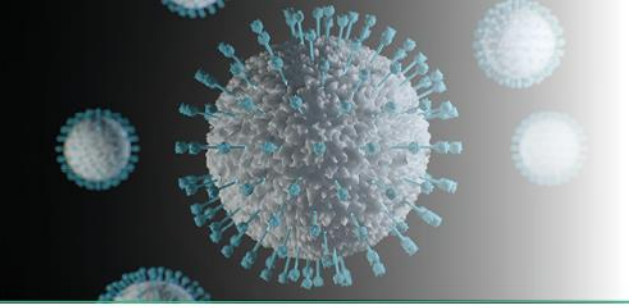


Hotel Leases[1] during the Corona Pandemic

The coronavirus poses great challenges, especially for the hotel industry. Trade fairs, sports and other major events have already been cancelled. From a legal point of view, hotel operators and hotel landlords are now faced with the question of how to react to empty hotel rooms and the considerable economic losses arising as a result. Are the hotel operators entitled to temporarily close the hotel despite a contractual obligation to reduce running costs? (1.) Can the hotel operators possibly invoke force majeure due to the coronavirus and thereby temporarily suspend their payment obligations? (2.) Is it also possible to suspend rental payments for other reasons (3.) or at least to reduce rental payments by invoking the existence of a defect? (4.)

1 Hotel closure

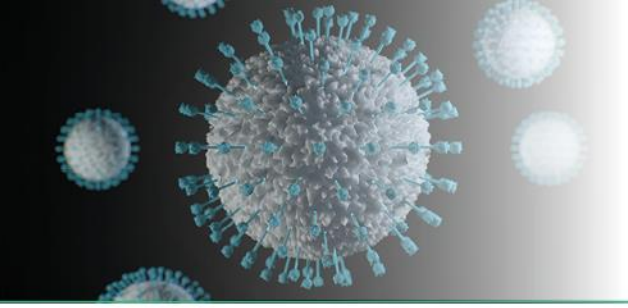
a. Obligations to operate

As a rule, hotel leases provide for an operating obligation on the part of the operator. An operating obligation is understood to mean the tenant's obligation to operate the rented rooms during fixed opening hours or core opening hours - in the case of hotels, as a rule 24/7 365/366 days p.a. - for the purpose specified in the lease. Closure of the hotel to reduce running costs could therefore lead to claims for damages by the landlord, contractual penalties and possibly to extraordinary termination without notice for good cause.

Discontinuation of the duty to operate due to interference with the basis of the contract?

The duty to operate can possibly fall away due to interference with the basis of the contract in accordance with § 313 BGB (German Civil Code) as a result of a modification of the contract. The parties to a contract often assume the existence or occurrence of certain circumstances (so-called "basis of a contract") without making this the subject of an explicit or at least tacit agreement or condition. The prerequisite for the applicability of § 313 BGB is that the basis of the contract has changed seriously after the conclusion of the contract and the parties would not have concluded the contract or would have concluded it with a different content if they had foreseen this change and the adherence to the unchanged contract cannot reasonably be expected of a party; in this context, the changed circumstance must not be assigned to the risk sphere of the party invoking the interference with the basis of the contract. The parties to a hotel lease did not foresee the outbreak and the consequences of the coronavirus when the lease was concluded and did not take it into account. The obligation of the tenant to continue to operate the hotel despite the outbreak of the coronavirus ultimately results in the tenant suffering considerable economic losses as a result of the effects and restrictions caused by the coronavirus. However, the lack of profitability of the hotel operation probably relates to the risk of the general entrepreneurial use and profit generation risk usually assumed by the tenant[2]. In particular, the agreement of an operating obligation on the part of the tenant generally indicates that the landlord deliberately wanted to burden the tenant with the risk of the lack of profitability of the hotel operation. Especially in the case of an agreed turnover-based rent, the operating obligation is intended to protect the landlord and oblige the tenant to generate the highest possible turnover-based rent. On the other hand, it could be argued that even if a turnover-based rent is agreed, an operating obligation would be in vain if, as a result of the coronavirus, no further significant turnover can be generated. In addition, it must be taken into account that landlords are pursuing the interest of maintaining the attractiveness of the hotel property with the operating obligation. A hotel that has been taken out of operation will have the stigma that a hotel cannot be successfully operated at this point. This naturally affects the value of the hotel property. This must be assessed differently if the hotel cannot be successfully operated because the hotel guests do not visit the hotel for external reasons. In this case, strict insistence on the operating obligation would not benefit anyone and would ultimately only serve to damage the tenant. Such conduct violates the principle of good faith (§ 242 BGB) and is not protected by the legal system. Ultimately, one will have to conclude from indications in the

[1] The statements also apply to hotel tenancy agreements.
[2] BGH, NJW 2000, 1714.



lease in each individual case whether an exception from the operating obligation can be argued. There are very good reasons to justify a deviation from the operating obligation in this respect via the legal institution of the discontinuation of the basis of the contract.

2 Force majeure clauses

It is possible that hotel leases contain a so-called “force majeure” clause, i.e. a clause on force majeure, which is intended to prevent disputes and/or interpretation risks in the event of force majeure. The German Civil Code does not in itself contain a general force majeure provision. Consequently, if the lease does not contain a force majeure clause, a party to the lease may not invoke it in the abstract.
Force majeure means an external event that has no operational connection and cannot be averted even by the utmost care that can reasonably be expected[3]. In the context of the present problem, the characteristic of the missing operational connection means that the cause of the unavoidable event must not lie in the (risk) sphere of the hotel operator[4].

The events to be included under force majeure can be listed in the lease either not at all, by way of example or even conclusively and can thus explicitly include or exclude a pandemic.
In the case of an exemplary list of force majeure events, without specifically mentioning the pandemic as such, or in the case that the force majeure is not defined contractually, the clause needs to be interpreted as to whether the coronavirus, i.e. a pandemic, is to be classified as force majeure. It might be helpful here that - at least in travel contract law - an epidemic (at that time in connection with the outbreak of the SARS virus in 2002/2003) has been classified as force majeure[5]. There are therefore good arguments for classifying the outbreak of a pandemic as force majeure by analogy in tenancy law.
Once the hurdle has been cleared that a force majeure clause is included in the lease, which also includes pandemics, the second step is to examine what legal consequences arise from this. For example, in the event of force majeure, the lease may provide for a reduction of the rent or a restriction of the operating obligation as a legal consequence.

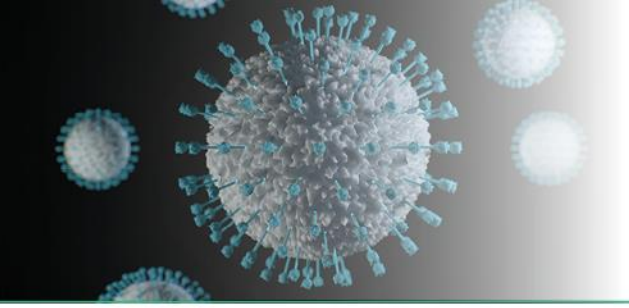
3 Removal of the obligation to pay rent

a. Due to impossibility

The tenant’s obligation to pay the rent is completely waived if the landlord is unable to fulfil his performance obligations, § 275 BGB. The landlord’s obligation to perform shall consist of relinquishing the hotel to the tenant for use within the scope of the purpose of the lease. The Federal Government has decreed that overnight stays in hotels for tourist purposes are prohibited. However, this does not make it impossible for the landlord to fulfil his obligation to perform. The landlord can continue to provide his services to the tenant and relinquish the property to him for use as a hotel, as the hotel operator can still rent the hotel rooms to business travellers, among others. Since it is not impossible for the landlord to provide his services, the tenant is still obliged to pay the rent and is not released from the obligation to pay the rent.

This may be assessed differently if a curfew is imposed or if overnight stays in hotels are banned completely, so that nobody can visit the hotel anymore. In such a case, it is necessary to define exactly whether there is a defect in the lease (see below) or a case of impossibility, since the provisions of tenancy law are special regulations compared to the general provisions on disruptions in performance (which also include § 275 BGB) when it comes to the consequences of material defects and defects of title. In any case, the fact that it is impossible could

[3] BGH decision dated 12.03.1987 – VII ZR 172/86.
[4] See BGH decision dated 16.05.2017 – X ZR 142/15.
[5] BeckOK BGB, § 651h, marginal note 20; AG Augsburg, decision dated 09.11.2004 - 14 C 4608/03.



be countered by the fact that curfews or a general ban on overnight stays in hotels are only a temporary (and therefore not unrecoverable) obstacle to use under public law.

b. Rent reduction

The question has increasingly arisen as to whether the rent can be reduced as a result of the effects of the coronavirus. The main focus is on the hotel operators' efforts to avoid negative cash flow by immediately reducing hotel rental expenses. Before turning to the question of whether the coronavirus and the resulting restrictions constitute a defect entitling the tenant to a reduction in rent, it is first necessary to examine in advance whether and to what extent the right to reduce rent is restricted under the lease. Very often, hotel leases contain the provision that the tenant is only entitled to a rent reduction if the defect has been legally established or is undisputed. Neither will it be possible for the tenant to obtain a judgment in the short term, nor is it likely that landlords will voluntarily admit that a pandemic constitutes a rent defect. If a rent reduction is contractually limited, the question of whether a pandemic is to be regarded as a defect does not even arise.

If a reduction in rent is not contractually limited or not excluded, the question must be answered as to whether a pandemic and its economic effects on a hotel operation constitute a defect in the hotel property.

a) Decline in room bookings

The mere decline in room bookings (mainly due to a lack of travel) should not per se constitute a rent defect, as failed profit expectations are always part of the tenant's risk[6]. The decline in (expected) room bookings as a result of the corona crisis simply means that the general entrepreneurial risk of utilisation and profit generation has materialised.

b) Current order of the Federal Government

The Federal Government recently ordered that overnight accommodation for tourist purposes is prohibited. This is accompanied by a restriction of use of the rented property. The question of whether a defect is present is determined by whether the public law restriction on commercial operations is based on the specific nature of the rented property, e.g. whether it is linked to its condition or location (in which case there is usually a material defect) or whether it is due to the personal or operational circumstances of the tenant. The Federal Government's restriction is intended to restrict tourism, ultimately to contain the number of infections. The Federal Government's order is linked to the type of hotel operation. It does not matter that the outbreak of the coronavirus per se is not within the sphere of influence of either the tenant or the landlord, as it is also undisputed that environmental defects such as street noise can also constitute a defect and that these do not have to be within the sphere of influence of a party to the lease. In the past, the BGH decided, among other things, that the question of whether a defect is present depends on whether the restriction of use or enjoyment is predominantly operation-related or object-related[7]. The order of the Federal Government constitutes a business-related impairment of use, so that there should therefore be no defect in the hotel property.

c) Where a hotel is ordered to close

The closure of hotels due to an official closure order - which is not currently the case, but could occur in the near future - completely excludes the contractual use. In some cases, a rent reduction of 100% is advocated in the event that the contractual use is excluded by official order (provided that the resulting restriction of use is directly related to the specific nature, condition or location of the leased property), since in such a case the landlord cannot make the leased premises available in accordance with the contract. Here too, however, we will again check in each individual case whether a different risk allocation has not been made in the lease. It is conceivable that such an official order could be regarded as

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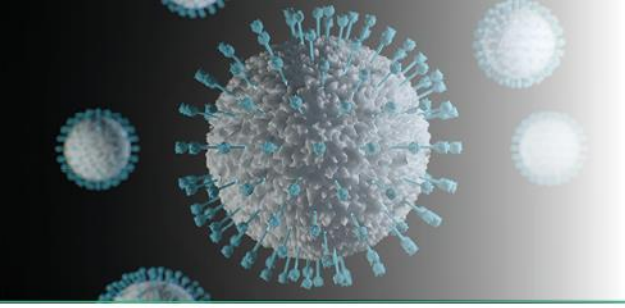
[6] Schmidt-Futterer, Mietrecht, § 536 BGB, marginal note 12.

[7] BGH, NJW-RR 1992, 267.



a regulation relating to the operation of the business, which is to be borne solely by the tenant under the terms of the lease.

d) Discontinuation of the basis of the contract

Also with regard to the rental payment obligation, it may be possible to argue that the basis for the contract (§ 313 BGB) has ceased to exist. When concluding the contract, tenant and landlord may have tacitly assumed that the use of the hotel environment will be possible without disturbance during the contract period. This expectation did not materialize. If one comes to the conclusion that the principle of the discontinuation of the basis of the contract is relevant, there are two legal consequences: primarily, the lease must be modified by mutual consent of the parties. If such a modification is not made - especially with regard to the amount of rent - there may be scope for extraordinary termination of the lease by one of the parties to the contract.

e) Unauthorized suspension or reduction of the rental payment

The most disadvantageous of all solutions is the arbitrary suspension or reduction of the rental payment, possibly with reference to a rent defect. If the tenant is in arrears with a certain amount - usually two months' rent - the landlord has the right to terminate the lease without notice. This also applies if the reduction of the rent was justified with the pandemic as a rent defect and a court later determines in the event of a dispute that the pandemic does not constitute a rent defect and the reduction was inadmissible. An extraordinary termination of the lease is not the only consequence threatening the tenant. The landlord may also claim damages from the tenant. And in the worst case, this consists of lost profit in the amount of the agreed rent for the remaining term of the lease.

4 Summary

The answers to the questions raised in the introduction ultimately require a decision based on a case-by-case examination of the agreements in the lease. Since both the tenant and the landlord will be severely affected by the coronavirus pandemic, it is advisable to approach the contractual partner at an early stage in order to jointly find a constructive and practicable solution for both parties (possibly by means of a deferral of rent payment, a reduction in rent, a graduated rent, a turnover component, etc.).

GET IN TOUCH WITH US!

Further information on topics during the coronavirus crisis:

https://deutschland.taylorwessing.com/de/coronavirus

Your contact partners

We are avilable to answer your questions and to examine your options for action:

Dr. Martin Bartlik, LL.M. (McGill)
Partner, Frankfurt

+49 69 97130-126
E: M.Bartlik@taylorwessing.com

Christine Weyand
Partner Frankfurt

+49 69 97130-226
C.Weyand@taylorwessing.com

Dr. Lars Hagen
Senior Associate, Frankfurt

+49 69 97130-308
L.Hagen@taylorwessing.com

Sarah Rafiqpur
Associate, Frankfurt

+49 69 97130-320
S.Rafiqpur@taylorwessing.com