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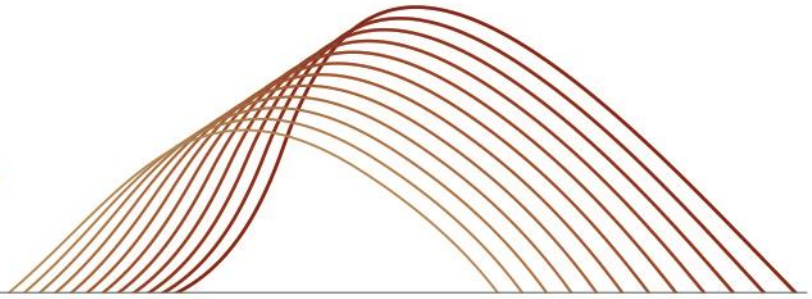

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German Federal High Court of Justice Rules Written Form Protection Clauses Void

By Dr. Jan Gernoth & Hannes Riedel

In a recently published verdict by the German Federal High Court of Justice (*Bundesgerichtshof*, **BGH**) from end of September 2017, the BGH ruled that a clause by which the parties to a lease agreement are obligated to cure written form violations are prohibited to terminate a lease agreement due to an existing violation of the German statutory written form requirement—regardless of an existing fixed lease term—is null and void. In the event of a termination on the basis of a written form violation, landlords and tenants alike are now only protected and terminations are only deemed invalid in the event a court rules that a termination by the respective party violates the principles of good faith—a question which has to be decided on a case-by-case basis.

Paul Hastings therefore strongly advises both landlords as well as tenants to take a close look at their respective current portfolio of lease agreements to make sure they do not bear any potential written form issues or violations or, in case of a positive finding, to conclude an amendment to the lease agreement with the counterparty by which the respective written form violation is cured.

Background

With its verdict from 27 September 2017, the Twelfth Senate of the BGH brought an end into a seemingly never-ending discussion over the treatment of the statutory written form requirement for long-term lease agreements in Germany—and by its decision sparked a fire in the form of lease terminations which might be difficult to extinguish with at least in the near future.

Written Form Requirement Under German Law

The dispute which was widely discussed by both German courts as well as amongst German legal literature pertains to the statutory requirement of written form for long-term lease agreements (agreements with a fixed term of more than one year), according to which all material terms must be included in the lease agreement and the lease document must be signed by both parties; furthermore, changes to material clauses of a lease agreement must be documented in a written amendment to a lease agreement, with specific requirements applying to such amendment. Under German statutory law, the consequence of a violation of this written form requirement is rather harsh: Regardless of any contractually agreed fixed term and/or termination rights or exclusion of such rights, both parties are entitled to terminate the lease agreement with a notice period of six months to the end of a quarter calendar year in the case of commercial lease agreements—without being obligated to pay any damages or other compensation in case a party decides to exercise such termination right.

Written Form Clauses

In the past, both lawyers and courts had developed a common practice under which it was acknowledged that landlords and tenants could protect themselves from the looming threat of a termination due to a written form violation in respect of their lease agreement by agreeing to include so-called "clauses to cure written form violations" ("Written Form Clauses") in their lease agreements. According to such clauses, in the event a written form violation is identified, both parties are obligated to perform all actions and take all measures necessary to cure such written form violation and must not terminate the lease agreement on the basis of a written from violation. Many courts have already decided over the validity of these Written Form Clauses in the last decades, with verdicts ranging from a very restrictive usability to a general acceptance. Until recently, the BGH itself had always refrained from ruling over the question whether a Written Form Clause itself is valid and instead always limited its verdicts revolving around questions in connection with a Written Form Clause to the validity of specific aspects of the Written Form Clause, such as its applicability against a purchaser of a real property who becomes the new landlord under a lease agreement by way of legal succession.

Verdict of the BGH—Voidness of Written Form Clauses

In its verdict from 27 September, the BGH now ruled that Written Form Clauses are void and therefore do not protect the landlord and/or tenant in the event of a violation of the written form regarding a lease agreement—a decision that comes as a shock for most landlords and tenants, who generally rely heavily on the validity of the Written Form Clause, as the contractually agreed term is the basis for their investments and their business plans.

The main argument of the BGH for its decision revolves around the regulatory purpose of Section 550 of the German Civil Code (*Bürgerliches Gesetzbuch*, "BGB"), in which the written form requirement for long-term lease agreements is codified. This regulatory purpose includes two main elements: (i) the protection of a potential acquirer of a real property who will enter into a lease agreement by way of legal succession under German law upon acquisition of the property and (ii) to protect the parties from hastily entering into agreements which, given more time to consider the consequences of such agreements and actually entering into a written agreement in the respective matter, at least one of the parties might not have entered into. Against this background, the BGH found that Written Form Clauses circumvent the purpose of Section 550 BGB, which was made when the legislation had made this statutory provision, with the result that such Written Form Clauses are deemed void.

Remaining Protection for Landlords and Tenants

Even though the BGH ruled that Written Form Clauses are generally regarded as void, in the case it had to decide over, the BGH nevertheless ruled that the landlord was not entitled to terminate the lease agreement. The reason for this is that the BGH found the termination of the landlord to be an act against the principles of good faith, as in the underlying case, it had been the landlord himself who had solely benefited from the violation of the written form clause in the first place.

This judgment will bring some relief to landlords and tenants who might otherwise have to fear that the respective other party might either cause or at least silently benefit from a non-written amendment to the lease agreement and might then use such a violation of the written form requirement to get rid of a lease agreement which the terminating party was unhappy about anyway.

However, this also means that future decisions and/or verdicts whether a landlord or tenant was entitled to terminate a lease agreement due to a violation of the written form will become decisions which are made on a case-by-case basis, with individual factors deciding over the question whether such termination is in violation of the principles of good faith or not. This

undoubtedly brings a considerable level of risk into the continuing existence of lease agreements with fixed terms which the respective parties had previously did not have any reason to be in doubt of.

The Future After the BGH Verdict

The consequence of this verdict by the BGH is that both landlords as well as tenants will have to carefully review their current lease agreements as well as their standard form lease agreements which are used to enter into new lease agreements. At the same time, also the ongoing management and administration of existing leases will have to be supervised more carefully—an obligation which become increasingly relevant for asset and property managers—in order to avoid the creation of written form violations in the course of an ongoing lease agreement.

Furthermore, a lot of precedents will have to be ruled by both lower and higher courts, the outcome of which might differ from court to court and which might bring a certain level of insecurity on the treatment and consequences of specific forms of written form violations and their impact on the respective lease agreement at least in the near future.

We would therefore recommend carefully reviewing all currently existing lease agreements in respect of potential written form issues and/or violations and taking particular care that the statutory written form requirement is observed in all agreements which are concluded with the respective counterpart.

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If you have any questions concerning these developing issues, please do not hesitate to contact either of the following Paul Hastings Frankfurt lawyers:

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