ALLEN & OVERY

Covid-19 Coronavirus: Real Estate and Covid-19

The questions we are being asked in France

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KEY INFORMATION

This note discusses a number of issues and queries that are arising in the commercial real estate investing and lending markets in France as a result of the Covid-19 pandemic.

It is a generic discussion of those issues, but each issue discussed is usually the subject of extensive negotiation when it comes to documentation. As a result, the terms and conditions of any sale and purchase/construction/lease/finance document (as applicable) should always be considered in the context of the particular document in which they are found and the specific facts and circumstances of the relevant deal.

As such, this note provides only a general analysis of issues likely to arise and it does not provide legal advice.

1. The occupational tenant wants to terminate its lease.

a. **If you are the landlord,** unless your tenant has a statutory or contractually negotiated break right which can be exercised in the near future, it is unlikely to be able to terminate its lease as a result of the Covid-19 pandemic. Save for specific termination rights that may be triggered if the demised premises are destroyed, it is very rare for French commercial leases to contain either a material adverse change clause or a specific force majeure clause. There is however, a general right in France to claim force majeure under article 1218 of the French civil code, which unless contractually waived or varied by the parties (rarely done in practice), will apply to all contracts including leases.

Your tenant may try to claim that its lease should be terminated as a result of the Covid-19 pandemic, possibly on the grounds of force majeure or as a result of the landlord not being able to deliver the demised premises if these have been closed-down by the authorities pursuant to Covid-19 emergency laws and regulations.

However, it is unlikely that such claims would be successful, as, regarding:

- force majeure, your tenant would have to not only demonstrate that the Covid-19 pandemic was unforeseeable and out of the parties' control but also that it renders the performance of its obligation impossible (not just harder) on a permanent basis (and not just on a temporary one); and

- the landlord's inability to deliver the demise, your tenant would have to demonstrate that this inability effectively lies on the landlord and that it is permanent.

b. **If you are the lender,** your borrower is most likely under an obligation under the facility agreement to ask for your consent to terminate the lease. This will not however apply if it is the tenant who terminates the lease. In that case, your borrower will most likely be under an obligation under the facility agreement to use its reasonable endeavours to find new tenants for the space.

2. The occupational tenant does not want to pay rent or wants to renegotiate how it pays rent or says that it is entitled not to pay rent under its lease.

a. **If you are the landlord,** most tenants will not have a right under their leases to withhold rent, have their rent suspended or reduced, or alter the way in which their rent is paid as a result of the Covid-19 pandemic subject to the following specific governmental intervention and general legal doctrine:

- French Ordonnance n° 2020-316 allows very small businesses adversely affected by the Covid-19 pandemic not to pay rent from 12 March until 24 September 2020 (unless further extended) and prohibits, during that period, landlords from applying or exercising against these businesses, penalties, interest, damages, lease termination clauses, set offs against deposits or bank guarantees.

  The criteria to benefit from these provisions are restrictive. For instance, the business must have no more than ten employees, not be controlled by another commercial entity, been ordered to close-down or have incurred a loss of turnover of 70% in March 2020 compared to March 2019 (all criteria must be satisfied, not just some);

- article 1218 of the French civil code allows parties to suspend the performance of their obligations on the grounds of force majeure. Whilst the unprecedented situation created by the Covid-19 pandemic could be considered unforeseeable and out of the parties' control, it would be very difficult for tenants to uphold that it renders the payment of rent (or any other sum payable under the lease) impossible and suspend payment on that basis, the French Supreme Court (Cour de Cassation) having always refused to consider that force majeure could be used by debtors to avoid paying their debts;

- article 1219 of the French civil code allows a party to not perform its obligations under an agreement if the other party fails to perform its own. Non-performance must be measured and proportional to the other party's non-performance (obligations must essentially be of similar importance). Given that under a French lease, the landlord's fundamental obligation is to deliver the premises and that the tenant's fundamental obligation is to pay rent, French courts have upheld that a tenant is entitled to suspend payment of rent if it is completely deprived from the enjoyment of the demise.

  A tenant may try to suspend rent payments on the above grounds as a result of the demised premises being closed-down by the authorities pursuant to Covid-19 emergency laws and regulations. The tenant would have to demonstrate that, whilst beyond the landlord's control, the

closing-down of the premises by the authorities effectively constitutes a non-performance by the landlord of its obligation to deliver premises which can be used by the tenant for the purposes for which they were demised;

- article 1195 of the French civil code allows a party to request the renegotiation of an agreement if an unpredictable change of circumstances renders the performance by that party of its obligation excessively onerous. It is unlikely that tenants will be able to claim on these grounds as article 1195 was implemented fairly recently and can apply only to leases entered into after 1 October 2016 and since that date it has become common practice for parties to contract out of article 1195 and waive any rights thereunder; and
- article 1343-5 of the French civil code allows the debtor of a sum to obtain in court the deferred payment or rescheduling of its debts over a period of 2 years if it demonstrates that its financial situation does not allow it to pay rent and service charges on the relevant due date. This relief is granted by the courts on a discretionary basis depending on the facts at hand and in light of the financial situation of the landlord and the tenant.

b. **If you are the lender,** your borrower is most likely under an obligation under the facility agreement to ask for your consent to the changes to the lease payment terms requested by the tenant, also considering that the legal claim for payment of rent is generally assigned to the lenders. The facility agreement should be carefully checked in order to assess whether such consent is required in all circumstances or whether specific thresholds apply. Your borrower will not be required (because there is a specific carve out in this respect in the facility agreement or generally because there are representations and undertakings for the borrower to comply with laws) to request your consent if a tenant is entitled under statutory law to refuse rental payments, reduce rent payments or defer rental payments (please see above for French Covid-19 measures that have been implemented in this respect). Your consent may be subject to a requirement that you must not unreasonably withhold or delay it. Even if not, if the facility agreement is governed by French law, you may still be subject at law to a general requirement not to act against bona fide.

   Your borrower is also most likely under an obligation under the facility agreement to exercise its rights under each lease in a proper and timely manner. If restrictions are imposed by laws not to terminate lease contracts, your borrower will not be required to assert a termination right payments.

   Lenders should also note that, in contrast with some other jurisdictions, there is currently no Covid-19 laws/measures granting any relief on principal or interest payments (other than interest payments assimilated to penalty payments) for facility agreements.

3. Are you seeing rent concessions in the market generally? Are there any issues with granting rent concessions to the occupational tenant?

a. **If you are the landlord,** while there may not be an express right in your tenant's (or other tenants') leases to withhold rent or have rent suspended (to the extent described above), given the extraordinary circumstances of the Covid-19 pandemic, many tenants (particularly in the retail and hospitality space) are nonetheless requesting rent and service charge concessions. We are seeing many landlords accommodating requests by tenants to pay rent monthly rather than quarterly in advance in order to preserve cash flows. Some tenants have also been requesting (and receiving) rent free periods (i.e. rent holidays) and/or rent deferrals (i.e. where the rent is deferred for a specified period but will ultimately still be paid to the landlord). Landlords should be clear as to whether they are agreeing a rent deferral or they are actually foregoing rent. Landlords are facing unenviable commercial decisions as to how best to proceed. Whilst it may arguably be in the landlords' best long term interest to help keep key retail tenants solvent over the next few difficult months, agreeing to rent suspensions may cause substantial issues for them, in particular if they have payment obligations to their lenders. Ultimately, whether landlords agree to accept such requests will be a matter of commercial negotiation.

   If you are a borrower and you are considering granting a rent concession to your tenant, you are also most likely under an obligation under your facility agreement to ask for your lender's consent before granting that rent concession, on which please see more below.

b. **If you are the lender,** your borrower is most likely under an obligation under the facility agreement to ask for your consent before granting the rent concession to the tenant. Your consent may, under the facility agreement, be subject to a requirement that you must not unreasonably withhold or delay it. Even if not, if the facility agreement is governed by French law, you may still be subject at law to a general requirement not to act against the principle of bona fide, effectively requiring you to take legitimate interests of your borrower into consideration when exercising your rights under the facility agreement. In the context of the current Covid-19 pandemic and its economic consequences, a prudent lender should exercise caution before considering refusing consent to the rent concession, unless it is evident beyond doubt that the rent concession proposed by your borrower is itself unreasonable in the current circumstances.

4. Does loss of rent or business interruption insurance cover Covid-19 consequences?

a. **If you are the landlord,** the answer will ultimately depend on the specific terms of the insurance policies, but it is unlikely that any loss of rent or business interruption insurance that you (or your tenant) have taken out will cover insurance against the impact of the Covid-19 pandemic. This is because: (i) it is very uncommon for loss of rent or business interruption insurance to cover infectious diseases at all; and (ii) even if you (or your tenant) have taken out insurance that covers infectious disease, that cover will only be limited to a list of known notifiable diseases at the time the insurance

was taken out and the insurance is therefore unlikely to cover Covid-19. In respect of loss of rent, this is usually linked to a loss of rent arising as a result of physical damage to the property (as per the rent suspension clause in the lease). Rent guarantee insurance (which is designed to protect landlords against rent arrears and rent defaults) may assist you if you are a residential landlord – but this is very rare in the context of commercial real estate.

b. **If you are the lender,** your facility agreement will inevitably include an extensive insurance undertaking. However, for the reasons set out above, it is unfortunately very unlikely that any insurance undertaking will cover insurance against the impact of the Covid-19 pandemic.

5. Are occupational tenants/landlords able to shut down their premises?

a. **If you are the landlord**, in respect of occupational tenants, most commercial leases contain a statutory compliance clause which will require the tenants to comply with all statutes, order and notices made by any competent authority. Consequently, tenants will largely be required to comply with orders from the relevant authorities to close-down in relation to the Covid-19 pandemic, otherwise they will be in breach of their lease. Under two French governmental decrees dated 14 and 15 March 2020 respectively, as restated and amended by subsequent regulation including decree n° 2020-423 dated 14 April 2020, the ministry of health and solidarity has ordered the closing down throughout the country from 15 March to 11 May 2020 (subject to further extension) of all non-essential establishments which are open to the general public including shopping centres, stores, stadia, museums, sports convention centres exposition galleries, library, dancing and playing halls, restaurants and bars and convention centres. Retail and hospitality leases may contain keep open clauses, requiring tenants to continue operating from their premises, but we do not believe that landlords would stand any chance of enforcing such clauses in light of the current enforced lockdown, since tenants could, in particular, validly use force majeure to suspend the performance of their keep open obligations.

b. **If you are the lender,** if your borrower threatens to suspend, or does suspend, carrying on its business, this may technically be a cessation of business event of default under the facility agreement. Some facility agreements will also have a specific "keep open" covenant (for example, on a hotel financing). However, in the context of the current Covid-19 pandemic and its economic consequences (and especially if your borrower is obliged to suspend its business), any suspension or cessation of business is unlikely to trigger a default under that provision as the suspension or cessation is forced and hopefully temporary. Moreover, most facility agreements will also include a general compliance with laws covenant and, if the relevant action is required by law, your borrower will need to comply with the law rather than any other contractual term of the facility agreement that would otherwise mean it is in breach of law. In addition Covid-19 laws have been implemented in France to allow the disapplication of certain sanctions for any non-performance, during a period of legal protection, by an obligor of its contractual obligations (article 4 of Ordonnance n° 2020-306 as amended by Ordonnance n°2020-427 of 15 April 2020). However such measures are not implementing a moratorium and debts remain legally payable on their due date. More specifically, those Covid-19 laws provide that penalty clauses (which may include late interest provisions) and more generally clauses which provide for the termination of an agreement or an early repayment

following the non-compliance by a debtor of its contractual obligations which would by their terms have taken effect during the period between 12 March 2020 and 24 August 2020 (included) will be of no effect until 24 August 2020 plus the number of days elapsed during 12 March 2020 and the date on which the relevant clause would have otherwise produced its effects between the parties. It is also to be noted that Ordonnance n°2020-427 of 15 April 2020 provides for a specific suspension regime for penalty clauses relating to contractual obligations other than payment obligations taking effect between the parties after the suspension period between 12 March 2020 and 24 August 2020 (included).

From a practical standpoint, in the context of loan agreements, we believe that the above suspension provisions should be construed as suspending (during the suspension period) late interest clauses and forfeiture clauses following the occurrence of an Event of Default. So for instance, a payment default could occur and trigger an Event of Default but the lenders would not be able to charge late interests or accelerate the relevant loans on the basis of such payment default/Event of Default.

6. A development is mid-construction and Covid-19 is going to result in delays or other issues with the contractor or construction programme.

In respect of construction projects in France, it is likely that the Covid-19 pandemic and its consequences will be qualified ultimately as a contractual legitimate cause of delay (administrative closures of certain sites, difficulties in getting work force and resources on site) and possibly trigger suspension rights under force majeure.

Further, pursuant to French Ordonnance n° 2020-306, construction companies may not suffer any legal adverse consequences, including termination of their contract or penalties, for being late in delivering part or all of their works if the contractually set date falls between 12 March 2020 and 24 August 2020 at the earliest.

The interruption of construction on most sites in France has led to discussions between the French federation of builders (FFB - Fédération Française du Bâtiment) and the Government to establish a set of measures ensuring that construction is resumed without endangering the workers' health and spreading the virus. A guide of good practices has been prepared as a result but the sector anticipates difficulties in implementing them due to current shortage of personal safety equipment in France (safety masks in particular).

Additionally, the following matters should be considered, and they may become more relevant as the full effects of the Covid-19 pandemic are felt:

- contractors having solvency issues because they cannot cope with the financial consequences of the impact of the Covid-19 pandemic. The usual considerations will apply here in terms of available

security, status of the works and how and when they are completed. There may of course be knock-on effects under agreements for lease and other relevant documents; and

- if works are suspended (whether by employers or by other events, including force majeure actions by the government), the contractual provisions around how long works can be suspended for before either party can terminate will kick in (subject the provisions of French Ordonnance n° 2020-306 mentioned above). However, it may be that, in the circumstances, neither party actually wants to terminate.

Specialist advice should be sought on insurance, but it seems highly unlikely that any policy of insurance will respond to cover the financial consequences of the Covid-19 pandemic. Even delay in start-up insurance, if taken out, is likely to exclude pandemics such as the Covid-19 pandemic or, at the very least, have stringent limits on any recovery. Put simply, insurance is unlikely to provide relief.

If the construction works feed in to an agreement for lease, or agreements for lease, it will also be important to consider the consequences of delays to the works on any target completion dates and long stop dates and any other potential consequences on the agreed arrangements, as well as on each lease. We have seen landlords seek to include clauses which expressly push out target completion and long stop dates where delays to the works are a result of the Covid-19 pandemic. It may be that the events under the relevant building contract (discussed above) would have the same effect in any case, but parties are likely to want to make the position clear.

7. Could Covid-19 consequences prevent completion of any sale and purchase agreements?

a. **If you are a Purchaser,** most commercial property asset sale and purchase agreements do not contain either a material adverse effect (MAE) clause or a force majeure clause. Under those conditions, if a buyer decides to pull out of a sale and purchase, it is likely that it will have to forfeit the deposit paid to the seller (although, as the impact of the Covid-19 pandemic is felt on the property market, the simple retention of a deposit may not adequately compensate a seller). Whether the seller has additional rights to damages will depend on what has been negotiated in the agreement.

   Where a corporate structure has been used to sell a commercial property, similar principles will usually apply. The share sale and purchase agreement may contain a MAE clause, but this is unlikely to be a general market MAE clause and will usually only apply if there has been a breach of the interim covenants or the warranties above a certain threshold. As such, any such MAE clause is unlikely to be triggered by the Covid-19 pandemic alone. Share sale and purchase agreements are, however, more likely to be conditional contracts and, as such, parties may look to try to ensure that the conditions are not met, either to extricate themselves from a deal during a period of uncertainty or as a means of renegotiating the price.

b. **For both buyers and acquisition lenders**, in respect of the Covid-19 pandemic potentially preventing funding by lenders at completion, unless the facility is being provided on a certain funds basis, please see answers to questions 8 and 9 below. If the facility agreement has an on-going

certain funds obligation, it is unlikely that the Covid-19 pandemic will relieve a lender of its obligation to fund the acquisition, but every facility agreement should be carefully considered on a transaction by transaction basis.

8. Impact on drawing the facility.

a. **In general,** in REF facility agreements the conditions that regulate the drawstop mechanism are the following:

   i. no default is continuing or would result from the proposed loan;

   ii. the repeating representations are true in all material respects;

   iii. (in investment facility agreements) loan to value not exceeding[, and debt yield/interest cover being at least,] a certain specified percentage immediately after the making of the loan;

   iv. (in development facility agreements)[loan to value and] loan to cost not exceeding a certain specified percentage immediately after the making of the loan; and

   v. (in development facility agreements) a certificate of the project monitor confirming such matters as, for example, that the proposed loan has been requested in respect of a cost which is included in the budgeted costs or that the remaining project costs to project completion are less than the available commitments.

   Drawstops are more likely to be an issue on investment deals that have not yet completed (and on which the final initial valuation has not yet been issued) and on development deals (which by their nature contemplate drawdowns throughout their life and for which delays are currently encountered due to the lockdown situation).

b. **If you are a lender,** on investment deals that have not yet completed we understand that in some jurisdictions valuers are starting to qualify their valuations by reference to the Covid-19 pandemic. While any such qualification would need to be reviewed on a transaction by transaction basis, a prudent lender should consider the circumstances carefully before drawstopping a facility on the basis of a valuation qualification, given how uncertain, volatile and politically sensitive the current circumstances are.

c. **If you are a borrower,** and your deal is a development deal, you will need to carry out an analysis of the impact of the Covid-19 pandemic on the time and cost of your development in order to determine whether a drawstop might apply. A prudent borrower will also do well to ensure it is currently compliant with any non-Covid-19-impacted obligations, to avoid inadvertently giving rise to potential hair-trigger drawstops.

d. **Please see question 9 below** for a discussion of potential material adverse effect drawstops.

9. Is Covid-19 a MAE event?

a. **For both landlords/borrowers and lenders,** except in the case of deals featuring very strong sponsors, REF facility agreements usually include a MAE event of default.

The definition of MAE is usually negotiated extensively and can therefore vary considerably. The definition of MAE in the currently published version of the LMA REF facility agreements (which is acknowledged as being quite wide) is:

"**Material Adverse Effect** means a material adverse effect on:

i. [the business, operations, property, condition (financial or otherwise) or prospects of an Obligor; or

ii. the ability of an Obligor to perform its obligations under the Finance Documents; or

iii. the validity or enforceability of, or the effectiveness or ranking of any Security granted or purported to be granted pursuant to any of, the Finance Documents; or

iv. the rights or remedies of any Finance Party under any of the Finance Documents.]".

Although every MAE provision will need to be interpreted in the context of its facility agreement and the specific facts and circumstances of the relevant deal, the impact of the Covid-19 pandemic on deals (which is likely to be on the timing, cost and value of deals) may be expressly covered by other specific events of default.

Indeed, the usually generic nature of MAE provisions means that it is rare to be able to conclude with absolute certainty that an event or circumstance has occurred which has had a MAE. As a result, MAE events of default are rarely invoked in practice. However, every MAE provision and every transaction will be different and the circumstances of Covid-19 are new; therefore, borrowers should consider any MAE provisions, particularly in the context of drawstop situations, carefully.

Please do not hesitate to get in touch with any of the A&O contacts listed below if you have any questions on any of the matters discussed in this note.

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