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Real Estate, Infrastructure and Hospitality Practice and Litigation and Alternative Dispute Resolution Practice Group Joint Newsletter

Bill amending several articles of Mexico City's Civil Code in regard to lease matters and health emergencies.

On February 4, 2021, Local Congressman Jesús Ricardo Fuentes Gómez submitted before the Congress of CDMX a bill to amend several articles of Mexico City´s Civil Code (the "**Civil Code**") in regard to lease matters and health emergencies.

The main argument and rationale behind the bill presented by the local Congressman is based on the repercussions that the COVID-19 health contingency has had in micro, small and medium-sized companies of Mexico City, since the measures being applied against said health emergency have forced the temporary closure of many establishments.

Since a large number of these companies carry out their businesses in leased properties, in addition to the losses for keeping their establishments closed, they are obliged to continue paying rent, as well as electricity and water services.

The bill proposes to amend article 1796 Bis, create a new article 1796 Quarter, and amend article 2431, all from the Civil Code, as follows (proposed text is underlined and bolded):

» *ARTICLE 1796 BIS. – In the scenario of the second paragraph of the immediately preceding article, there is a right to request the modification of the agreement. The request shall be made within the thirty days following* ***the events considered force majeure, acts of god, after a Health Emergency Declaration or an Emergency Declaration, being obliged*** *to indicate the motives on which it is based.*

Article 1796 Bis refers to the second paragraph of Article 1796, which provides the legal figure known as the "rebus sic stantibus". Considering the foregoing, when proposing the addition of the underlined text to article 1796 Bis, the legislator is identifying textually and specifically the Declarations of Health Emergency as one of the cases that can be considered for the purpose of applying the rebus sic stantibus clause, which goes hand in hand with the bill´s motive.

» ***ARTICLE 1796 QUARTER. – In cases of mercantile leases, and when dealing with force majeure, acts of god, health emergencies or emergency declarations through which***

activities are suspended and the leased property is totally closed, the rescission due to breach of contract shall not proceed. Neither will the 30-day period indicated in article 1796 bis apply.

Regarding the addition of article 1796 Quater, a deficient legislative technique is being used when referring to "commercial leases". We consider that the legislator should be more clear and establish that the text refers to leases for "commercial purposes".

The landlord shall not be able to demand the rent payment totally, only partially and for storage purposes, until the competent authority establishes a reduction of the consequences of the act of god or force majeure in which there are health risks establishing an adjustment in the agreed rent of the main agreement.

The reduction shall be proportional to the number of days that the closure lasted due to force majeure, health emergency or emergency declaration.

This paragraph practically changes the nature of the original lease agreement to a 'storage' agreement if closure of an establishment is ordered by a competent authority.

It is noteworthy that the legislator uses the text "*reduction of the consequences of acts of god or force majeure*", considering that the consequences of acts of god or force majeure cannot be alleviated by an authority; we believe that at this point the legislator was referring to the competent authority changing the severity of the security measures.

» *ARTICLE 2431. – If due to acts of god, force majeure,* ***health emergency or emergency declaration*** *the tenant is unable to fully use the leased property, the rent shall not be incurred while the impediment continues, and if the latter lasts for more than two months, the rescission of the agreement may be requested.*

Finally, the legislator proposes to specifically include the Declarations of Health Emergencies as one of the cases of force majeure or acts of god for the purposes of article 2431 of the Civil Code. The article provides that in these cases if the tenant is impeded from using the leased property, it will not be bound to pay rent for the duration of the impediment, and after two months, it can request the termination of the lease agreement.

» ***When the act of god, force majeure or health emergency or emergency declaration leaves tenant insolvent, the latter may notify landlord as of the date of insolvency of a term of 2 months, during which no rent will be incurred.***

» ***Once the two-month term elapses, tenant may request the early termination of the agreement.***

Likewise, the legislator specifically includes the scenario where, if due to unforeseeable circumstances or force majeure, the tenant is left in an "*insolvency state*", tenant must notify the landlord to obtain the benefit of not paying rent for two months and requesting the termination of the agreement if the unforeseeable circumstances or force majeure lasts for more than two months, in terms of the aforementioned article 2431.

This last amendment proposal opens the scope of article 2431 so that it not only applies if "*the tenant is totally impeded from using the leased property*", but also applies if the tenant falls in an insolvency state as a result of the force majeure event or act of god. It is noteworthy that this requirement of insolvency status is indicated in the bill, since the legislator is not clear if it refers to a total insolvency status of the tenant, or only of the specific business unit (e.g., branch) which intends to terminate the lease.

It is important to note that the state of insolvency must be caused by an act of god or force majeure and not by any other cause. However, we consider that, in the way in which the reform project was drafted, the existence of a "state of insolvency" is left to a completely subjective assessment and responsibility of the tenant, which could easily be argued by the tenant, in order to prevent the fulfillment of its rent payment obligations, favoring the payment of other types of debts (i.e., supply of raw materials), thereby establishing a true de facto priority in the enforceability of the obligations to the tenant.

We consider that the bill puts the landlord in an evident defenseless state, since the proposed text does not include or foresee that the landlord may terminate the agreement, since the landlord would also be interested in leasing the property to a third party to continue receiving rent.

The foregoing could lead to abuses by tenants who seek a way to evade their obligations under their lease agreement, since the legislator intends to leave a door open to the tenant to terminate the current lease agreement, without the landlord having an effective defense.

In addition to the aforementioned, it is important to specify that the legislator foresees that the tenant can terminate the lease, without the need for a judicial declaration, a situation that would greatly affect the landlords, since in case of force majeure, act of god or health emergency such as that which occurred during 2020, the courts from several states of the Republic normally suspend their activities and make

it impossible for the landlord to go before a judge to enforce their rights against an illegal contractual termination by tenant.

Since this is still a bill that has not yet been approved, we will closely follow how the revision and discussion stages evolve before the CDMX Congress.

Learn more about this bill in the following link.

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