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Force majeure, acts of God and other useful concepts to be aware of in connection with lease relationships in the face of the effects of SARS-CoV2 ("COVID-19")

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Introduction

COVID-19 and the health emergency declaration issued by the authorities may have effects and consequences on the fulfillment of lease agreements depending on: i) the economic activity carried out by the tenant, ii) the agreed use for the leased asset and iii) the real affectation to said use, derived from an act of God or force majeure.

In the event of a partial or total impediment in the use of the leased asset, the tenant may have the option (right) to notify the landlord that the rent (totally or partially) will NOT be caused until the event of force majeure ceases, and shall take the corresponding steps to exercise his/her rights -*such as formal notification to the landlord*- regardless of the previous compliance of the agreement by the tenant.

The factual and legal conditions existing in the phases of suspension and resumption of activities will undoubtedly imply a challenge for both landlords and tenants. Therefore, the success that can be achieved through negotiation, or by facing a lawsuit, will greatly depend on obtaining prompt and efficient legal advice that allows each of the parties to know what he/she is entitled to and the alternatives to exercise his/her rights in the current complex scenario.

Background

On March 30, 2020, the General Health Council published a resolution declaring the COVID-19 epidemic a health emergency due to force majeure, specifying that the Ministry of Health would subsequently determine all the actions that would be necessary to address said emergency.

Thereafter, the Ministry of Health published a resolution specifying the extraordinary measures to address the health emergency caused by COVID-19, including the immediate suspension of "non-essential" activities during the period running from March 30 to April 30, 2020 in order to mitigate the spread and contagion of COVID-19 in the community, reducing the burden of the disease, its complications and deaths of the population residing in the national territory.

The Ministry of Health stated which activities were considered essential and therefore could continue operating. However, the ambiguity and lack of precision in the wording of the resolution generated uncertainty that led state governments to interpret what should be understood as an essential activity, publishing resolutions and "clarifying" decrees on the subject, applicable in each of the entities of the Republic.

Thus, the governments of Baja California, Mexico City, Colima, Guerrero, State of Mexico, Michoacán and Nuevo León, among others, issued multiple decrees through which they specified or even added activities such as *"...private construction, tourism, lodging establishments, department stores, shopping centers, paint stores, clothing stores, shoe stores, ballrooms, movie theaters, theaters, auditoriums, bars, canteens, furniture stores, private clubs, casinos, night clubs, discotheques and similar establishments, shower and steam baths, gyms, athletic complexes, museums, zoos; gaming arcades, mechanical and electromechanical arcades; bowling alleys, pool halls, recreational parks... "*.

On April 21, 2020, a resolution was published to establish that the health emergency and the suspension of non-essential activities would continue to be in force until May 31, 2020.

Both the pandemic caused by COVID-19 and the declaration of the health emergency are considered as force majeure, which have impacted or may impact the fulfillment of agreements. In the following sections we will specifically address the effects of such force majeure in lease relationships in Mexico, of both chattels and real estate, whether industrial, commercial or housing, in light of the applicable legislation in each state and the applicable legal theories.

Conceptual Framework. Acts of God and Force Majeure

In accordance with the legal traditions adopted by Mexican law, when two or more parties reach an agreement and materialize it into a contract, its effects become binding and mandatory for them. This means that they are obliged to comply with the terms and conditions of the agreement, without any discretion to interpret them. Civil law, in contractual matters, calls this principle *pacta sunt servanda.*

There are exceptions to this principle of exact fulfillment of the agreement which allow the agreement to be amended depending on different circumstances, such as the will of the parties (when the parties voluntarily agree to amend their contractual relationship), a court judgment or a consequence of a legal provision -*for example, in laws regulating unforeseen events in contracts, on which we will elaborate below*-, among other issues.

Among the main exclusions of civil liability for contracting parties, the Civil Codes of the different states provide for acts of God and force majeure.

In general, we can say that an act of God or force majeure exists when an unforeseeable or unavoidable event occurs that makes it impossible to comply with an obligation. However, it is important to point out that not all Civil Codes of the Mexican states treat these legal figures in the same way, attributing different meanings to them and, therefore, the legal consequences may vary from case to case.

Effects of COVID-19 as an Act of God and/or Force Majeure on Lease Agreements

When due to an act of God or force majeure the tenant is completely prevented from using the leased asset, NO rent will be caused. If the impediment is only partial, then the tenant may request a reduction in the rent, at the discretion of independent experts.

The Civil Codes of the states contain similar provisions, allowing the rent not to be caused or rent reductions, in the event that of an act of God or force majeure impacts the use of the leased asset.

Tenants will always be entitled to this right, as applicable to both chattels and real estate, and it may not be waived.

Whenever due to an act of God and/or force majeure event the use and enjoyment of the leased asset -whether a chattel or real estate- is totally or partially prevented, the consequence may be: i) an impact on the rent and/or ii) the rescission of the agreement.

What are the consequences when a tenant is totally prevented from using a leased asset?

As a general rule, when the tenant is totally prevented from using the leased asset, the legal consequence will be that the agreed rent shall not be caused for the duration of the hindrance. This consequence is NOT provided for in the legislation of Jalisco and the State of Mexico.

It is important to note that under the circumstances the rent **shall not be caused**, which means there will be no duty to pay rent for as long as the impediment lasts.

What are the consequences when a tenant is partially prevented from using a leased asset?

When the prevention from using the leased asset is partial, the tenant may request the reduction of the rent in the percentage that the parties agree upon or, in its absence, in the proportion determined by independent experts, considering the actual effect on the use of the leased asset.

Termination of the Agreement

Total Prevention of Use

Whenever the use of the leased asset is totally prevented, and such prevention of use lasts for more than two months, the tenant may request the termination of the agreement. There are some exceptions to this rule**:** i) in Jalisco, a period of one month is provided; ii) in Puebla, a period of at least six months is provided and iii) in the State of Mexico, no specific period is provided, so it is subject to interpretation when the tenant may request the termination derived from the total impediment to use the property.

Partial Prevention of Use

In the event that the use of the leased asset is only partially prevented, then the parties (jointly) may decide upon the termination of the agreement. This provision is not applicable in Jalisco, State of Mexico and Puebla, where the same exceptions mentioned above apply.

What kinds of lease agreements are likely to be affected by an act of God and/or force majeure?

All agreements whose purpose is the lease of real estate, such as offices, warehouses, workshops and factories, among others, as well as those executed with respect to chattels, such as machinery, equipment, automobiles, furniture, among others.

Leases that provide US dollar denominated rent

In some states of Mexico, it is possible to claim that a change in circumstances, due to unforeseeable events, entitles the parties to renegotiate the terms of the lease, as per what is known in law as the "hardship theory".

In Mexico, the Hardship Theory was introduced to the civil legislation of Mexico City in January 2010, amending Article 1796 and introducing Articles 1796 Bis and 1796 Ter, which provide the possibility granted to one of the parties to request a judge to amend or terminate an agreement because, due to unforeseeable events, his/her obligations became significantly more onerous than those originally agreed to, generating an imbalance in the contractual relationship.

It is important to note that prior to 2010, the hardship theory was not expressly regulated by the civil laws of the states, which were subject to the principle known as *pacta sunt servanda*, which provides that agreements must be complied with according to their terms.

However, this hardship theory has not been expressly introduced into the Code of Commerce, the Federal Civil Code –*applicable in lieu of specific provisions in the Code of Commerce*-, nor into most civil legislation in Mexico, since it is only regulated in a certain way, in the legislations of Mexico City, Coahuila, Guanajuato, Guerrero, Jalisco, State of Mexico, San Luis Potosi, Sinaloa and Veracruz.

With this in mind, in the case of lease agreements, tenants could invoke the right provided for in Article 1796 Bis of the Civil Code for Mexico City, and in the corresponding articles of those legislations that provide the figure, to request the "amendment of the agreement" -specifically, the reduction in the amount of the rent- as a consequence of the emergence of a national extraordinary event that could not be foreseen and that caused the obligations of the tenant to be more onerous than those originally agreed to. Therefore, the strong depreciation of the Mexican Peso against the American Dollar, as a consequence of the collapse of oil prices in the first quarter of this year and the effects of the COVID-19 pandemic, could be considered extraordinary events subject to the Hardship Theory.