following Gibson Dunn lawyers prepared this client update: Markus Rieder, Finn Zeidler, Annekathrin Schmoll, Sebastian Schoon, Alexander Klein, Ferdinand M. Fromholzer, Silke Beiter, Wilhelm Reinhardt, Peter Decker, Daniel Gebauer, Benno Schwarz, Andreas Dürr, and Carla Baum. Gibson Dunn lawyers regularly counsel clients on the issues raised by this pandemic, and we are working with many of our clients on their response to COVID-19.

Please feel free to contact the Gibson Dunn lawyer with whom you usually work, the authors, or any member of the team in ***Frankfurt*** *or* ***Munich****:*

Gibson Dunn in Germany:

Finance, Restructuring and Insolvency
Sebastian Schoon (+49 69 247 411 505, sschoon@gibsondunn.com)
Birgit Friedl (+49 89 189 33 180, bfriedl@gibsondunn.com)
Alexander Klein (+49 69 247 411 505, aklein@gibsondunn.com)
Marcus Geiss (+49 89 189 33 180, mgeiss@gibsondunn.com)

General Corporate, Corporate Transactions and Capital Markets
Lutz Englisch (+49 89 189 33 150), lenglisch@gibsondunn.com)
Markus Nauheim (+49 89 189 33 122, mnauheim@gibsondunn.com)
Ferdinand Fromholzer (+49 89 189 33 170, ffromholzer@gibsondunn.com)
Dirk Oberbracht (+49 69 247 411 503, doberbracht@gibsondunn.com)
Wilhelm Reinhardt (+49 69 247 411 502, wreinhardt@gibsondunn.com)
Birgit Friedl (+49 89 189 33 180, bfriedl@gibsondunn.com)
Silke Beiter (+49 89 189 33 170, sbeiter@gibsondunn.com)
Annekatrin Pelster (+49 69 247 411 502, apelster@gibsondunn.com)
Marcus Geiss (+49 89 189 33 180, mgeiss@gibsondunn.com)

Litigation
Michael Walther (+49 89 189 33 180, mwalther@gibsondunn.com)
Mark Zimmer (+49 89 189 33 130, mzimmer@gibsondunn.com)
Finn Zeidler (+49 69 247 411 504, fzeidler@gibsondunn.com)

Markus Rieder (+49 89189 33 170, mrieder@gibsondunn.com)
Kai Gesing (+49 89 189 33 180, kgesing@gibsondunn.com)
Ralf van Ermingen-Marbach (+49 89 18933 130, rvanermingenmarbach@gibsondunn.com)

Antitrust
Michael Walther (+49 89 189 33 180, mwalther@gibsondunn.com)
Jens-Olrik Murach (+32 2 554 7240, jmurach@gibsondunn.com)
Kai Gesing (+49 89 189 33 180, kgesing@gibsondunn.com)

International Trade, Sanctions and Export Control
Michael Walther (+49 89 189 33 180, mwalther@gibsondunn.com)
Richard Roeder (+49 89 189 33 180, rroeder@gibsondunn.com)

Tax
Hans Martin Schmid (+49 89 189 33 110, mschmid@gibsondunn.com)

Labor Law
Mark Zimmer (+49 89 189 33 130, mzimmer@gibsondunn.com)

Real Estate
Peter Decker (+49 89 189 33 115, pdecker@gibsondunn.com)
Daniel Gebauer (+49 89 189 33 115, dgebauer@gibsondunn.com)

Technology Transactions / Intellectual Property / Data Privacy
Michael Walther (+49 89 189 33 180, mwalther@gibsondunn.com)
Kai Gesing (+49 89 189 33 180, kgesing@gibsondunn.com)

Corporate Compliance / White Collar Matters
Benno Schwarz (+49 89 189 33 110, bschwarz@gibsondunn.com)
Michael Walther (+49 89 189 33 180, mwalther@gibsondunn.com)
Mark Zimmer (+49 89 189 33 130, mzimmer@gibsondunn.com)
Finn Zeidler (+49 69 247 411 504, fzeidler@gibsondunn.com)
Markus Rieder (+49 89189 33 170, mrieder@gibsondunn.com)
Ralf van Ermingen-Marbach (+49 89 18933 130, rvanermingenmarbach@gibsondunn.com)