

## Covid-19 coronavirus – Key considerations from a Luxembourg real estate perspective

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As Covid-19 coronavirus continues to spread across the world including the Grand Duchy of Luxembourg, tenants and landlords, as well as buyers and sellers of real estate will encounter challenges in complying with contractual obligations due to measures undertaken by the government and the legislator in light of the state of emergency declared in the Grand Duchy of Luxembourg.

We have prepared this brief outline of the major questions raised in the real estate sector from a Luxembourg law perspective. We will update as the days and weeks go by – this remains of course a rapidly evolving situation. As always, we are happy to provide further information on any of these topics – please just reach out to your usual Allen & Overy Luxembourg contact.

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## General framework

Within the framework of commercial relations, the question has recently been raised as to whether the pandemic caused by the Covid-19 as well as the government measures taken in that context may be considered as a *force majeure* event and, as such, whether this would make it possible to suspend or terminate contractual obligations.

In general terms, the obligor is required to perform the service envisaged by the contract: it is in default and obliged to compensate the obligee for damages where it does not properly perform the services.

Articles 1147 and 1148 of the Luxembourg Civil Code provide that the obligor may evade its responsibility by proving that its failure to perform has been caused by an "external event". To be qualified as a *force majeure* event in the meaning of the Luxembourg Civil Code, an event has to be irresistible (i.e. one whose adverse effects could not have been prevented by appropriate measures), unpredictable (i.e. unforeseeable at time of signing) and external (i.e. outside the contracting parties' control).

In order to characterise the *force majeure*, the judges carry out a case-by-case analysis of the situation. There is no standard case law that could apply to all cases, including epidemics.

Each contract needs to be looked at individually to check whether it contains a *force majeure* clause, and if it does, identify whether it is one that seeks to define what *force majeure* means – whether via an exhaustive list or via examples of what *force majeure* can mean – or if there is no definition at all.

Generally speaking and although the Civil Code does not provide for any particular procedure as regards *force majeure* events, we advise all clients to evaluate the impact of Covid-19 on their contractual obligations and notify their contracting parties as soon as possible in writing of any disruptions.

## Specific situations in the real estate sector

### Lease agreements - Suspension of rent payments

Generally speaking, in all instances, it is essential to review the specific language in the lease to determine whether, and to what extent, performance is excused as a result of Covid-19. To our knowledge, the vast majority of the Luxembourg lease agreements do not contain general *force majeure* provisions and/or clauses which would allow the tenant to suspend the payment of rent/service charges in light of the Covid-19 pandemic.

If the lease agreement is silent as to *force majeure*, courts will determine whether to excuse performance during the *force majeure* event based on general principles of Luxembourg law (e.g. concept of *force majeure* / lawful non-performance (*exception d'inexécution*)).

To be qualified as a *force majeure* event in the meaning of the Luxembourg Civil Code, an event has to be irresistible, unpredictable and external.

Although the Covid-19 pandemic and the measures taken by the Luxembourg government will probably qualify as a *force majeure* event, the debtor, i.e. the tenant, must be prevented from fulfilling its obligations. The tenant's main obligation is to pay the rent. It is generally admitted by the courts that a party cannot use a *force majeure* event to excuse the obligation to pay the rent, unless the impossibility extends to the obligation to pay itself (e.g. in the case of a total breakdown of the banking system leading, for example, to an impossibility to make a wire transfer).

There may be alternative routes for a tenant to reduce its financial exposure, for instance on the grounds of lawful non-performance (*exception d'inexécution*), hardship (*théorie de l'imprévision*) (although such concept is currently not commonly recognized by Luxembourg case law) or article 1722 of the Civil Code (i.e. reduction in rent in case of partial loss of the premises as further set out below).

In an office lease context, the tenant does not have strong arguments to suspend payment of rent and/or service charges, but several arguments can be put forward by the tenant. Those arguments are in our view more convincing if used by a retail tenant directly affected by the Covid-19 measures (shops, restaurants, etc.), but could to some extent also be used by an office tenant, depending on its specific situation and of the situation of the building.

## Lease agreements - Termination of agreements

In the absence of any contractual provisions, it will be very difficult for a tenant to terminate the lease agreement by invoking *force majeure*. If the tenant is deprived of the enjoyment of its premises as a result of a government act and not as a result of a default of the landlord, the latter has fulfilled all its contractual obligations towards the tenant. Thus, the tenant may not plead non-fulfilment of the landlord's contractual obligations in order to request a termination of the lease agreement.

The tenant could resort to the application of Article 1722 of the Luxembourg Civil Code, which provides for the reduction in rent in case of partial loss of the premises. Some legal authors are of the opinion that exceptional circumstances due to fortuitous events or *force majeure*, and therefore beyond the tenant's control, may prevent the tenant from enjoying the premises and that such a situation can be assimilated to total destruction. It would lead to the termination of the lease by operation of law when the deprivation of enjoyment is total and final, and its suspension if it is only temporary. When it is partial, permanent or temporary, the tenant could request a reduction of the rent or the termination of the lease. We are not aware of any Luxembourg case law in that context.

The fact that a (retail) tenant is in financial difficulties is not a valid reason to terminate the lease agreement under Luxembourg law. The bill about commercial lease agreements presented initially contained such a provision (i.e. possibility for the tenant to terminate the lease agreement under certain circumstances in case

of financial difficulties), but such provision was never adopted in the final version of the act dated 3 February 2018 on commercial lease agreements.

## Construction contracts

Construction sites had to be closed with effect from 20 March 2020, 5.00 pm CET. The restriction does not apply to construction sites for hospitals or in relation to critical infrastructure, in case of need.

Furthermore, all handcraft activities from skilled professionals out of their workshop have been prohibited with effect from 20 March 2020, 5.00 pm CET. Exceptions are possible only for breakdown and troubleshooting services, for repair works, for moving services and for decontamination. Safety relevant maintenance services are allowed.

In the absence of any contractual provisions, courts will most probably recognize that the factual circumstances caused by the pandemic and its consequences (government policies) amount to a *force majeure* event. The recognition of a *force majeure* event relieves the contractor from the performance of the contract until after the event, but it does not terminate the contract as a whole.

Parties should consider the implications on clauses providing for liquidated damages in the event of delays in project completion. While a *force majeure* event typically absolves the relying party of liability for non-performance, other impacts will likely be felt beyond those ordinarily expected (amendments to existing contracts to cover a longer than expected period of construction, higher overhead costs, etc.).

When assessing the potential impact of Covid-19 on a project, it may be necessary to consider the wider implications outside the immediate employer/contractor relationship. Lenders and borrowers should consider whether the construction halt constitutes an event of default under the loan agreement (failure to achieve milestones, etc.). Subcontractors may also be facing liquidity issues.

## Impact on transactions

- Pre-signing stage: parties need to take into account Luxembourg law rules on the termination of pre-contractual negotiations. Despite the current situation, the general principle of good faith in negotiations continues to apply and any termination of pre-contractual negotiations needs to be made in appropriate format and in line with any process letters or equivalent to avoid any claims for damages by the counterparty. It may be impossible to sign and exchange contracts in original form. Various clients have already asked us for advice on how to solve this. The solution often depends on the nature of the document to be signed, and the degree of comfort that the counterparty requires as to the due execution of the document. There is a spectrum of comfort and effectiveness, ranging from the wet ink original through to e-signatures through to oral or verbal contracts. The use of e-signatures is a major focus currently, and there are important legal and practical points to be considered depending on which e-signature provider or platform is proposed.

- Between signing and closing: a number of issues may arise in relation to transactions between signing and closing:
  - Given that most sale and purchase agreements do not contain general *force majeure* provisions, the question as to whether Covid-19 would constitute a legitimate excuse to not close is of crucial importance. To fail or refuse to close could put the buyer or the seller in breach, thereby exposing the defaulting party to possible liquidated damages specified in the contract, loss of deposit monies and potential suit for performance. As regards asset deals, notaries' offices are still open and buyers relying on financing need to be physically present, or be represented by virtue of an authenticated proxy, in order to execute the mortgage deed. The execution of the deed is therefore still possible for Luxembourg residents so that it could be argued that the current measures taken are not sufficient reason to trigger protection due to a *force majeure* event.
  - Share sale and purchase agreements sometimes provide for material adverse change (MAC) clauses that enable the buyer to terminate the agreement or at least have the seller represent that as of the closing date no MAC has occurred. MAC clauses are typically focussed on the business of the target company and on the property and not linked to *force majeure* events, pandemics or the like. A significant deterioration of the target's business (loss of rental income due to bankruptcy of tenants, etc.) between signing and closing could however trigger such a MAC clause. The determination whether a MAC has occurred is a highly fact-specific inquiry tested against the language of the MAC definition. It is almost impossible to give general guidance.
  - *Force majeure* events relieve the debtor from the duty of specific performance. Any obligations owed by the seller to the buyer during the period between signing and closing (performance of specific repairs for instance) can therefore be excused on the basis of *force majeure*. More problematic are deliverables that cannot be undertaken, but are a closing condition.
  - Pre-closing covenants may require the seller to ensure that the activities of the target are carried on in the ordinary course of business, and specific events may require the consent of the buyer. It may be that urgent action needs to be taken by the target and that this action (e.g. seeking additional financing, or claiming under or renegotiating material contracts) requires consent from the buyer.
  - Contractual provisions may require a physical completion meeting and/or the delivery of certain originals as closing deliverables. We take the view that in the vast majority of cases, it should be possible to accommodate any contractual obligations without the need for a physical closing meeting that would presumably be in breach of the currently applicable "state of emergency" framework. For example, parties can agree to replace physical meetings with virtual meetings (including if needed with videoconference) and originals can be directly dispatched to relevant parties via courier services (including if needed with prior verifications of scans of the originals between legal advisers). Parties shall keep in mind that under Luxembourg law they are bound by a general good faith principle and attempts to delay or avoid closing of executed transactions on this basis could give rise to damage claims and/or specific performance. This would need to be analysed on a case-by-case basis.
- Post-closing stage: post-completion covenants in sale and purchase agreements shall as a matter of principle continue to remain in full effect. However, the same *force majeure* considerations as set out above apply and parties may seek to obtain the suspension/cancellation of certain obligations that can no longer

be materially fulfilled (e.g. release of escrow funds in the event that some specific works are undertaken before a set date).

## Coverage by insurance

- There is normally no cover for Covid-19 under property insurance policies.
- Representations and warranties insurance policyholders should anticipate exclusions from coverage for losses related to Covid-19 in the future.

## Relevant Allen & Overy contact



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Keeping abreast of the operational impacts of Covid-19 on our clients' businesses is important to us. Please [click here](#) to access our Covid-19 global microsite for more information as well as our insights on the situation as it evolves.

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