



EFFECTS OF THE COVID19 ON URBAN PROPERTY LEASES FOR NON-HOUSING USE

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INTRODUCTION

As a result of the spread of the COVID-19 coronavirus, we are living through a period of uncertainty in which, by means of Royal Decree 463/2020 of 14 March, which declared the state of alarm for the management of the health crisis situation caused by the COVID-19 (the "Royal Decree"), the state of alarm has been declared throughout the national territory for an initial period of fifteen days, which can be extended.

From the Real Estate/Financial-Real Estate/Promotion and Construction Department of ONTIER, we would like to make ourselves available to our clients for the purpose of clarifying any questions that may arise from the situation in which we find ourselves.

In this way, by means of this bulletin (the "Bulletin") we will proceed to analyze the effects that the state of alarm, the propagation of COVID-19 and its consequences on the economy, cause in the leases of urban properties for other uses than housing.

The Royal Decree, among other measures, and for the purposes of this Bulletin, (i) restricts the freedom of movement of persons, limiting it to those journeys that are absolutely essential and which are provided for in article 7 of the Royal Decree; and (ii) suspends, in general, any commercial activity, with the exceptions provided for in article 10 of the aforementioned Royal Decree.

These measures, and others that will be adopted, are having an enormous impact on the socio-economic life of the country, especially affecting those who carry out some commercial activity. Thus, in this Bulletin, we intend to analyze the consequences that these circumstances may have on urban property leases for non-housing use.

EXPRESS AGREEMENTS PROVIDED FOR IN THE LEASES

Before analysing those principles or rules that are applicable to any contract and that justify, or may justify, certain breaches of contract or, rather, the exemption from liability in the event of non-compliance, it is important to consider, in the first place, those agreements or clauses that may have been agreed by the parties in each lease contract that, in some cases, allow the lessee to free himself from the contract and, in others, mitigate the negative effects of a situation as unfavorable as the current one.

Thus, by way of illustration only, it would be necessary to check whether the following regulations are included in the lease contracts, which would be fully applicable if necessary:

- (i) The existence in the lease of clauses or agreements that allow the lessee to withdraw or terminate the lease. In this respect, it is usually necessary for certain circumstances to exist that enable the lessee to terminate the lease; or, for the lease to be terminated, it is necessary for the lessee to pay a certain amount of money as damages for early termination of the lease. La existencia en el contrato de arrendamiento de algún sistema de

renta variable o mixta, que permitiera ajustes en el importe de la renta en función de la cifra de ventas o volumen de negocio de la arrendataria.

- (ii) The existence of express provisions in the lease regulating effects derived from the occurrence of situations of force majeure, as well as their definition/determination.

THE PRINCIPLE OF INALTERABILITY OF CONTRACTS OR PACTA SUNT SERVANDA. FORCE MAJEURE. THE REBUS SIC STANTIBUS CLAUSE

Articles 1089, 1091, 1254, 1255, 1256 and 1258 of the Civil Code, among others, reflect a basic legal principle in our legal system, according to which contracts have the force of law between the contracting parties and must be performed in accordance with them ("Pacta sunt servanda"). Notwithstanding the foregoing, the legislator itself establishes exceptions to this elementary principle of law, admitting, for example, the possibility of rescission and termination of contracts in certain cases: rescission due to injury (articles 1291 and 1292 Civil Code) or the exercise of the termination faculty in contracts with bilateral obligations, that is, for both parties (article 1124 Civil Code). In addition, the legislator provides for the figure of force majeure in article 1.105 of the Civil Code, by virtue of which no one is liable for events that could not have been foreseen or which, if foreseen, were unavoidable.

Finally, case law has taken up and shaped the so-called "rebus sic stantibus" clause, which allows the modification or termination of the contract due to circumstances or alterations in the existing situation or circumstances existing at the time of the conclusion of the contract, when the alteration is so marked that it increases extraordinarily the onerousness or cost of the services of one of the parties or ends up frustrating the very purpose of the contract.

These last two assumptions, i.e. force majeure and the rebus sic stantibus' clause, will be discussed below:

Force majeure

As noted above, force majeure, together with fortuitous events, are regulated by Article 1.105 of the Civil Code, which states: "Apart from the cases expressly mentioned in the law, and those in which the obligation is so stated, no one shall be liable for events that could not have been foreseen, or which, if foreseen, were unavoidable.

Force majeure is therefore one of the cases provided for in our legal system which allows the defaulting or debtor party, if assessed by the courts, to suspend performance of certain obligations and to exonerate the defaulting party from liability.

In accordance with Article 1.105 of the Civil Code, and especially in view of the generality of the doctrine and case law, we can point out the following as necessary requirements for force majeure to occur:

- *It must be an unforeseeable or unavoidable event: by unforeseeable event we must understand the quality that an event has and the consequences that it usually brings, so that observation of reality does not allow us to anticipate that this event will occur and bring about consequences of such magnitude; while by unavoidable event we must understand the inability to prevent either the event itself from occurring or its consequences from materializing.*
- *That the event is not the result of the debtor's will: that is to say, that there is good faith on the part of the defaulting party using force majeure, to which, moreover, the burden of proof would correspond; and*
- *That such an event, in addition to being unforeseeable or unavoidable, makes performance of the obligation in question impossible.* Conviene señalar que, en caso de concurrir fuerza mayor, el deudor no deja de estar obligado al cumplimiento de aquello a que resulta obligado si dicho cumplimiento fuere todavía posible, especialmente cuando

se trata de obligaciones de tracto único. Es decir, para este supuesto, el deudor únicamente quedaría exonerado de cualquier indemnización por daños y perjuicios pero continuaría obligado al cumplimiento de la obligación.

On the other hand, in the case of successive obligations, a category which includes lease contracts, the temporary impossibility of performance due to force majeure may lead to a suspension of the obligation (e.g. payment of rent).

The timing note is essential, since once the debtor is no longer subject to force majeure, he would resume normal performance of his obligations. Como decíamos, debe tratarse de una imposibilidad temporal, ya que si la obligación deviene definitivamente imposible para el deudor, no estaríamos ya ante un supuesto de fuerza mayor sino, a nuestro juicio, de imposibilidad física, prevista en el artículo 1.184 del Código Civil.

"Rebus sic stantibus" clause

The "rebus sic stantibus" clause is a case-law-type construction, the purpose of which is to restore the economic balance of assets in contracts for successive contracts in the event of unforeseeable circumstances which have led to an extraordinary change in circumstances to the detriment of only one of the parties to the contract.

In order to assess the possible application of this provision, it is necessary to review the requirements that repeated case law requires for its application and to assess them in relation to the actual case:

- That the contract is of a successive nature or refers to a future moment.
- Extraordinary alteration of the circumstances at the time of performance of the contract in relation to those prevailing at the time of its conclusion.
- An exorbitant disproportion, beyond all calculation, between the services of the contracting parties that truly collapse the contract or annihilate the balance of services.
- That all this occurs due to the occurrence of radically unforeseeable circumstances, with no other means of remedying the damage.

Conclusions

Taking into consideration what has been referred to so far, we can conclude the following:

- (i) With regard to the possibility of alleging force majeure in the circumstances caused by the COVID-19 virus, it would appear that the first two requirements referred to above have been met, i.e. unpredictability, inevitability and events beyond the debtor's control, in the sense that the health, social and economic crisis we are suffering from was unimaginable until just a few weeks ago, and therefore neither party can be blamed for the lack of foresight, let alone for having caused it.

In this way, while the economic circumstances remain unpredictable and with no prospect of stabilization, the obligation to pay rent may prove to be excessively burdensome for the tenant, making it materially impossible for it to be fully complied with in the future without jeopardizing the economic viability of the project, and a temporary suspension of rent could therefore be justified in the current situation.

Notwithstanding the above, the principle of the duty to mitigate damage, even in exceptional situations such as force majeure, must be taken into consideration and would apply. Thus, when it has not been possible or will not be possible to comply with the agreed obligations, it must be possible to prove that all alternative means within reach have been exploited and exhausted.

The time frame in which the failure to comply has occurred or will occur is also essential in assessing the occurrence of force

majeure. In this sense, the Royal Decree has been recently approved and it is evident that we are still in a very early stage of the crisis so that, in these circumstances, it may be difficult to sustain a situation of ruin or material impossibility to comply with what was agreed.

For the assessment of this type of cases, it is essential to take into account the entry into force of the Royal Decree, which contains the legal obligation of commercial closure for companies that own an activity to the public (except those activities that are essential).

In this sense, the legal obligation to close (subject to and with the exception that it will have to be reviewed on a case-by-case basis) makes it impossible for the lessee to enjoy the use of the property that is the object of the lease and, in essence, the consideration for the payment of the rental income.

This is an unforeseeable and unavoidable event, unconnected to the lessee, which has resulted in a Royal Decree (as well as other additional measures) making it obligatory for the lessee to close down his business (except for essential activities included in the Royal Decree itself) which do not allow the use

of the property and therefore, the commercial sale through it, aspects that (according to each case and specific contract, which will have to be analyzed in particular) from its signature, constitute the object of the lease contract (commercial use and utilization of the property, by virtue of which the payment of the rent is produced) thus producing the balance of considerations.

- (ii) With regard to the "rebus sic stantibus" clause, we understand that, in the current circumstances, the requirements for its fulfilment could be met, but the situation is still too incipient to assess its prolonged development in time (as regards its application with immediate effect), so we do not recommend its application at this very early stage of the COVID-19 situation. Therefore, as with force majeure, it is premature to speak at this point of an imbalance in the performance of the parties, on the understanding that this situation must be prolonged over time for it to actually occur.



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