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CORPORATE & COMMERCIAL AND DISPUTE RESOLUTION ALERT

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Lease Agreements and COVID-19

The spread of the COVID-19 virus is an on-going global crisis. On 23 March 2020, the President announced a nationwide lockdown for 21 days with effect from midnight on 26 March 2020 up until midnight on 16 April 2020. This was further extended on 9 April 2020 for an additional 14 days. It is uncertain whether further extensions will be ordered or, if not, how life might slowly return to "normal". As a direct result of the nationwide lockdown, all businesses' doors (save for those providing essential services) had to shut from 27 March 2020 up until at least 30 April 2020. What does this mean for monthly rent payments? Are tenants entitled to a remission of rental during this period and, if so, to what extent? This is a question on the minds of many tenants and landlords alike.

Lease Agreements and COVID-19

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Lease agreements

As a starting point, it is worth considering the fundamentals of a lease. The primary elements of a lease are that: (1) the landlord gives the tenant use and enjoyment of the property; and (2) the tenant pays the landlord rent for such use and enjoyment of the property. These rights and obligations are "reciprocal". This means that they must be performed one against the other. Put differently, each party is entitled to enforce performance by the other party. Beyond the essentials of a lease, the rights and obligations of the parties to a lease are determined by the terms of the lease agreement and (in the absence of agreed lease terms) by the residual rules of the South African common law governing leases.

Supervening impossibility of performance and *vis major*

The South African common law principle of supervening impossibility of performance caters for situations where performance in terms of the contract has become impossible after the contract has been entered into. If performance of a contract, or if the performance of certain of the obligations in terms of the contract, becomes impossible due to unforeseen circumstances or events (in other words not caused by the parties), the parties are excused from performing in terms of the contract (or such obligations that have become impossible to perform).

In recent weeks, the concepts of *vis major* and *force majeure* have come under the spotlight. Although the terms *force majeure* and *vis major* are often used interchangeably in common parlance, *force majeure* is used in the context of contractual arrangements, whereas *vis major* is recognised as a South African common law concept. A *vis major* refers to an extraordinary event or circumstance beyond the control of the parties, including a so-called "act of God". In order for a *vis major* to trigger the type of impossibility of performance that extinguishes a party's contractual obligations, performance has to be objectively impossible. A reasonable person must be objectively unable to perform due to circumstances which are unavoidable and not the fault of either party. The current COVID-19 pandemic and the national lockdown are considered to be examples of *vis major*.

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So, what does this mean for tenants and landlords? The financial implications of COVID-19 on a lease agreement insofar as rent payments are concerned will be regulated either by way of a *force majeure* clause in the lease agreement or, in the absence of a *force majeure* clause, in terms of the South African common law.

Force majeure and exclusion clauses

What exactly is a *force majeure* clause and what does it look like? A *force majeure* clause will typically excuse performance in the event of certain extraordinary events such as pandemics, acts of war, strikes, lockouts, riots, hurricanes, floods, fire, explosions and acts of God. These clauses usually provide that the failure by a party to carry out or observe the terms and conditions of the agreement (as a result of the extraordinary event) will not give rise to any claim against the party in question or be deemed to be a breach of the agreement.

These clauses generally state that upon giving written notice to the other party, the relevant obligation will be suspended during the continuance of the inability caused and such party will be relieved of any liability during such period. In the event that a lease agreement contains a *force majeure* clause, the specific terms of the *force majeure* clause will determine whether the tenant will be entitled to a reduction in the rental payable or a payment holiday.

Lease agreements generally contain exclusion clauses, the purpose of which is to exclude certain claims or liabilities which normally lie in the hands of contracting parties. A typical example of such an exclusion clause would be where the parties agree that a tenant will not have any claim of whatsoever nature (including a claim for remission of rental and/or loss of profit) against a landlord as a result of, among other things, *force majeure*.

Public policy and other considerations

The enforceability of *force majeure* and exclusion clauses is, however, subject to certain public policy and constitutional considerations. Some clauses in a lease agreement may be found to be contrary to public policy (and thus unenforceable) if the imposed obligations are unduly burdensome on a tenant. For example, the following may be regarded as being contrary to public policy and thus unenforceable in certain circumstances: (1) clauses that provide that no deductions whatsoever may be made from rent payments; and (2) clauses that prevent a tenant from withholding paying rent under any circumstances.

There are also other legal considerations which may impact on any possible rent remission claim, including for example, legislation such as the Consumer Protection Act, No 68 of 2008 (CPA). The CPA applies to a customer (i.e. a tenant) which is a natural person or a juristic person with an asset value or annual turnover less than R2 million.

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In the absence of a *force majeure* clause in a lease agreement, the South African common law will apply.

Section 54(1)(b) of the CPA provides that "[w]hen a supplier undertakes to perform any services for or on behalf of a consumer, the consumer has a right to the performance of the services in a manner and quality that persons are generally entitled to expect". Section 54(2)(b) further states that "If a supplier fails to perform a service to the standards contemplated in subsection (1), the consumer may require the supplier to refund to the consumer a reasonable portion of the price paid for the services performed and goods supplied, having regard to the extent of the failure." It could be argued that a tenant subject to the CPA will have a remedy available outside of their common law remedy for a reduction of rent payable to the extent that the tenant's use and enjoyment of the property is diminished due to COVID-19 during the national lockdown.

The common law position

In the absence of a *force majeure* clause in a lease agreement, the South African common law will apply. At common law a tenant cannot claim a remission of rent simply because it is economically difficult to pay rent due to straitened economic circumstances. To be entitled a remission of rent under the common law, a tenant's loss of its use and enjoyment of the leased premises must be the objective, direct and the immediate result of the *vis major*. In addition to this, the tenant must prove that the occurrence was unforeseen, uncontrollable, and the direct cause of the inability to perform. In this regard, if the tenant is unable to use the premises as a result of the lockdown, the tenant may very well be successful in a claim for remission of rent.

The argument is based on the reciprocal nature of a lease – the landlord is obliged to provide a tenant with use and enjoyment of the premises, for which use and enjoyment the tenant pays rent. The question is whether the landlord, as a result of the lockdown, is still in a position to provide the tenant with use and enjoyment of the premises. As Government has now prohibited trading due to the national lockdown (except in certain limited circumstances), landlords are not in such a position and tenants are not allowed to trade, in order to comply with the lockdown, and both landlords and tenants are thus excused from complying with their respective obligations.

This will, depending on the particular lease agreement, result in a pro rata rent remission. Whether these considerations however, apply to rates and taxes and other recovery charges, the position is less clear, but a tenant will remain liable for all utilities which it actually consumes during the lockdown period, for example electricity still utilised on the leased premises during the lockdown period.

COVID-19 Block Exemption for Property Retail Sector

The position in respect of certain retail tenants is somewhat clearer thanks to the COVID-19 Block Exemption for the Property Retail Sector. On 24 March 2020, the Minister of Trade and Industry published regulations for the purpose of, among other things, enabling the retail property sector to minimise the negative impact on the ability of designated retail tenants to manage their finances during the national disaster. These regulations will remain in operation for as long as the

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As a possible solution, on 7 April 2020, the Property Industry Group announced an industry-wide proposed retail tenant assistance relief package.

declaration of COVID-19 in terms of the National Disaster Management Act 57 of 2002 as a national disaster subsists, or until they are withdrawn by the Minister, whichever comes earlier. Annexure A to the regulations lists those considered to be the "designated retail tenants" as (1) clothing, footwear and home textile retailers; (2) personal care services; and (3) restaurants.

The regulations allow for retail tenants (in the above three categories only) and retail property landlords to enter into three types of agreements, which would under normal circumstances, be prohibited under the Competition Act 89 of 1998 (as amended). These agreements are limited to agreements in respect of (1) payment holidays and/or rent discount for tenants; (2) limitations on the eviction of tenants; and (3) the suspension or adjustment to lease agreement clauses that restrict the designated retail tenants from undertaking reasonable measures required to protect viability during the national disaster.

But what about retail tenants who do not fall into any of these categories? And what about commercial tenants? Here the position is somewhat more complicated as no comparable regulations have been released, notwithstanding that many landlords will fall into both camps, with both retail and commercial tenants on their books.

Property Industry Group's Relief Package for Retail Tenants amidst COVID-19

In response to the national lockdown, the South African REIT Association, South African Property Owners Association and the South African Council of Shopping Centres established the Property Industry Group, which has been working to find viable solutions in response to the potentially devastating economic effects of the national lockdown. As a possible solution, on 7 April 2020, the Property Industry Group announced an industry-wide proposed retail tenant assistance relief package.

This "relief package" focuses on small, medium and micro enterprises (SMMEs), being those entities which have an annual turnover of up to R80 million, across all sectors and seeks to provide assistance and support to SMMEs which are unable to operate during the national lockdown. Although SMMEs are the primary focus, the Property Industry Group has extended the scope to include large retailers heavily affected by the lockdown.

The proposal recommends: (1) certain minimum and maximum rental discount percentages where rental will be waived partially or fully, as well as rental deferrals; and (2) the eligibility requirements for such relief. The proposal also suggests that landlords will, on

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a case-by-case basis, also consider providing relief for office, industrial and hospitality tenants where the lockdown severely impacted the tenant and where it is justified, and that these tenants will negotiate relief terms directly with their landlords. No rental discount percentages or rental deferrals are, however, proposed in respect of these types of tenants though.

Although there has been no indication that this announcement is legally binding on tenants and landlords, it serves as a guideline and an attempt to assist the relevant parties to come to an amicable solution which is economically viable for both the tenant and the landlord. The proposal allows landlords the flexibility and discretion to make an informed decision on the appropriate "relief" offered to tenants, but also gives tenants an indication of what they can expect when entering into discussions with their landlords. At the time of publication, it was specifically stated that the package was based on the assumption that the lockdown would not extend beyond 21 days. It remains to be seen whether this will be revisited in light of the lockdown extension.

Conclusion

Landlords and tenants need to carefully consider the wording of each clause in order to be certain of the impact of COVID-19 on their contractual obligations. Tenants must caution against simply withholding rent payments, as this may inadvertently trigger a contractual breach. Government has warned against parties simply reverting to invoking *force majeure* clauses and has encouraged landlords and tenants to engage in open discussions as regards the impact of COVID-19 on their contractual obligations and the best way of navigating the next few months. The risk of no rent payments could have a crippling effect on the South African economy, as this has a knock-on effect on many landlords' bank repayments, but so will widespread tenant evictions. A balance has to be struck between preserving tenant and landlord rights, ensuring staff wellbeing and keeping businesses afloat.

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Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 1 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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