

## Legal Status in Spain

APR 8, 20

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# 1. Contracts

# Contracts

## Contractual obligations in times of COVID-19

*The health crisis we are currently facing has had a major impact on contractual relations, so that on many occasions the fulfilment of the obligations of one of the parties to the contract becomes impossible or excessively burdensome.*

One of the most immediate direct consequences is that some companies cannot meet their obligations to other economic actors. In other cases, it would constitute a disproportionate burden for one of the parties to meet its obligations because the *cause* that led the parties to enter into the agreement has substantially changed or no longer exists. Think, for example, of those businesses – selling non-essential items - that by law, must remain closed to the public: can they cancel their orders placed with their suppliers? Must they pay the rent for the business premises or office? What about the provision of services, can these be interrupted without the prior notice initially established?

Although each of these questions requires its own specific analysis, the law, case law and legal practice provide us with different mechanisms that can help us to counterbalance some economic consequences of the crisis.

### 1. What the parties negotiated: the *Pacta Sunt Servanda* principle.

First, in the search for possible solutions, we must focus on the *Pacta Sunt Servanda* principle. This Latin phrase constitutes one of the basic principles of our civil law and tells us that “the agreements between the parties must be complied with”, which means that from a practical point of view, the parties must attend to what they initially agreed, that is, whether the contract signed included regulations about cases of force majeure or special situations and, if so, how their consequences were regulated must be analyzed.

### 2. Application of force majeure cases:

For those cases in which the parties have not established a specific regulation in the contract, a possible solution can be found in our Civil Code. Articles 1.105, 1.182 and 1.184 of the Civil Code regulate force majeure and define it as those extraordinary events that involve the release of debtors from their obligations due to the supervening impossibility of complying with the agreed obligations. However, this legal form requires certain assumptions to be made in order to be applied:

- ❖ That the obligatory service becomes impossible to provide, this impossibility may be partial or total, temporary or permanent, depending on the case, the effects of each situation will be different.

- ❖ That the relevant circumstances are unforeseeable and unavoidable, that is to say: circumstances that would have been impossible to foresee at the time of signing the contract and that, if they had been foreseen, would have been unavoidable.
- ❖ That the party claiming force majeure is acting in good faith and has taken all the measures within their power to mitigate the consequences of their failure to fulfill their obligations. In the same way, the force majeure event must not be attributable to the debtor.
- ❖ There must be a causal link between the non-fulfillment of the obligation and the circumstance of force majeure. In any case, it is the debtor who must prove that the reason for their non-fulfillment is directly related to the circumstance of force majeure, thus bearing the burden of proof.

Exemption from performance of certain obligations covered by force majeure is not absolute, our case law has gradually defined certain limits to it: force majeure cannot be applied to monetary obligations, i.e. debtors cannot generally claim the impossibility of fulfilling their obligations on account of force majeure. Furthermore, in most cases, force majeure only allows for the temporary suspension of obligations, which means that debtors are not indefinitely exempted from fulfilling their obligations, but rather that there is a “suspension” of obligations.

Furthermore, the party invoking force majeure shall not be liable for damages caused by its failure to comply.

### **3. An economic imbalance in the contract: The “*Rebus Sic Stantibus*” doctrine.**

The “*Rebus Sic Stantibus*” doctrine is a construction based on the principle of equity which jurisprudence has gradually accepted and defined regarding its application. This doctrine makes it possible to restore balance between the parties to the contract when, as a result of supervening circumstances, it becomes impossible or excessively burdensome for one of the parties to comply with their obligation. We should be very cautious when it comes to admitting this principle. Thus, jurisprudence has gradually established certain requirements for its application:

- ❖ That there is an extraordinary alteration of the initial circumstances of the contract foreseen at the time of its signing in relation to those existing at the time of the extraordinary circumstances. That these circumstances generate an exorbitant disproportion beyond all calculation between the benefits of the contracting parties, which would truly bring about the collapse of the contract by obliterating the equilibrium of the parties’ positions.
- ❖ That the circumstances were unforeseeable at the time the contract was signed and therefore the parties could not have taken the change into account. Circumstances considered “normal uncertainties” of the legal transaction, i.e. those which were taken into consideration by the parties or which reasonably should have been taken into consideration, are not covered by the application of this principle.

- ❖ That they are supervening circumstances and that these occurred after the obligation was created but before it was complied with. For practical purposes, this requirement means that there must be a period between the time of conclusion of the contract and the fulfillment of the obligation.

In short, the “*Rebus Sic Stantibus*” principle aims at restoring or balancing the obligations of the contracting parties when truly extraordinary circumstances substantially change the initial balance of the contract. However, it must be considered that the application of this principle has traditionally been very restrictive by the Spanish Courts, although in recent years a certain degree of openness can be observed.

To conclude, each individual case must be analyzed in detail in order to discern the legal forms that can best be adapted to the specific circumstances.

In any case, the truth is that we are facing an unprecedented situation that not only entails economic problems over an extended period but will also cause a high level of litigation in the short, medium and long term. We therefore believe that the law and our courts must offer a legal solution to those economic actors who have seen their capacity to comply with their obligations reduced as a result of the current health crisis.

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## 2. Energy

# Energy

## 1. Introduction

The supply of electrical energy and natural gas is one of the areas that is being affected by the measures adopted by the Spanish Government as a result of the COVID-19 pandemic and, in particular, by the declaration of the State of Alarm and the additional restrictions decreed within its framework.

There follows a brief analysis of the obligations of power and natural gas suppliers and the rights of their customers under the regulations approved following the declaration of the State of Alarm in Spain.

## 2. Domestic customers

The main obligations established for power and natural gas suppliers in relation to domestic customers are:

- (a) During the month following the entry into force of Royal Decree Law 8/2020 of 17 March, they cannot suspend supply to those customers who are vulnerable, severely vulnerable or at risk of social exclusion as defined in Royal Decree 897/2017 of 6 October (basically, domestic consumers with a low income and large families).
- (b) While the State of Alarm is in force, the supply of power and natural gas to individual customers in their habitual residence cannot be suspended for reasons other than the security of supply, of persons and of installations.

## 3. Non-domestic customers (companies, SMEs and self-employed workers)

Exceptionally and while the State of Alarm remains in force, the following measures may be applied to supply points owned by **self-employed workers and companies**:

### - Power supply

- (a) Customers can at any time temporarily suspend or modify their supply contracts, or extensions of such contracts, in order to agree an alternative offer with the supplier with whom they have an existing contract to adapt their contracts to their new consumption patterns, without any penalty charge.
- (b) Distributors shall comply with requests for changes of power or access charges, whether or not the consumer has voluntarily changed the technical conditions of their contract for third-party access to the network within a period of less than twelve months, and even if no change has been made to the structure of access charges or charges affecting them.

- **Natural gas supply**

- (a) Customers can ask their supplier to modify the daily volume hired, so that they are included within a toll scale corresponding to a lower annual consumption or to temporarily suspend the supply contract at no cost to them.
- (b) The supplier may request from the distributor any of the following measures: (i) change of the toll scale of the transport and distribution toll term; (ii) the reduction of the flow hired in outgoing capacity products of standard duration or of indefinite duration, in the latter case without waiting for the expiry of the 12 month term from the last modification of the flow hired and without this modification being counted for the purposes of the minimum period for the request of a new modification; and (iii) the cancellation of the outgoing capacity products hired and the temporary suspension of access contracts of indefinite duration, without any restriction.

Exceptionally and while the State of Alarm is in force, the following measures may be applied to electricity and natural gas supply points of **self-employed workers and SMEs**:

- (a) Customers may request the suspension of payment of invoices corresponding to billing periods containing days within the State of Alarm period, including all their billing categories.
- (b) In these cases of suspension of the payment of invoices, suppliers (i) shall be exempted from the obligation to pay the access tolls to the transport and distribution networks/the transport and distribution toll term corresponding to invoices deferred to the distributor; (ii) shall be exempted from VAT payment, Excise Duty on Power, where applicable, and Excise Duty on Mineral Oils, where applicable, corresponding to invoices for which payment has been suspended under the terms of the agreement, until such time as the customer concerned has paid them in full, or six months have elapsed since the end of the State of Alarm.
- (c) Once the State of Alarm is lifted, the amounts owed by customers as a cause of the suspension of payments shall be included in equal parts in the invoices issued by the power and natural gas suppliers, corresponding to the billing periods in which the following six months are included.
- (d) Self-employed workers and SMEs that make use of the suspension of invoicing cannot change their electricity or natural gas supplier until the payment of the amount accumulated during the suspension has been completed.

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## 3. Real Estate

# Real Estate

## Housing Leases

The main measures adopted by the government in relation to housing leases subject to the Urban Leases Law introduced by Royal Decree-Law 11/2020 of 31 March (henceforth RDL 11/2020), adopting additional urgent social and economic measures to address COVID-19 are detailed below.

**1. Extraordinary extension of contracts:** in the event of the termination of the mandatory or tacit extensions established in the housing contracts referred to in articles 9.1 and 10. 1 of the Urban Rentals Law that occur during the period between the date of entry into force of RDL 11/2020 (2 April 2020) and two months after the State of Alarm is lifted, the tenant can request an extraordinary extension of the contract of up to six months, which must be accepted by the lessor except in those cases when the parties have previously agreed to other terms or conditions.

**2. Deferred rent payment:** people in a particularly vulnerable situation who are holders of a housing lease contract subject to the Urban Leases Law signed with a lease company or public entity, or a large property owner (natural or legal person who owns ten or more urban properties, excluding garages and storage rooms, or a constructed surface area of more than 1.500 m<sup>2</sup>), can request from the lease company the temporary and extraordinary postponement of the payment of the rent within one month to be counted from the entry into force of RDL 11/2020, provided that such postponement or remission has not already been agreed between the parties.

If no agreement has been reached between lessor and tenant, the lessor must choose one of the following alternatives, which must be communicated to the tenant within a period of seven (7) working days:

- (a) A 50% rent reduction up to a maximum of four (4) monthly payments.
- (b) an automatic deferral on rent payment without penalty or interest, also for a maximum of four (4) monthly instalments which will be charged to the corresponding rents for at least three (3) years after the end of the period in which the deferral has been applied and always within the period during which the contract or any of its extensions is in force.

In the event that the tenant unduly benefits from the deferral, that is, without being in a situation of economic vulnerability, they will be responsible not only for the damages caused, but also for the expenses generated by virtue of the application of these exceptional measures, without prejudice to other responsibilities they may have incurred.

**3. Exceptional and transitory modification of the contractual conditions:** people in a particularly vulnerable situation who are holders of a housing lease contract subject to the Urban Leases Law signed with a lessor that does not meet the characteristics indicated in the previous section (company or public entity, or a large holder), can request from the lessor a temporary and extraordinary postponement in the payment of the rent, provided that this has not previously been agreed by the parties. The lessor may accept the conditions of deferment or debt fractioning or propose alternatives to those proposed by the tenant. If the lessor does not accept the proposals made, the tenant will have the right to access a series of transitional assistance measures established within the framework of RDL 11/2020.

**4. Eviction procedure:** the possibility of suspending eviction procedures after the lifting of the suspension of the terms and procedural deadlines due to the end of the State of Alarm is enabled in those cases in which the tenant of a property intended for housing and subject to the Urban Leases Law accredits being in a situation of supervening social or economic vulnerability as a result of the effects of the COVID-19.

If the lessor establishes that they are in the same situation as the tenant, this fact will be taken into account to determine the period of extraordinary suspension and in the choice of the social protection measures to be adopted. If the lessor proves to be in the same situation as the tenant, this circumstance will be taken into account to determine the period of extraordinary suspension and in the definition of the social protection measures to be adopted. The suspension granted shall be retroactive to the date on which the situation of vulnerability started and for the time strictly necessary, the calculation of days being resumed when the suspension is lifted.

## Commercial Property Leases

However, to date, the Government has not yet provided a solution to the problem of commercial property leases, a cost that is becoming critical for many microenterprises and self-employed workers.

The obligation to cease all non-essential activity prevents the use of rented commercial premises, which leads to the question of what legal effect this situation has on the lease, and in particular whether the obligation to pay rent is suspended or whether a reduction can be applied to it.

**1. Legislation.** In the absence of emergency regulations by the government in the context of the State of Alarm, we must refer to general civil law.

The legislation in force, the Urban Rentals Law (Ley de Arrendamientos Urbanos) and the Civil Code are of little use in these cases since they do not regulate this exceptional circumstance produced by such an unforeseeable cause.

However, the jurisprudence of the Supreme Court has recognized the possibility of modifying or suspending the obligations of a lease if circumstances of force majeure, such as an epidemic or pandemic, and this is in accordance with the "*rebus sic stantibus*" doctrine, which determines that in the event of an unforeseeable change of circumstances that alters the economic balance

of the contract creating an excessive burden on one of the parties, its obligations can be modified to create the most reasonable balance between the parties' interests.

Similarly, the jurisprudence has also interpreted this exceptional circumstance, in principle, as not permitting the termination of the contract, but only its modification on a case-by-case basis. Termination would only be possible in the event of absolute frustration of the object of the contract which is impossible to repair.

**2. Solution to potential conflicts.** In view of this uncertainty, it is clear that there is no single solution for all contracts, and that solutions should therefore depend on the circumstances of each case (duration of the contract, expenses to be paid in addition to the rent, type of business conducted on the premises, and in particular, whether part of it could survive, e.g. a restaurant with home delivery service or a bakery that may continue to operate with a predictable loss of sales).

In short, at present the solution to this problem depends exclusively on the willingness of the parties to negotiate a change in conditions based on the parameters described above for the duration of the State of Alarm and the cessation of economic activity.

In practice, as is already the case, the tenant may try to negotiate a specific modification of their payment obligations - without claiming absolute exemption - by seeking intermediate solutions such as a temporary rent reduction, a temporary exemption from payment with a future payment obligation or an extension of the contract with a grace period.

If the landlord refuses any change in conditions, a subsequent legal action could be considered once the State of Alarm has ended. This would certainly not mitigate the harmful effects on the tenant in the short term, but it could be an additional negotiating weapon in the current situation, since on the basis of jurisprudence, certain claims by tenants could be accepted by the courts.

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