COVID-19: POSSIBLE CONSEQUENCES ON LEASE AGREEMENTS

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Italian Litigation and Real Estate Alert

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SUMMARY

The restrictive measures adopted by the Italian Government for trying to contain the spread of the COVID-19 epidemic has forced the suspension of most of the commercial activities and will likely lead to several situations of economic distress. As regards commercial lease agreements, the forced closure of premises has already raised questions on the tenant's right to request the suspension or the reduction of the rents during the lockdown period. This alert is aimed at providing some first comments and suggestions on the legal remedies that may be of interest in the Italian legal framework, also in view of possible litigation scenarios.

THE LEGAL FRAMEWORK - IN BRIEF

The COVID-19 emergency has led to the adoption in Italy of urgent legislative measures that, in the attempt to minimize the spread of the epidemic, have significantly limited free movements of people and commercial and industrial activities.

In particular, the Decree of the President of the Council of Ministers dated 11 March 2020 suspended all retails activities, including those located within shopping centers, except the one related to the sale of food and essential goods listed in Annex 1 of the Decree. Restaurants, bars, pubs, ice-cream shops and bakeries were suspended too. The following Decree of the President of the Council of Ministers dated 22 March 2020, modified by Decree of the Minister of Infrastructures and Economic Development dated 25 March 2020, suspended productive industrial and commercial activities, except those listed in Annex 1 of the Decree. The suspension period was then prorogated by further decrees. To date, pursuant to the Decree of the President of the Council of Ministers dated 10 April 2020, that has partially amended the restrictive measures adopted by the previous decrees and repealed the latter, the suspension period will last until 3 May 2020.

The legal framework related to the COVID-19 emergency is continuously in progress, subject to the evolution of the epidemiological situation. It cannot be excluded that, starting from May, the Italian Government may prolong the restrictive measures already adopted or may decide to progressively reopen commercial activities, probably with the obligation to adopt specific safety rules and measures.
In this scenario, it should be investigated what kind of legal remedies may be invoked by the parties of a contract for avoiding possible liabilities arising from the breach of their obligations or for rebalancing contractual relationships that may have become unreasonably burdensome.

POSSIBLE CONSEQUENCES ON LEASE AGREEMENTS

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As regards commercial lease agreements, it may be questioned what kind of defense may be invoked by the tenant that was forced by the law to suspend its activities and what legal reasons may support the landlord against the tenant's request to suspend the payment of the rents.

This paper is only aimed at suggesting a few possible arguments in light of the general principles of Italian law and shall not be considered as a legal opinion. In particular, it is not intended to regulate any individual case, that, on the contrary, shall be analyzed and evaluated taking into consideration every specific facts and contractual frameworks.

The Right to Withdraw for Serious Reasons from Commercial Lease Agreements

Pursuant to Article 27, paragraph 8 of Law No. 392/1978, the tenant of a commercial lease agreement has the right to withdraw at any time for serious reasons, with six months prior notice. The right of withdrawal is effective even if not expressly provided by the parties in the lease agreement.

According to case law, the serious reasons that entitle the tenant to withdraw from the agreement shall depend on unpredictable external facts and circumstances that occur after the signing to the agreement and make unbearable, under an economic perspective, the performance of the agreement.

The forced closure of the premises and/or the economic distress resulting from the COVID-19 emergency, being unpredictable external circumstances independent from the tenant's will and conduct, may be thus seen as serious reasons for withdrawing from the lease agreement.

However, it should be noted that, in case of withdrawal from the lease agreement pursuant to Article 27 of Law No. 392/1978, the tenant would be nonetheless obliged to pay the rents up to the expiration of the six months notice period. Moreover, the withdrawal would necessarily lead to the termination of the agreement and this may not be in the interest of the tenant if he is willing to continue the contract, once the emergency is over.

Impossibility of the Performance

The tenant that is not interested in terminating the agreement may nonetheless request the landlord to suspend the payment of the rents during the emergency period, without incurring in any legal consequences for breach of his contractual obligations.

This remedy may be supported by Article 1218 of the Italian Civil Code, according to which the debtor that does not precisely perform his obligation has to compensate the relevant damages, unless he proves that the performance was made impossible by facts and circumstances for which he is not responsible.

This remedy appears to be also supported by Article 91 of Law Decree No. 18 of 17 March 2020 (so called “*Cura Italia*”), pursuant to which the respect of the restrictive measures of Law Decree No. 6 of 23 February 2020 (i.e. the measures adopted for limiting the pandemic) shall always be taken into consideration in order to exclude the debtor's liability, according to Articles 1218 and 1223 of the Italian Civil Code.

Further to the above, the tenant may also rely on Article 1256 of the Italian Civil Code, that deals with the principle of force majeure in the Italian legal framework.

Pursuant to said provision of law, the obligation is terminated if the performance is made impossible by facts or circumstances for which the debtor is not responsible. If the impossibility is only temporary, and as long as it lasts, the debtor is not liable for the delay in the performance.

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According to authors and case law, the debtor is not responsible for the impossibility of the performance in case of *factum principis*, i.e. in case legislative or administrative orders or measures make the performance of the obligation definitely or temporary impossible.

The tenant may thus invoke the force majeure for temporarily suspending the payment of the rents, without incurring in any contractual consequence, if a factum principis did prevent the regular performance of his activities, as in case his activity is included in those suspended due to the COVID-19 emergency.

This said, as regards lease agreements, it appears nonetheless questionable to sustain that the measures adopted by the mentioned legislation make in fact “impossible” for the tenant to pay the rents, also assuming the temporary duration of such extraordinary measures and impediments. In fact, under a different perspective, if the tenant's business is suspended by the law, it is actually the landlord's obligation to guarantee to the tenant the uninterrupted use of the property that becomes impossible, and this in reason of circumstances for which the landlord is without fault.

If commercial activities are forced by the law to stay closed, the tenant may thus challenge the complete lack of the landlord's performance to guarantee the use of the property. In this case, however, the landlord may likely invoke the force majeure, in the form of a *factum principis*, for sustaining that his obligation was made impossible by external circumstances beyond his control, in order to prevent any possible consequence in terms of contractual liability.

Hardship

Even assuming, as anticipated above, that the tenant cannot invoke the impossibility of his performance for avoiding the payment of the rents, he may nonetheless sustain that his payment obligation has become excessively burdensome due to the exceptional situation caused by the COVID-19 emergency.

In this respect, pursuant to Article 1467 of the Italian Civil Code, if one of the parties' obligation has become excessively burdensome due to extraordinary and unpredictable events, said party may request the termination of the agreement. The other party may however prevent the termination of the agreement by offering to fairly amend the contractual conditions.

In order to invoke the remedy of Article 1467 of the Italian Civil Code, the excessive burdensome of the obligation shall exceed the economic risk originally accepted by the parties and shall be caused by extraordinary events that the parties may not have predicted at the signing of the agreement.

It is worth noticing that the events that may cause the excessive burdensome of the obligation shall not necessarily be strictly related to the contract, but may also depend on a financial distress of the debtor. Therefore, if the tenant support the argument that the payment of the rents have become too burdensome due to the events related to the COVID-19 emergency (and this even more if the emergency situation will last for a while), he may invoke the mentioned provision of law, that, in principle, would lead to the termination of the lease agreement. However, in this case, the landlord may prevent the termination by offering to fairly modify the terms of the contract and rebalance the parties' obligations.

Good Faith in the Performance of Contracts

In addition to the above, it must be noted that, pursuant to Article 1337 of the Italian Civil Code, a contract shall be executed in good faith by the parties. It is thus possible that, in the scenario we are facing, a tenant may also

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invoke this general principle of law in order to obtain - at least temporarily - a rebalance of the contractual conditions.

In this respect, in order to limit the impact of the restrictive measures on lease agreements, Article 65 of Law Decree No. 18 of 17 March 2020 provides for a tax credit of 60% of the amount of the rent paid in the month of March 2020. However, this specific tax credit applies only to the lease of specific properties (i.e. shops and artisans' workshops) and with the exclusion of the commercial activities that were not suspended by the emergency legislation.

Moreover, to date, the Italian Government has not explicitly regulated the possible renegotiation by the parties of the contractual terms. To the purpose, it would thus be necessary to verify if specific clauses are contained in the lease agreement that may allow the parties to modify, for example, the amount of the rent, in consideration of the exceptional circumstances occurred. We may also expect that such clauses will be probably included in lease agreements from now on.

It is worth to mention that, if the parties reach an agreement for modifying the contractual conditions, the agreement can be registered before the Italian Tax Agency without paying taxes or other duties. In addition, according to the Circular No. 8/E of the Italian Tax Authority dated 3 April 2020 the usual term of 30-days period for registering the deed is prolonged in view of easing such incumbents.

The application of the remedies briefly described above will mainly depend on the progression of the epidemic, the duration of the restrictive measures and the economic consequences on the business of the parties of the lease agreement.

If the parties will not renegotiate the contractual conditions, maybe in the attempt to avoid possible judicial scenarios, it will be up to the Court to evaluate in each specific case if the legal remedies suggested in this paper will be applicable and to what extent. It is likely, in particular, that the duration of the restrictive measures will significantly impact on the tenant's right to request the termination of the contract.

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