Concluding a lease agreement after the pandemic. What should a tenant pay attention to?

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The pandemic and the restrictive measures that came in its wake hit all market participants hard. The first to suffer, naturally, were tenants, who attempted (often fruitlessly) to win a discount on rent from the landlord or the possibility of vacating leased premises without penalty. This resulted in headlines in the media about how a considerable number of small and medium enterprises had not survived the lockdown, shuttered windows on cafés and stores, and also friends' photos of home offices or brand-new co-working setups on social media. Obviously, the landlords were the next in line: more and more premises stood empty. When both sides of a legal relationship are suffering losses, it becomes reasonable to cooperate rather than compete, in order to save the business. As there could potentially be a "second wave" of the pandemic, this should both be reflected in contracts. Let's take a look at the conditions that a tenant should look to put in a lease agreement.

The problem of defining the purpose of the premises

As a rule, the purpose of leased premises is frequently specified in the most general terms: "as office space", "for public catering", etc. This works if various types of activity are carried out on the premises – for example, a shop and a café. However, when the government restricted certain types of activities during the pandemic (remember, restaurants were only allowed to offer takeaway service), many tenants found themselves in a difficult negotiating position: how could they prove that the premises were unusable if in fact part of the activity could not be performed, and the premises were not used for this activity, whereas at the same time no one was prohibiting another activity that was being performed? In the end, if the café was forced to close, but the shop was not, the landlord would argue that the tenant could use the entire floor space as a shop and thus would decide not to compromise.

This problem can be resolved by making sure that the lease agreement describes in as much detail as possible the intended use of the premises, taking all parameters into account (for example, how much floor space is to be used for each activity).

It is also important that the purpose of the leased premises does not violate the permitted use of the building and land plot as a whole according to the urban planning regulations. Otherwise, the owners of the building could be subject to administrative liability[1],

[1] 308-ES19-10562 of the Russian Supreme Court dated 21 October 2019.

which, generally speaking, rebounds on the tenants as well, through the obligation to reimburse penalties.

How to reduce the amount of space leased

From the start of the pandemic, most tenants probably began to think about cutting the amount of space they leased: how to "scale down" the office to the right size? From a legal standpoint, this condition was the tenant's right to partially withdraw from the lease agreement. Of course, this is of no benefit to the landlord, but it is possible under certain conditions.

Firstly, taking into consideration the worsening economy, it is better for the landlord if the tenant keeps leasing at least part of the premises, rather than the landlord letting them go entirely and looking for a new tenant, probably on less attractive commercial terms, or trying and collect debt from the current tenant through the courts. Secondly, it is possible to stipulate a provision that the amount of space leased may be reduced in certain circumstances (restrictive measures imposed by the government, a drop in revenues to a certain level, etc.) in return for a reasonable penalty or compensation of losses paid by the tenant.

As a commercial alternative, the tenant can also be given rights to sublet part of the premises, on the provision that the landlord cannot refuse to approve the sublease without significant cause.

Provision on repudiation of the lease agreement in full – a double-edged sword

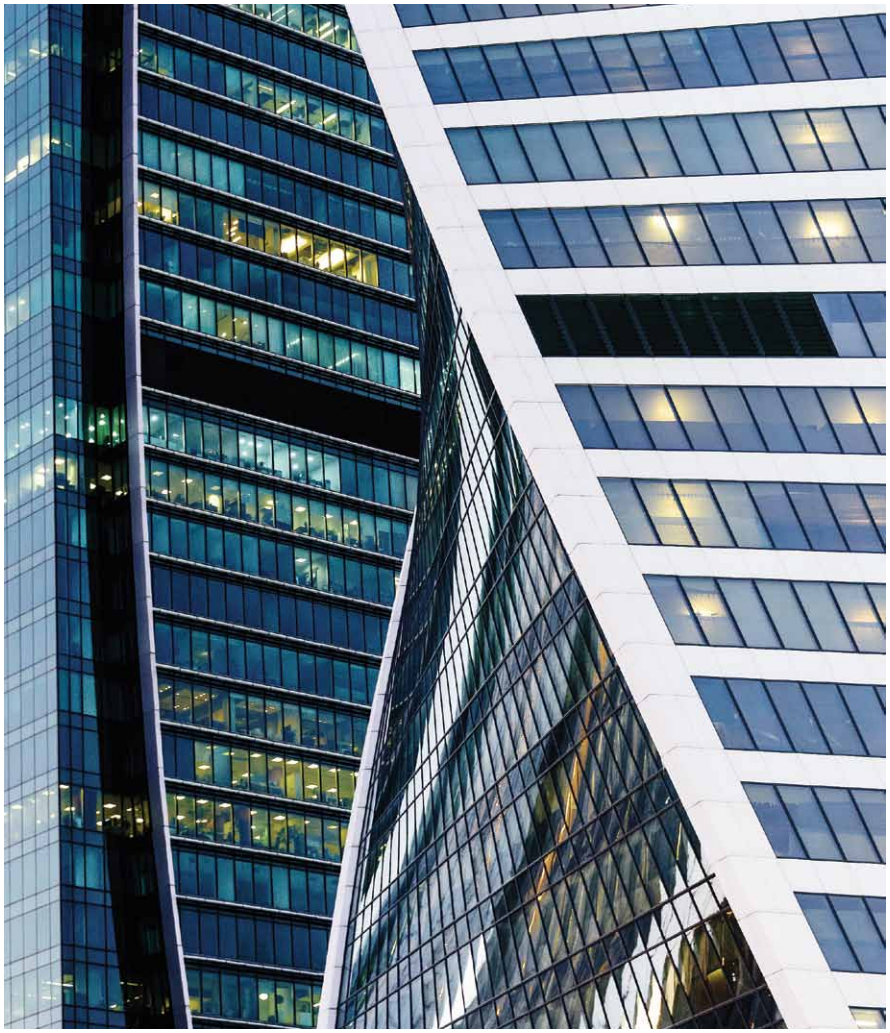
The lease agreement may stipulate the right of unilateral repudiation on the basis of notification, whether due to breach of contract or at the will of the tenant[2]. Such a right is a very strong weapon in the hands of the tenant and consequently is used in limited cases.

[2] Article 450.1 of the RF Civil Code, the positions of the higher courts.

One such case could arise if the restrictive measures impeding the use of the premises last longer than a set period of time. Another possible option for the lessee would be to agree on so-called "windows of opportunity" – periods during which the tenant may unilaterally repudiate the agreement without incurring any penalties, for example, once every three years.

How to revise the terms on the lease payment

The main issue of concern for tenants during the pandemic is how and to what extent the lease payment can be reduced during the period when the premises are not being used. Landlords have either not made any concessions whatsoever or have forwarded counter arguments on the partial use of the premises (some employees were still coming to the premises, the servers and equipment were still working, etc.) and on the expenses on the upkeep of the premises (cleaning, for example) and utility expenses.



Tenants that paid for utilities based on metre readings, but for everything else based on a lump-sum payment (a so-called base or fixed lease payment) have found it particularly hard to reach an agreement. While everything is clear as concerns the utility payments, how does one separate the payment for parking, for example, which was definitely not used, from the lump-sum payment?

For this reason, we recommend that the lease payment be as detailed as possible so that the parties can agree on a waiver of payment for property and premises (e.g. parking spaces) or services of the landlord (e.g. weekly wet cleaning) that are clearly not being used.

A separate provision on a waiver of part of the lease payment for unused premises and services if these premises could not actually be used for their designated purpose over a certain period in connection with the introduction of the restrictive measures could help to smooth out the process of waiving this part of the payment.

Clause 4 of Article 614 of the RF Civil Code allows the tenant to demand a reduction in the lease payment if the terms of use stipulated by the lease agreement or the condition of the property deteriorated considerably for reasons beyond their control, is as a rule applied in a fairly limited number of cases, such as building repairs[3], a power outage[4], etc. Therefore, it makes sense for the tenant to agree with the landlord on the list of cases when it does not have to make the lease payment because it is unable to use the premises for their designated purpose and to include state-imposed restrictions in this list.

Re-evaluation of the force-majeure clause

It would appear that no one expected the pandemic, in other words, it could be considered a classic force-majeure circumstance (extraordinary and unavoid-

[3] Judgment No. F06-20323/2017 of the Commercial Court of Volga District dated 12 May 2017 in case No. A65-25310/2016.

[4] Judgment No. F05-8666/2016 of the Commercial Court of Moscow District dated 5 July 2016 in case No. A40-115211/15.

able). However, in practice the standard force-majeure provisions were effectively of no help to the parties. Why?

The classic concept of force majeure – a party is unable to perform its obligations as a result of extraordinary and unavoidable circumstances – was not applicable, as neither party found itself in this situation. On the one hand, tenants could have performed their obligations to make lease payments, as the banks were open. On the other hand, it was not advantageous for landlords to close access to the premises, as they did not want to miss out on lease payments.

However, the Supreme Court of the Russian Federation issued clarifications that make it possible to consider the situation from a different angle.

According to the clarifications, "As a general rule, the fact that a debtor does not have the necessary funds does not serve as grounds for releasing the debtor from liability for default on its obligations. However, if the lack of funds was caused by the restrictive measures, then this may be declared as grounds for release from liability. Release from liability is admissible if a reasonable and prudent party to a business transaction could not have avoided the adverse financial consequences caused by the restrictive measures[5]."

Consequently, dire financial straits may now potentially serve as grounds for the release of a tenant from liability in connection with force majeure.

If both parties incur losses, it is logical to agree on sharing the burden than to end up without premises or without a tenant and thus with no incoming lease payments.

Effective cooperation: we establish the negotiating procedure

The government's controversial attempt to regulate landlord–tenant relations during the pandemic by adopting and subsequently amending Article 19 of Federal Law No. 98-FZ dated 1 April 2020[6] merely underlies the need for the parties to cooperate. If both parties incur losses, it is more logical for them to agree on sharing the burden than to put endless pressure on their counterparty, and as a result end up without premises (the tenant) or without a tenant and thus with no incoming lease payments (the landlord).

Here Article 434.1 of the RF Civil Code on the procedure for holding negotiations offers some help. To use the norms of this article as effectively as possible, it is advisable to include a separate section in the lease agreement on the rules for negotiations.

These rules are well developed in court practice[7]. They can stipulate the general negotiating procedures: who is responsible for the negotiations, communications methods (including online), the deadlines for approving proposals, the document signing procedure, and also liability for the violation of this procedure. It is also important to stipulate a convenient end to negotiations – the ability to terminate them if the parties fail to find common ground. Otherwise, there is a risk that a party's conduct will be considered to be in bad faith, and accordingly that damages will be recovered. In practice, this means preventing the sudden and unjustified termination of negotiations, the provision of inaccurate information, the holding of parallel negotiations in violation of the provisions on exclusive negotiations, etc.

[5] "Overview No. 1 of Certain Issues Related to Court Practice on the Application of Legislation and Measures to Prevent the Spread of the Novel Coronavirus Infection (COVID-19) in the Russian Federation" (approved by the Presidium of the Supreme Court of the Russian Federation on 21 April 2020).

[6] Federal Law No. 98-FZ dated 1 April 2020 "On Amending Certain Legislative Acts of the Russian Federation on Preventing Emergencies and Emergency Response".

[7] See, for example, the Judgments of the Commercial Court of Moscow District, No. F05-16349/2017 dated 29 November 2017 in case No. A41-90214/2016, the Commercial Court of North Caucasus District, No. F08-10035/2017 dated 18 January 2018 in case No. A32-41814/2016, and Ruling No. 305-ES19-19395 of the Judicial Panel for Economic Disputes of the Russian Supreme Court dated 29 January 2020 in case No. A40-98757/2018.