

Impact of COVID-19 on tenants' payment obligations

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Summary

Stay-at-home orders attempting to contain the COVID-19 outbreak creates headache for finance managers paying for empty offices. As a result, several questions arise regarding commercial lease contracts under Russian law:

- Should tenants be released from their payment obligations during the COVID-19 crisis, especially if they stop their activities?
- Should tenants be excused from liability/interest if they have delayed rental payments during the COVID-19 crisis?
- Should tenants be entitled to reduce the payment of the rent?
- Can tenants terminate the lease agreement because of COVID-19?
- What should tenants consider while making new lease arrangements during the COVID-19 crisis?

1. Should tenants be released from payment obligations during the COVID-19 crisis, especially if they stop their activities?

- As a rule, tenants remain liable to pay rent.
- Tenant's suspension of activities in view of the COVID-19 pandemic does not *per se* constitute a ground for the non-payment of rent. According to the case law supported by the Supreme Court, as long as the leased premises remain under control of the tenant, the tenant's failure to use the leased property does not terminate or alter its payment obligation.
- In other words, it is the tenant's risk that it cannot utilize the premises if the premises are made available. Considering the COVID-19 pandemic, as long as governmental measures affect the tenants' business activities, and do not prohibit the operation of a particular building itself, the tenant bears the risk of not using the premises.

2. Should tenants be excused from liability if they have delayed rental payments during the COVID-19 crisis? (1)

- Generally, COVID-19 can be considered force majeure under Russian law, depending on the circumstances. However, under Art. 401(3) of the Russian Civil Code force majeure can unlikely be invoked with regard to financial obligations, such as the duty to pay rent. Therefore, unless the courts adopt a more flexible approach, the general concept of force majeure cannot release tenants from liability for delay.
- The conclusion may be different in respect of select tenants, which are covered by the newly introduced statutory COVID-19 relief regime. On 1 April 2020 a new Federal Law No. 98-FZ (hereinafter, the “**COVID-19 Relief Act**”) was adopted, which created a legal framework to help tenants to overcome the crisis.
- According to Article 19 of the COVID-19 Relief Act, select tenants may demand that the landlord should defer payment of rent, and the landlord must conclude an addendum to such leases within 30 days from the tenant’s request. The terms and period of deferral is stipulated by the Russian Government in a separate Decree adopted on 3 April 2020 (Decree No. 439).

2. Should tenants be excused from liability if they have delayed rental payments during the COVID-19 crisis? (2)

Decree No. 439 provides that:

- only tenants that operate in the most affected industries are eligible for the deferral of payment. The list of such most affected industries is specified in Decree of the Russian Government No. 434 and currently focuses on passenger transportation services, entertainment, tourist activities, hotel business, restaurants, etc. Therefore, those companies, which operate in these businesses, may apply for a deferral of rent;
- 100% of the rent payable during the COVID-19 crisis can be deferred, and 50% of the rent after the COVID-19 crisis until 01 October 2020 can be deferred as well;
- repayment begins from 01 January 2021 and should end no later than on 01 January 2023 by equal monthly installments not exceeding 50% of the monthly rate, without any interest;
- deferral does not affect utility payments as well as reimbursement of the landlord's actual costs;

3. Should tenants be entitled to reduce the payment of the rent? (1)

Art. 614(4) of the Russian Civil Code:

- Under this article tenants may claim reduction of rent in case the conditions of using office premises have substantially worsened. However, according to pre-crisis case law, this provision cannot be extended to restrictions on the activities of the tenants, but only covers impediments directly related to the rented premises (primarily their physical condition).
- However, temporary difficulties of the tenant to use the office premises which remain in the same condition cannot give a ground for rent reduction. Therefore, unless the courts adopt an expansive view of this Article, the COVID-19 outbreak will not by itself trigger this provision.

3. Should tenants be entitled to reduce the payment of the rent? (2)

- Article 19(3) of the new COVID-19 Relief Act:

At the same time, Article 19(3) of the new COVID-19 Relief Act states that the tenant may claim reduction of the rent in 2020 in case the use of the leased property has become “impossible” due to the governmental measures arising from the COVID-19.

- Decree of the Moscow Mayor dated 10.04.2020 No. 42-UM:

In several Russian regions, for example, in Moscow, state authorities prohibited people from visiting the premises which are used for certain businesses. In particular, in Moscow from 13 April 2020 to 19 April 2020, it is prohibited for everyone (including clients and employees, except select employees such as security guards and persons responsible for conducting procedures that cannot be interrupted) to visit offices of companies engaged in select types of activities (including construction and design companies, consulting, legal, scientific, educational service companies, etc.).

3. Should tenants be entitled to reduce the payment of the rent? (3)

- The provisions of Article 19(3) of the new COVID-19 Relief Act may become the basis for negotiations between the lessee and the lessor. However, it is unclear how these provisions will be applied by the courts in case of dispute. In the absence of clarifications or judicial interpretation, Article 19(3) of the new COVID-19 Relief Act is debatable since it does not define the term “impossible to use premises”, which may be understood very narrowly (as physically impossible, which is not feasible). Furthermore, the law does not provide for a specific amount of rent reduction in this case.
- However, the fact that these provisions were introduced may signal to the courts that they should flexibly apply the existing rules of fundamental change of circumstances (Art. 451 of the Russian Civil Code) to reduce the rent based on the principle of economic reasonableness during the COVID-19 outbreak. We anticipate further development of the case law on how these provisions are intended to operate.

4. Can tenants terminate the lease agreement because of COVID-19?

- Tenants may refer to the doctrine of fundamental change of circumstances (Art. 451 of the Russian Civil Code) to terminate or change their lease arrangements.
- Tenants have to demonstrate four elements of the Art. 451 test to prevail on the merits: (1) the contractual equilibrium has been fundamentally altered and contract performance became excessively more onerous, (2) due to an unforeseeable reason that (3) cannot be overcome or avoided, and (4) the risk of which is not borne by either party.
- For tenants who are leasing regular office space, it may be difficult to meet the first prong and prove that the contract equilibrium has fundamentally changed, as usually this would mean that the costs of performance compared to the value of counter-performance were increased by at least 50%. As long as it is not prohibited for a particular office-based company to continue working from its office, this will unlikely be triggered. However, if governmental measures fully prohibit such work (i.e. due to total isolation), the situation may change.

5. What should tenants consider while making new lease arrangements during the COVID-19 crisis?

- For lease agreements concluded after the outbreak of COVID-19 (especially after the first governmental measures), the traditional rules on force majeure and hardship will not be relevant. Likewise, the new COVID-19 Relief Act expressly excludes lease agreements concluded after the COVID-19 related governmental measures from their scope. Therefore, new lease agreements will not be protected by statutory mechanisms, and it will be impossible to reduce rent or terminate such lease agreements even in case of escalated governmental response measures.
- In this regard, for new leases, it is strongly advisable to negotiate a tailored contractual mechanism of rental fee reduction/deferral of payment in case the COVID-19 regime is tightened. The parties may also agree on a grace period for payment during the upcoming peak of the COVID-19 outbreak.

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