The Supreme Court Presidium's Second Review: how COVID-19 regulations apply to leases

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The Supreme Court of the Russian Federation (the **Supreme Court**) on April 30, 2020, published a second review of court practice applying laws and measures to prevent the spread of COVID-19 (the **Second Review**). The Supreme Court's first review was published on April 21, 2020.

As in the first review, the key issues clarified in the Second Review deal with how to apply procedural, civil, criminal and administrative legislation, as well as bankruptcy laws.

In this alert we provide our analysis of the Supreme Court's clarifications in the Second Review of the most interesting and frequently discussed issues in recent days. These include how to apply certain provisions of Article 19 of Federal Law No. 98-FZ of April 1, 2020 (**Law 98-FZ**) ***granting tenants rent deferrals and discounts***, and Russian Federation Government Resolution No. 439 of April 3, 2020 (**Resolution 439**), setting forth ***the requirements for granting rent deferrals.***

Our analysis of the Second Review has shown that the Supreme Court either didn't answer the most pressing questions about leases or its clarifications have caused more uncertainty.

Question: When are the obligations of the parties under a lease agreement considered amended to grant the tenant a rent payment deferral under Article 19(1) of Law 98-FZ?

Here is the Supreme Court's clarification on this issue:

(A) The obligations of the parties to a lease agreement are considered **amended** to grant the tenant a rent deferral **as of the date the state of high alert** or emergency was introduced in the Russian Federation constituent entity (region), **regardless of the date the addendum to the lease agreement was made**.

Dentons' comment: *We believe this is one of the Supreme Court's most ambiguous clarifications in the Second Review. What did the Supreme Court want to say with this wording?*

If it merely means the rent deferral is effective from the date the state of high alert was introduced and not from the effective date of the addendum covering the deferral, then this provision was already worded quite clearly in item 4 of Resolution 439 and lease parties didn't really question it.

Despite adoption of Resolution 439 some tenants operating in affected industries and entitled to a rent deferral were continuing to pay rent under the lease agreement, including March and April payments. One of the most pressing questions lease market players ask during recent weeks is whether March and April payments made by tenants should be seen as payment for those months or advance payments for future months when the deferred amounts should be repaid? Did the Supreme Court want to address the issue of March and April payments by the above clarification? If this is the interpretation, then does the clarification mean that payments tenants made for March, April and subsequent months cannot be applied toward rent for those periods and must either be applied toward future payment obligations or refunded to tenants? The Supreme Court didn't provide a clear and unambiguous clarification

that would help to eliminate further disputes between the parties over how to interpret it.

(B) The parties to a lease agreement **may determine an** earlier time from when to defer the tenant's rent, considering, **considering that the tenant's position cannot be made worse** than the conditions of the requirements set forth in Resolution 439.

Dentons' comment: *Particularly important in this clarification are the Supreme Court's words that "the tenant's position cannot be made worse than the conditions of the requirements set forth in Resolution 439." Tenants and real estate owners are now actively discussing looser rent terms for tenants. In this situation, the question is whether the owner and tenant can agree on terms other than those set out in Resolution 439.*

In practice, there are often situations where it is in both parties' interests to agree on different terms. For example, the owner gives the tenant a discount (not a deferral) or allows the tenant to return some of the leased space (thereby reducing the tenant's total rent payments). However, the tenant continues to pay for this every month or agrees to extend the lease term, or the parties agree on other terms, not just the rent amount and when it is to be paid. In other words, the parties often try to make a kind of "package deal" that is in both the owner's and the tenant's interest.

The question is whether such terms will be considered to "worsen the tenant's position"? What criteria should the parties use to define a "worsening position"? Can a tenant later try to challenge such an addendum by claiming that it places the tenant in a position that is worse than the requirements set by Resolution 439?

We believe that to achieve equity between the lease parties it would be fair to stipulate that if the owner and the tenant agreed to amend the lease agreement on terms other than those provided for by Resolution 439 (and this arrangement is set forth in an addendum signed by the parties), then neither party should face a risk of the signed addendum later being challenged.

(C) If the **tenant has not paid rent** in the amount and by the dates set in the lease, and **the landlord knew or must have known** that the tenant operated in industries of Russia's economy most affected by COVID-19, **the landlord will notify the tenant that it is entitled to** a **deferral** under Law 98-FZ. In the absence of such a notification, **the landlord is considered to have given the tenant a deferral on the terms of Resolution 439**. Similar consequences apply if the landlord **unreasonably avoided** entering into an addendum or the landlord's behavior **gave the tenant reason to believe** that the deferral would be granted, or **did not object** to the tenant paying rent on the terms of Resolution 439.

Dentons' comment: *The Supreme Court essentially made the landlord (!) responsible for checking whether its tenants who are late paying rent are entities operating in affected industries. Whether or not the owner has the technical capability to do such a check in each case, it is entirely unclear why the Supreme Court placed such an obligation on owners. Where is an owner that manages large properties with dozens or hundreds of tenants to get the resources to comply with the obligation? We don't understand the logic of the Supreme Court's clarification.*

Question: Is it enough that a real estate tenant operates in Russian industries most affected by the deteriorating situation caused by the spread of COVID-19 to receive a rent deferral under Article 19(1) of Law 98-FZ? Is it necessary in this case to determine why the leased property cannot be used for its purpose?

The Supreme Court gave the following clarification on this question:

(A) **The list of industries** of Russia's economy most affected by the deteriorating situation caused by the spread of COVID-19 **was approved** by RF Government Resolution No. 434 of April 3, 2020.

Dentons' comment: *You may recall that the initial version of Resolution 434 covered only repayment holidays for SMEs. Resolution 434 was amended on April 18 and the amendments make it possible to indirectly conclude that the list of affected industries also applies to leases.*

In the Second Review the Supreme Court finally stated explicitly that the list of affected industries approved by Resolution 434 applies to leases, including requests for the deferrals under Resolution 439.

(B) **It is enough** that a tenant operates in **affected industries to be entitled to a** rent **deferral**.

It is not necessary to determine whether there are **other, additional grounds or conditions** for granting a deferral, e.g., inability to use the leased property for its purpose.

And, **if a landlord proves** that a particular **tenant** was **not actually affected and will obviously not be affected** in the current situation, and the tenant's requests are a case of **acting in bad faith** (for example, if it uses leased property contrary to the restrictions), depending on the facts of the case and considering the nature and consequences of the conduct, **the court could refuse to protect** all or part of the tenant's right.

Dentons' comment: *This is a very interesting and contradictory clarification from the Supreme Court. On one hand, the Supreme Court has said that tenants only need to meet the formal criteria of Resolution 439 to get a deferral (namely, to have one of the OKVED codes listed in Resolution 434 as the primary activity code in the Unified State Register of Legal Entities as at March 1, 2020).*

On the other hand, the Supreme Court gave owners the option not to grant a deferral if the landlord is able to demonstrate that the tenant was not actually affected and will obviously not be affected in this situation. This clarification has a critical impact on the lease market.

The current situation is that almost all tenants are asking owners for deferrals, discounts, etc. However, many owners have recently asked whether they should grant deferrals to any tenant who meets the formal criteria. After all, it is often the case that a tenant formally falls under Resolution 439 but its business was not actually affected at all by the crisis, or was only slightly affected (for example, companies with a large percentage of online sales). The Supreme Court gave owners the right to have their own view of each specific situation and not to grant a deferral if there is convincing evidence that the tenant's business was not affected. It's another question how owners should prove their case. Apparently, they may use any arguments with the understanding that a court will later determine whether the arguments were justified if the parties don't agree.

Also interesting is the example cited by the Supreme Court of an unscrupulous tenant using the leased property contrary to the restrictions. Does this mean, for example, that the landlord may deny a deferral to a tenant from an affected industry if it is found that employees occasionally visited the tenant's offices although this was prohibited by a legislative act?

Question: When are the obligations of the parties to a lease agreement considered amended to *reduce the rent amount* under Article 19(3) of Law 98-FZ?

Here is the Supreme Court's clarification on this issue:

(A) Rent should be reduced as of when **it became impossible to use the property for the initially agreed purpose** regardless of the date of the addendum to reduce the rent.

Dentons' comment: *It isn't clear in either the clarification discussed in item A of the first issue above (when deferrals start to apply) or in this clarification whether the Supreme Court only wants to clarify the time when discounts agreed by the tenant and the owner of the real estate should start to apply. Or does the Supreme Court also want to say that the "inability to use property" which it mentions in Article 19(3) of Law 98-FZ means an inability to use property for its permitted use stipulated in the lease. In other words, does it mean that an office tenant may request a rent discount under Article 19(3) of Law 98-FZ if it still uses the office shut down by the restrictions to store property and to operate servers needed for the tenant's employees to work remotely?*

(B) If a suit is filed to collect rent, the tenant could object by saying that **the landlord unreasonably avoided** entering into an addendum reducing the rent. In this case the amount of rent determined by the requirements of Article 19(3) of Law 98-FZ should be collected. For example, **the reduced rent amount may be determined considering the amount by which rent is ordinarily reduced in such a situation.**

Dentons' comment: *This is yet another very ambiguous clarification from the Supreme Court. How can one determine the discount a tenant is entitled to in a particular situation where the "ordinary" amount is the criterion? Can a tenant who learned that another tenant in the same property was given a certain discount refer to this discount and request the same? It is obvious that, in practice, the owner considers a wide range of factors when deciding what discount or other breaks to give a tenant (even within the same property). For example, the importance of a particular tenant, that tenant's financial condition, the leasable area,*

the current rate, lease term, etc. A legitimate question arises: what principle can be used to determine some "ordinary" discount? Nevertheless, this clarification could pose a risk for owners if other tenants learn about the discounts they give. At a minimum, owners will have to pay more attention to confidentiality provisions and liability for breaching them.

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