

CONSTRUCTIVE DISCUSSION TOOLKIT

UAE toolkit for discussions
between landlords and
tenants in light of Covid-19





Illustration: Healthcare by Sam Hadley

INTRODUCTION

Much has been said locally and internationally regarding the potential application of 'force majeure' type clauses in lease contracts that may apply in the context of Covid19. From a UAE perspective, Civil Code provisions that address force majeure have also been widely commented on. How useful however is 'force majeure' as framework for discussions and what are the implications practically and legally in raising such arguments?

In this article we unpick the key threads of landlord and tenant relationships in the UAE, apply the various contractual and statutory tests to these, then step back and look at the matter from a more practical perspective in order to provide landlords and tenants with a useful basis for navigating their way through this difficult period and beyond.



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BACKGROUND

THE UAE CONTEXT

Whilst the crisis is primarily a health crisis, the impacts have been dramatic in financial terms.

Many OECD countries have looked to the financial crisis play book. The purchase by reserve banks of government bonds or quantitative easing as it is better known has ensured liquidity and access to cash. Moreover, as with the financial crisis, the Federal Reserve has also stepped into the corporate bond market employing something similar to the Troubled Asset Relief Programme or TARP as it is better known by buying corporate bonds.

These measures and the speed with which they have been implemented have stabilised the financial markets and the banking system which, unlike in the early stages of the financial crisis, is now positioned to play a vital role in supporting the economy through the implementation of government support schemes.

Many OECD governments have gone further than stability measures and have crossed into fiscal support through hand-outs, tax breaks and payroll support. Helicopter money as it is termed. In the US this has taken the form of the Pay-check Protection Program (PPP). In addition the Federal Reserve has agreed to purchase 95% of interest free, then low interest loans made by banks to support business through the Main Street Lending Program (MSLP). Such support has relieved a significant part of the financial burden upon tenants in such jurisdictions. Programs like the PPP and MSLP are however enabled by

a large tax base, which is not the case in the UAE.

The UAE Central Bank has announced support in the form of liquidity measures of US\$100bn including a zero cost funding facility of Dirhams 50bn made available to the banks for the duration of 2020. This will require collateral from the banks and will eventually incur costs. Accordingly, unless a MSLP like measure is also unveiled, banks will remain prudent with their lending and lending is likely to be to those clients who can in turn provide collateral or have strong balance sheets. In the context of this article, that is institutional tenants and the majority of landlords provided they were not over-leveraged coming into this crisis.

What this means from a landlord and tenant perspective is that liquidity may be there but it will not be free save in the short term. Accordingly other than for institutional tenants, tenants may have no other option than to look to their landlords for rent relief from a cash-flow perspective. Such cash-flowing by landlords may present some risks but it is also 'secured' to those landlords through the lease itself. Provided a tenant can see its way through to profitable trading from the premises, a tenant will not walk away from the investments they have made in terms of fit-out and any goodwill.

Thankfully the larger (and often government affiliated) landlords have lead by example and have made it clear that they have programmes for the deferral of rentals which may bridge matters for select tenants

in the short term. What may prove more controversial will be outright waivers of rent as that is a cost to the landlord that cannot be bridged by the UAE Central Bank facility.

Whilst no-one could rule out a MSLP type program or even helicopter money, for the moment that is not on the table. Moreover, we anticipate any such schemes are more likely to appear when demand has returned and such stimulus can be deployed into the real economy. In other words when people can go out and spend it in the sectors that have been impacted the most significantly. In particular the travel, retail, leisure and food and beverage sectors.

Assuming no further fiscal support is given, this does have one tangible benefit which is that there is no fiscal drag once the crisis is over, in other words, there will be less need for additional taxes or cuts in government spending to re-balance the books. This may lead to a faster recovery as was evident after GFC. In addition lower interest rates internationally and a loosening of loan to equity ratios and capital reserve requirements by the Central Bank should also be stimulatory.

With this background in mind, we can begin to see the dilemma facing landlords and tenants in the short and medium term and the need for both landlords and tenants to structure their discussions in ways that will optimise outcomes.



EXECUTIVE SUMMARY

Whilst we consider the balance of this article contains information will form part of any detailed discussions, we anticipate that some readers may want to get to the crux of the matter before undertaking a more detailed review of the finer points. Accordingly, we set out below firstly a checklist of issues and then a summary of 'do's' and 'don'ts' for consideration:

CHECKLIST

- **Make contact:** Whether you are a landlord or a tenant, you should now have made contact with the other party and had broad discussions as to how the crisis may affect you or them.
- **Contact your bank:** Whether you are a landlord or a tenant, you should explore the extent to which your bank may assist. If you are a landlord, is there any case for facilitating loans or providing a measure of underwriting for deserving tenants?
- **Identify the relevant legal documents:** The lease is the obvious document, but consider also insurance policies and your corporate documents.
- **Consider legal and compliance issues:** Landlords and tenants will need to consider the merits of any claims to waive or defer rent, terminate or take further legal action. Landlords may need to make a case for rent deferrals or waivers to their boards and boards may need to make this to shareholders. Tenants may need to consider a range of issues including, bounced cheque laws and in some cases bankruptcy laws and procedures.

- **Take legal advice:** If you do not have an expert in house legal team, external legal advice should be sought. You will not be able to develop proper plans and strategies if you do not have a clear base to start from.
- **Develop models:** Develop a number of models to help predict your position over a time period of say 18-24 months. Develop best, worst, and probable outcomes for each of such time periods and consider how you can optimise the outcomes for each scenario;
- **Synthesise information:** Combine the information you have gathered above and develop a strategy. Consider the 'dos' and 'don'ts' set out below.
- **Review and adapt:** Review and adapt your strategy regularly having regard to the positions taken and the evolving circumstances.

DOS AND DON'TS

- **Do consider in detail your own circumstances.** Each financing, corporate or lease arrangement needs to be considered in its own legal, contractual and factual context. Use this article to develop the issues and feed this into your scenarios above.
- **Do prepare.** In many cases the damage is unlikely to be reversed over a short period. Use our checklist above and commentary below to know where you stand and develop strategies.
- **Do be patient.** At this stage no-one can predict the outcomes of this crisis with certainty. You may want to avoid making commitments too early, though fortune may favour the bold.
- **Don't be positional.** Unless you are sure of your position legally and fully understand the outcomes, it may be better to avoid taking a firm legal position. The situation remains unclear and what may appear a likely outcome now may not be the ultimate outcome.
- **Do communicate.** Being communicative will enable both parties to prepare for the eventualities. Consider also whether good faith disclosures may shift the dial in a positive way.
- **Do consider the merits.** You should not underestimate the human factor in this crisis, business owners, governments, judges are all human beings and want good and just outcomes. Sharing your position openly and honestly and listening to the other party may in some cases be the best strategy.
- **Don't be rigid.** If you want to make a commitment, ensure that you include any contingencies. Think about up-side opportunities as well as downside risks.
- **Do be creative.** Cash consideration is just one means of valuing a business relationship. There are numerous others.
- **Don't view this solely through a legal prism.** Depending on the circumstances, the law gives judges a wide discretion to do what is 'reasonable'. Don't wait for a judge to decide, work together to achieve an equitable outcome.
- **Do check your insurance.**
- **Do collaborate.** For example Landlord's may have better access to credit at a reasonable price, make use of such advantages.

WHAT ARE THE KEY CONTRACTUAL, CIVIL CODE AND OTHER PROVISIONS?

CONTRACTUAL PROVISIONS

The standard contractual position with regard to disruptions in a commercial lease would be to state that where an event prevents the premises from being used, the rent will abate (ie: not accrue) or partially abate for the period that the event prevents or partially prevents such use. It is important however that the exact wording of the lease be considered as there are considerable variations in these types of clauses. Some leases may also state that where the event continues for a period (commonly six months or more) either party may terminate the lease.

The key element that must be present before such a clause will apply is that the premises (or part) cannot be used and herein lies the problem for a tenant seeking relief under such a clause. Can it truly be said that the premises themselves cannot be used or is the inability to use the premises linked, not to the premises itself, but to another

extraneous factor – being Covid19 and any Government regulation? Moreover, who is the regulated party? Is it the tenant who is prevented from using the premises or the landlord who must close the premises? If it is the tenant who is required to close then surely the rent is due and payable.

In addition to the above uncertainties, the factual matrix may have a bearing on the situation. For example, in a mall premises, the landlord may be forced to close the mall, preventing tenants from accessing their premises which would create a stronger case for a tenant to claim that the tenant was prevented from using the premises. This would only be true however to the extent that there were not wider regulations that applied to tenants with similar operations (ie: leisure, retail or food and beverage) outside of malls.

Offices and other commercial premises entail different considerations. Whilst working from home is being encouraged as far as we are aware there have been no outright statements from the authorities preventing office or commercial tenants from accessing or operating from their premises. Similarly, food and beverage and other retail premises may face challenges if they have been operating delivery services from the premises, though a partial abatement may still be a possible argument.

Finally, many of such clauses require physical damage to the premises and even damage by insured risks (thereby ensuring that the landlord is going to be able to claim its loss of rent insurance). If physical damage is required, scope for a waiver or abatement of the rent under such a clause may be limited. There may however be other claims possible.

INSURANCE

Tenants may want to check that they do not have business interruption insurance. Due to the fairly recent SARs, MERS and H1N1 outbreaks, there are now common exclusions for pandemics or epidemics but it is still an avenue that warrants investigation.

Landlords may also hold loss of rent policies should tenants default, though such policies will be of no

benefit to tenants as the insurer will have a claim against the tenant for any unpaid rent should the insurer pay against the landlord's claim. It may be possible, in appropriate cases, for landlords to persuade insurers that the landlord accept less rent than that which is due from the tenant in order to mitigate against the insolvency of the tenant giving rise to a loss of rent claim and on this basis agree

with the insurer, that the insurer should contribute to this loss. This strategy may be limited if there are exclusions in the loss of rent policy in relation to epidemics or pandemics in the policy.

CIVIL CODE PROVISIONS

The above represents a contractual analysis of a typical commercial lease clause. In the UAE, the wording of the lease is however subject to the provisions of the Civil Code and in some cases the provisions of the Civil Code may even override the clear terms of the lease, particularly if wider issues of public policy arise.

The Civil Code has general application to lease contracts. The reader may be aware of the “impossibility” type arguments under Article 273 of the Civil Code as follows:

Article 273.-(1) In contracts binding on both parties, if force majeure supervenes which makes the performance of the obligation impossible, the corresponding obligation shall cease, and the contract shall be automatically cancelled. (2) In the case of partial impossibility, that part of the contract which is impossible shall be extinguished, and the same shall apply to temporary impossibility in continuing contracts, and in those two cases it shall be permissible for the obligor to cancel the contract provided that the obligee is so aware.

Looking carefully at the wording of this Article, you will note that the key test is that the force majeure event makes the performance of the obligation ‘impossible’. Impossibility is a very high threshold. Could it

really be said that the use of the premises is impossible? Moreover the article refers to ‘cancellation’ or ‘extinguishment’ of the obligation the subject of the force majeure event which suggests a permanent state of affairs which the events brought about by Covid19 are not.

In our view, this article is ill suited to the circumstances brought about by Covid19. Firstly, use of the premises is not rendered impossible. Secondly, the circumstances are temporary and do not justify something so extreme as cancellation or termination of the lease in whole or in part. Whilst the circumstance may bring about financial stress that may cause a tenant to default in due course, this would be a separate event that would be distinct from the direct effect of Covid19 and associated regulation.

Finally, it is open to the landlord to argue in most cases that the force majeure event in this case is not an obligation on the landlord to prevent use of the premises but an obligation on the tenant to stop certain forms of trading. Accordingly the landlord could be seen as meeting its obligations to provide the premises and the tenant is not prevented by the force majeure event from making rent payments.

Article 249 below is perhaps better suited:

Article 249.-If exceptional circumstances of a public nature which could not have been foreseen occur as a result of which the performance of the contractual obligation, even if not impossible, becomes oppressive for the obligor so as to threaten him with grave loss, it shall be permissible for the judge, in accordance with the circumstances and after weighing up the interests of each party, to reduce the oppressive obligation to a reasonable level if justice so requires, and any agreement to the contrary shall be void.

Article 249 has a number of distinct advantages for tenants over Article 273. Firstly it states expressly that ‘impossibility’ is not required. Secondly it refers directly to the financial circumstances of the obligor. Thirdly, it appears to contemplate something in the nature of a pandemic or epidemic through the use of the words, ‘exceptional circumstances of a public nature’. Finally, it allows the judge to disregard the wording of any contract in order to achieve a just outcome.

A threshold that may prove problematic is whether the ‘circumstances of a public nature’ could have been ‘foreseen’. Whilst an epidemic or pandemic could be foreseen so could any manner of events and therefore to read the ‘foreseeability’ requirement too widely would render this Article meaningless. Accordingly it is probable that ‘foreseeability’ test

would be read narrowly to mean the ‘circumstance of a public nature’ would not be foreseeable where it was incapable of being predicted with any certainty. The wording ‘exceptional circumstances of a public nature’ would mitigate against such an interpretation being used in a wide range of circumstances. Moreover even if a pandemic is considered foreseeable, the nature of the pandemic and any government response would not be foreseeable.

Article 249, has a distinct disadvantage over Article 273 for tenants in that if the force majeure does prevent the landlord from providing the premises pursuant to 273, this would cancel the corresponding obligation on the tenant to pay the rent. Article 249 in contrast leaves it to a judge to weigh up the interests of each party and reduce the oppressive obligation to reasonable level.

There would be nothing inequitable in employing the approach in Article 249 as landlords may also face losses if waivers of rent are sought. A process of weighing up the interests of each party would seem meritorious, though the parties may prefer to undertake this task themselves or perhaps with the assistance of expert mediators rather than go through the time and expense of having the matter proceed through formal legal channels.

In addition to the articles of general application above, the Civil Code also has several Articles of relevance to ‘contracts of hire’ which include lease contracts. We set these out in full below:

Article 781.-(1) If the whole of the enjoyment of the thing leased is lost, the lessee shall not be obliged to pay the rent in respect of the period of the loss of enjoyment. (2) If the loss of the enjoyment is partial and is such to affect the enjoyment intended, he shall have the right to cancel the contract and the obligation to pay the rent shall lapse as from the date of the cancellation. (3) If the lessor repairs the thing hired prior to the cancellation the lessee shall be relieved of the obligation to pay rent to the extent of his loss of use, and he shall have no option to cancel.

We consider Article 781 is predicated on the ‘loss’ or ‘partial loss’ of the thing hired which is not the applicable to the current crisis where the premises themselves are not affected. Sub-Article (3) also contemplates the repair of the thing hired. Much like the common clause in lease contracts discussed in more detail above, this Article appears to contemplate physical damage to the premises and is not suited to the circumstances brought about by Covid19.

Article 782 of the Civil Code also applies to lease contracts as follows:

Article 782.-(1) If by any act of the competent authorities it becomes impossible to derive full enjoyment from the thing hired through no cause on the part of the lessee, the lease shall be cancelled and the obligation to pay the rent shall cease as from the date of the impossibility arising. (2) If the impossibility affects the enjoyment of part of the property hired in such a way as to affect the enjoyment intended, the lessee may cancel the contract and his obligation to pay the rent shall cease as from the time he notifies the lessor.

Article 782 requires that it is ‘impossible’ to derive the full benefit of the lease and the fact that termination is sanctioned in these circumstances means that the act must be permanent. In our view, this Article is also ill suited to the circumstances brought about by Covid19 for similar reasons to those outlined in relation to Article 249 above.

Article 794 is very broadly worded as follows:

Article 794.- (1) It shall be permissible for either of the contracting parties, for some unforeseen reason connected with him, to require that the contract of hire be terminated, and he shall then be liable for any harm sustained by the other contracting party arising out of such termination, within the limits laid down by custom. (2) If it is the lessor who requires the termination of the contract, the lessee shall not be bound to return the thing hire until he is paid compensation or is given a sufficient guarantee.

Article 794 approaches the tenant’s or landlords circumstances from a subjective perspective through the words ‘for some unforeseen reason connected with him’. This Article was used during the financial crisis to allow termination of contracts by tenants due to changes in financial circumstances. Its application due to financial circumstances may be more limited now however due to the Federal Bankruptcy law.

BOUNCED CHEQUE ISSUES

The custom in the UAE is for tenants to provide post-dated cheques as security for payment of rent. The liability, should the cheque not be honoured, is both civil and criminal with the criminal liability attaching to the signatory of the cheque. Pursuant to Dubai Law No. 1 of 2017 and public prosecution decision No. 88 of 2017, bounced cheques under AED 200,000 result in a fine of AED 10,000 only, with smaller defaults attracting smaller fines. This law is only applicable in Dubai.

If the bankruptcy procedures under the Federal Bankruptcy law are used, this also prevents criminal cases in relation to cheques. This would however require that the bankruptcy procedures be commenced through the court which would result in the owners and directors of the company losing management control in favour of a court appointed administrator. Creditors can also use the bankruptcy procedures and therefore any threats to use these procedures should be considered carefully.

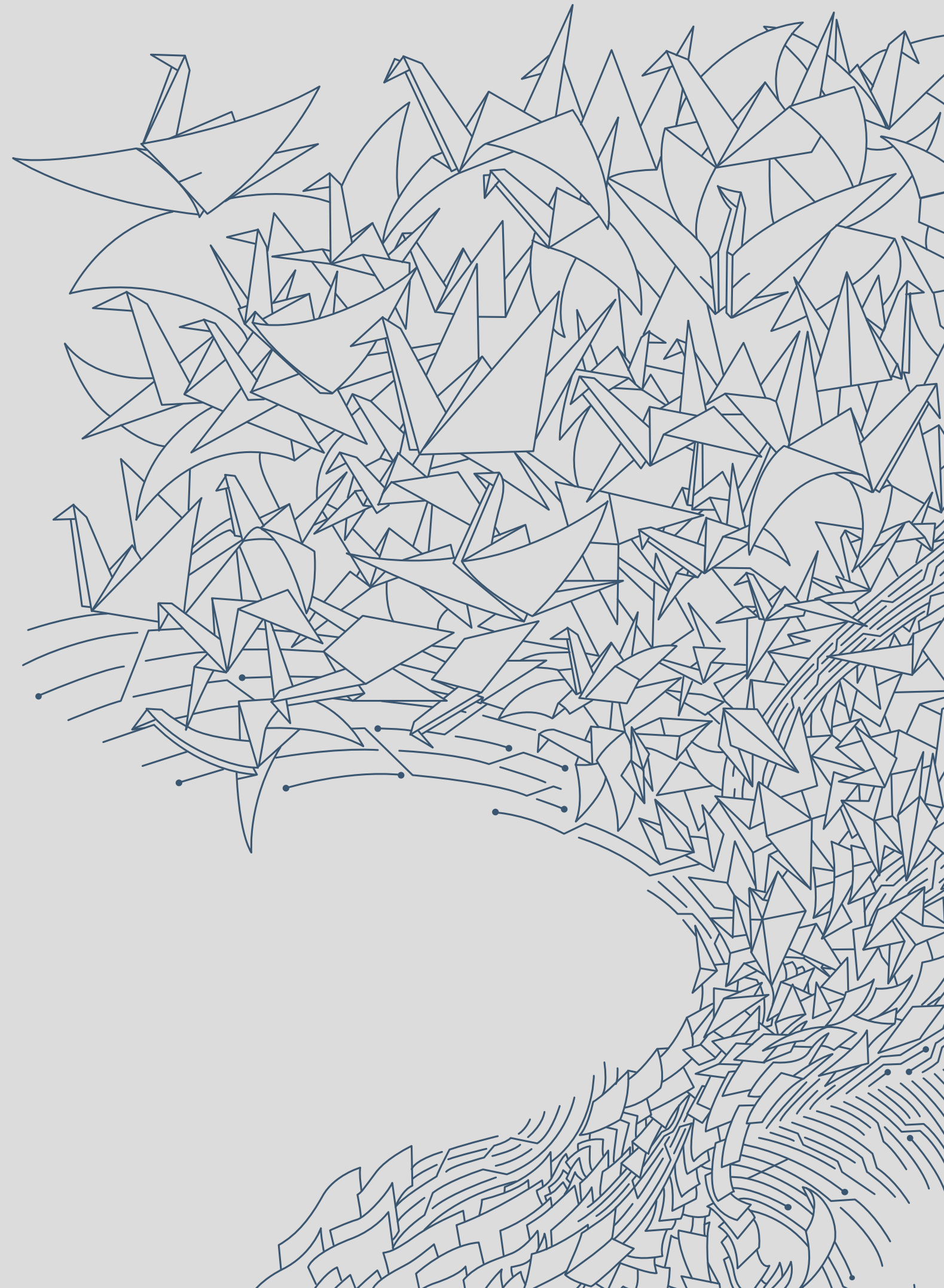
In practice, we consider it likely that (though have no confirmation of this) the public prosecution will not progress bounced cheque cases during any period of lockdown or suspended trading. Moreover, we would query whether it is in a landlord's interests to progress such proceedings to the point where this may involve a key member of the tenant company absconding or being unable to operate their business.

ENFORCEMENT ISSUES

Unlike in many common law jurisdictions, landlords cannot simply re-enter a premises wherever the tenant is in default following notice though that position is slightly more nuanced in the DIFC or ADGM.

Proceedings have to be taken before the forum having jurisdiction and the landlord cannot re-enter until an order is obtained and executed. It is difficult to put a timeline on this particularly in the current circumstances. If there is an arbitration clause, an arbitral award will have to be obtained prior to seeking an order for eviction, resulting in further delays.

In essence therefore, eviction is a lengthy process. Landlords will also want to consider what their alternatives may be in terms of new tenants during this period also.



SETTLEMENTS AND OTHER MEANS OF RESOLUTION

From the commentary above there should be a basis for sensible discussion between landlords and tenants. It will also be clear from the above that circumstances and the legal, financial and commercial positions of landlords and tenants can vary substantially.

Without attempting to address the merits of each situation, we outline below some possible settlements:

- Cash-flow relief only: On this basis landlords would agree to defer rents and penalties but not waive any of the rental. This is effectively a loan by the landlord to tenant. Landlords may accordingly want additional security for such loans. Landlords may also consider if there is any solution with the landlord's bank that could see loans made directly to the tenant with limited recourse to the landlord thereby sharing any risk with the bank.
- Waiver of rents: On this basis, landlords may forgive a certain amount of the rental to support the tenant's solvency. Such an arrangement leaves the landlord directly out of pocket. It may however be able to be justified from a commercial and corporate compliance point of view on the basis that the risk in supporting the tenant is less than risk of attempting eviction and finding a new tenant.
- Waivers with upside protection: Landlords may allow a waiver of the rent with some ability to recoup the losses based on an upside to tenant trading for a period following the crisis, for example through a revenue or profit share arrangements.
- Equity investment in the tenant: A landlord may be prepared to exchange rentals due for equity in the tenant though share transfers. This may allow the landlord the ability to participate in the profits of the tenant which in certain cases may be an attractive proposition for the landlord.
- Taking of additional premises of the landlord by the tenant: A tenant which is ordinarily profitable may be able to work constructively with a landlord in relation to other premises of the landlord. Whilst this may be in the form of a contract to pay sometime in the future it may represent a beneficial solution for both parties.
- Termination: In some cases, the landlord or the tenant may not see any path back through to the tenant trading profitably. In such circumstances, the landlord or the tenant may wish to consider the circumstances upon which they may agree to terminate the lease and allow the landlord to put the premises back on the market.

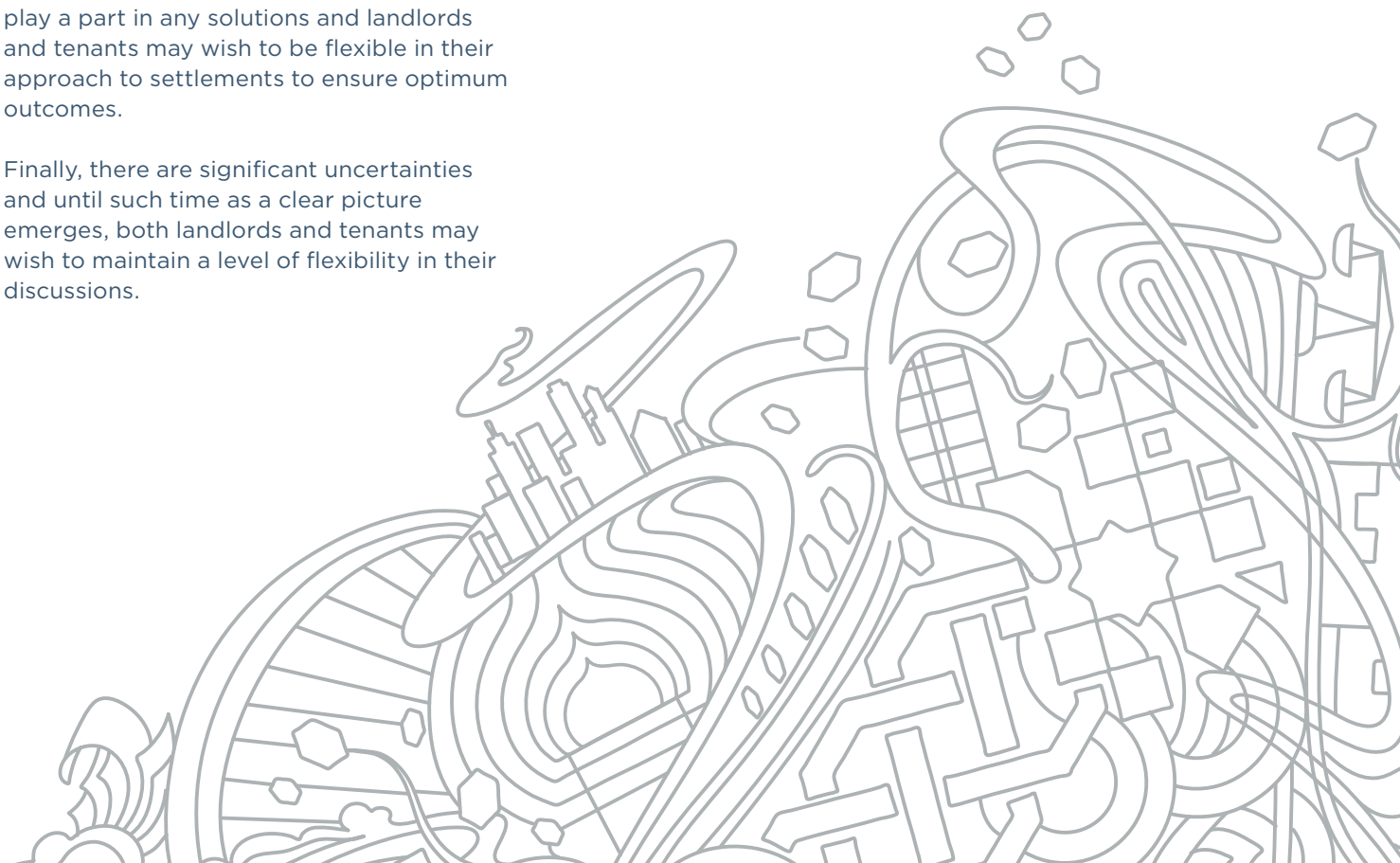
CONCLUSIONS

Whilst the kind of support that is available in some OECD economies is unlikely to materialise in the UAE, it is unlikely also that there will be financial contagion issues as seen in the GFC. In the context of landlord and tenant relationships, many tenants will suffer significant falls in revenues that can only be partially mitigated through cost reducing measures.

Inevitably some tenants may need to approach landlords for further support. This could take the form of support with cash-flow or more substantive support such as rent waivers. Whilst there are legal arguments for support, circumstances vary and the specifics of each case need to be looked at in detail.

Whilst legal considerations are important, commercial considerations are also likely to play a part in any solutions and landlords and tenants may wish to be flexible in their approach to settlements to ensure optimum outcomes.

Finally, there are significant uncertainties and until such time as a clear picture emerges, both landlords and tenants may wish to maintain a level of flexibility in their discussions.



**PROBLEMS. POSSIBILITIES.
COMPLEXITY. CLARITY.
OBSTACLES. OPPORTUNITIES.
THE DIFFERENCE IS IMAGINATION.
THE DIFFERENCE IS **AG.****

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