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Commercial Property - Germany

Priority rental rights in insolvency

Contributed by **SIBETH Partnerschaft**

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Parties to rental contracts for commercial premises often agree priority rental rights. In practice, this concept is used to cover a whole series of legal structures. These range from fixed options for the tenant to a promise made by the landlord as a business policy that if any additional premises become available, they will be offered to the tenant. In 2010 the Berlin Court of Appeal issued a ruling on such priority rental rights in insolvency; the decision has recently been published.⁽¹⁾

In its ruling, the appeal court defined a 'priority rental right' as a right of the tenant which is similar to the pre-emptive right of purchase, as defined in Sections 463 and following of the Civil Code. On the basis of such priority rental rights, the tenant is entitled to become a party to a rental contract for specific premises which the landlord has concluded with a third party, and the landlord must notify the tenant of the conclusion of this contract. The tenant must exercise its right to enter into the rental contract concluded with the third party within a certain timeframe, which is either contractually agreed or defined as two months from notification by the landlord as specified in the law. Such a priority rental right can be created for a specific tenancy or for all future lettings of the relevant premises.

In the case before the court, the tenant had a priority rental right for all future lettings of the premises. However, the rental contract developed in such a way that that the landlord became insolvent and the rented premises were purchased from the insolvency administrator by a buyer; this buyer was thus entitled to a special right of termination under Section 111 of the Insolvency Act. The buyer then exercised this right and thus terminated the original rental contract. After the conclusion of a further rental contract between the purchaser and a third party, the tenant claimed its priority rental right under the rental contract in order to use the rented premises again.

Normally, such a priority rental right – like a rental option – passes to the purchaser under Section 566 of the code if the property is sold.

According to the court, the priority rental right under the original rental contract which has been transferred to the purchaser does not exist after termination. The court reasoned that this is the purpose of the right of termination under Section 111 of the Insolvency Act, which entitles the purchaser to terminate a rental contract to which it has become a party by transfer, even if the fixed rental period or any further option periods to which the tenant is entitled under the rental contract have not yet expired. In the view of the court, the same right must apply to priority rental rights because, in this respect, they have the same function as a rental option. This applies both to a non-recurring priority rental right and to a priority rental right which extends to all future lettings.

The appeal court also rejected the argument that the purchaser could change the priority rental right by revising the rental contract and agreeing new terms with the third party, which the tenant with the priority rental contract would then have to take over. Instead, the court ruled that under Section 111 of the Insolvency Act, the purchaser should have complete freedom of disposal over the purchased property, and especially should have the right to bring about a change of tenancy.

This ruling is relevant to sales from insolvency assets and the special right of termination to which

the purchaser is entitled under Section 111 of the Insolvency Act. The appeal court explicitly underlined that the right of termination under the Insolvency Act is subject to the same provisions as the right of termination under Section 57(a) of the Compulsory Auction and Administration Act when property is purchased through compulsory auction. Therefore, a priority rental right of the tenant does not protect the tenant in a compulsory auction.

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Endnotes

⁽¹⁾ Decision 8 W 46/109, September 23 2010.

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