

We invite you to read and share this memorandum prepared by our Real Estate and Commercial Law Practice Group

María Carolina Arroyo, Partner
Carin Stelp, Senior Associate
May, 2020

**The effects of
Covid-19 on
Lease Agreements
in Panama**

In this memorandum we will address the following topics:

- The general regime governing lease agreements in Panama
- The regulations adopted in Panama regarding lease agreements as a result of COVID-19
- The concept of force majeure in relation to lease agreements
- The concept of termination due to hardship in relation to lease agreements
- Our answers to frequently asked questions regarding lease agreements in view of COVID-19 events

I. General regime governing lease agreements in Panama

Leases in Panama are divided into two categories:



The first covers residential leases with a monthly rental rate of US\$ 150 or less.

Tenants in the first category of residential leases are protected by the law governing lease agreements ("Law 93 of 1973"), which grants tenants certain rights that are a matter of public policy and, therefore, cannot be modified by contract. These rights include forcing a buyer to respect an existing lease in the event that the property is sold; requiring a minimum lease term of three years, with the right to extend for additional terms of three years if the tenant has paid the required monthly rent; and allowing the tenant to terminate the lease at any time by giving 30 days prior notice to the landlord.



The second category covers residential leases with a monthly rental rate of more than US\$ 150, as well as leases of premises for commercial, professional, industrial or educational use, regardless of the amount of the rental rate.

However, in the second category, residential leases over US\$150 per month, and all leases for commercial, professional, industrial or educational use, are governed generally by the principle of contractual freedom enshrined in the Civil Code, with only a few mandatory provisions required by Law 93 of 1973 that are applicable to all lease agreement. As such, the parties in this category are free to agree on the rental rate, the term, the grounds for early termination, penalties in the event of undue termination, and other commercial terms.

II. Regulations adopted in Panama regarding lease agreements as a result of COVID-19

Since March 16, through Resolution No. 154-2020, the Ministry of Housing and Land Management ("MIVIOT") has suspended eviction processes, and has encouraged landlords and tenants affected by the situation to reach mutual agreements that respond to the needs of both parties.

On May 1, 2020, Executive Decree 145 was enacted, *"Which dictates measures on leases and eviction processes, and addresses other measures."* This decree has the following main effects:

- a. Suspends, for the duration of the National State of Emergency, Executive Decree No. 294 of December 7, 1994 and Executive Decree No. 7 of January 10, 1995, which exclude leases in the second category described above from the majority of the provisions of Law 93 of 1973.
- b. Suspends, for the duration of the National State of Emergency, all eviction processes for all properties used for residential, commercial, professional, industrial and educational purposes, regardless of the rental rate.
- c. Empowers the MIVIOT to oversee all lease agreements contemplated in Law 93 of 1973, regardless of the rental rate.
- d. Extends, under the same terms and conditions, lease agreements whose term ends during the period in which eviction proceedings are suspended, and while the decree remains in force.
- e. For the duration of National State of Emergency and up to two (2) months after the lifting of the emergency measures, freezes rental fees, increases to rental rates and/or penalty clauses for unilateral termination of the agreement and those related to interest for late payment.
- f. After the effects of the national emergency declaration have ceased, tenants who refuse to pay the rental fees not paid during this period without cause, will be subject to penalties according to Law 93 of 1973.
- g. Landlords and tenants may settle their disputes by mutual agreement. Such agreements will have a duration of two (2) years from the date of their registration in the MIVIOT's General Directorate for Lease Agreements and will remain in force as long as the tenant does not violate such mutual agreement.
- h. Landlords who, by any means or actions, suspend the supply of gas, water, electricity or other services, in order to pressure the tenant to vacate the property, or who violates the provisions contained in Executive Decree 145, will be penalized in accordance with Law 93 of 1973.

- i. Tenants who have not been economically affected by the National State of Emergency and who do not comply with their obligations to pay the rental fee, will be subject to penalties in accordance with Law 93 of 1973. In case of a dispute, the tenant has the burden of demonstrating such economic effects to the MIVIOT's General Directorate for Lease Agreements.
- j. The penalties stipulated in Executive Decree 145 will be applied by the General Directorate for Lease Agreements, and include fines of between US\$ 10.00 and US\$ 1,000.00 or jail time of 30 to 90 days, or both, without prejudice to the penalties that may be claimed by the other party for damages for breach of contract.

Requests for reconsideration of decisions issued as a result of Executive Decree 145 may be presented before the General Directorate for Lease Agreements, and appeals before the Minister of MIVIOT. Once these government channels have been exhausted, further appeals may be made through a contentious administrative lawsuit with full jurisdiction before the Third Chamber of the Supreme Court of Justice.

As mentioned, this decree stipulates the freezing of rental fees, increases to the rental rate, penalties for unilateral termination, and the payment of interest for late payment for the duration of the National State of Emergency and up to two (2) months after the lifting of the state of emergency.

It is important to highlight that this decree only freezes the obligations described above, it does not condone them. As such, it does not allow either party to terminate the agreement without paying a penalty, if such a penalty was agreed in the original lease. In this sense, there is no regulation in the Executive Decree that exempts tenants from paying their rental fees. Although the fact that eviction procedures have been suspended could have as a practical consequence that some tenants stop paying their rental fees since, for the moment, there is no risk that they can be evicted from the property for non-payment. However, the unpaid rental fees will continue to accrue and must be paid once the term of the suspension ends, unless the parties enter into a payment arrangement. Although the decree does not indicate when or how said fees must be paid, we are of the opinion that such rental fees will be payable two (2) months after the end of the national state of emergency, unless otherwise agreed. It must also be noted that Executive Decree 145 must have ceased to be in force in order to proceed with eviction actions. A tenant who refuses to pay the unpaid fees will be subject to sanctions imposed by the MIVIOT as described above.

Finally, it is important to note that the decree states that if a tenant stops paying the rental fee without being economically affected by the state of emergency, such tenant will be sanctioned by MIVIOT, as described above. However, the decree does not define what constitutes “economically affected,” or how said effects must be verified.

III. Analysis of the concept of force majeure in relation to lease agreements

The concept of force majeure is included in the Civil Code of Panama. As such, it is applicable to all agreements, covenants, or contracts, even when the agreement does not include a specific clause regarding this concept.

When the agreement includes a force majeure provision, said provision may be complementary to the basic concept included in the Civil Code and outline specific procedures or additional rights and obligations for the parties in the event of a force majeure event.

Although the Government of Panama has declared a state of emergency and implemented measures to restrict the movement persons, some necessary businesses have been able to continue operating (e.g. hospitals, supermarkets, pharmacies, fuel stations, and others). As such, the existence or not of a situation of force majeure depends on an analysis of the particularities of each lease agreement.

It is important to note that force majeure is considered “transitory”, and only suspend the obligations of the parties while the event is ongoing. Once the event has ceased, the parties’ originally agreed obligations become enforceable again. As such, unless there is a specific clause in the agreement allowing the termination of the agreement in the event of force majeure, the occurrence of such an event does not give either party the right to terminate the agreement

IV. Analysis of the concept of termination due to hardship in relation to lease agreements

Article 1161-A of the Civil Code establishes the possibility that a party may request the termination of a bilateral contract due to hardship. The first thing to note about this concept is that it does not give the affected party the power to unilaterally declare the agreement terminated. Rather, this concept allows the party affected by hardship to request the termination of the agreement. That is to say, in order to terminate or modify the agreement, the concept of hardship requires a judicial ruling or a private agreement of the parties.

Additionally, the party against whom the termination has been requested may prevent it by offering to equitably modify the conditions of the agreement. In other words, the other party has the possibility of reestablishing the contractual balance in order to avoid termination of the agreement.

FAQ

V. Responses to frequently asked questions regarding lease agreements in view of COVID-19 events

1. Can tenants stop paying the rental fee as a result of the regulations adopted by the Government of Panama regarding COVID-19?

No, the regulations adopted by the Government of Panama do not include the suspension or forgiveness of rental fees. The fact that eviction procedures are suspended could have the practical consequence that some tenants may stop paying their rental fees because, for the moment, there is no risk that they can be evicted from the property for non-payment. However, in such a case, the tenant who stops paying rental fees will continue to accrue that debt. In practice, therefore, it is in the best interest of both the landlord (to try to prevent their tenants from defaulting and to avoid, in turn, being in default to their own creditors, including banks and property administrators in the case where the property is located within a condominium) and the tenant (to avoid having their debt accrue, which could lead to financial consequences such as insolvency), to negotiate a modification to the terms of the lease agreement in a way that is satisfactory to both parties.

2. Can a landlord start or continue a tenant eviction process if the tenant stops paying the rental fee?

No, eviction processes are currently suspended. The landlord will have to wait until the National State of Emergency is lifted.

3. What happens to periodic increases in the rental fees that have been agreed to in the lease agreement?

For the duration of the National State of Emergency and up to two (2) months after the lifting of these measures, rental fees, fees increases and/or penalties for the unilateral termination of the lease agreement, as well as interest due as a result of late payment, are frozen.

4. Can a landlord request the cutting off or suspension of public services to the leased property in the event that the tenant ceases to pay the rental fee?

No, the landlord may not cut off or suspend public services. Such actions, such as suspending the supply of gas, water, electricity, and other services, as a measure to pressure the tenant to vacate the property, shall be subject to penalties applied by the MIVIOT's General Directorate for Lease Agreements.

5. Can a landlord and tenant negotiate the modification of the terms of the lease agreement during the National State of Emergency?

Yes, amendments to the lease agreement can be agreed as long as there are no violations of public policy or mandatory compliance.

6. What happens to lease agreements that expire during the current National State of Emergency?

These lease agreements are automatically extended, under the same terms and conditions, during the entire time that the suspension of eviction measures is in force.

7. Can a tenant allege force majeure to suspend the lease agreement, or allege hardship to terminate the lease agreement?

This requires a case by case evaluation, for which reason it is advisable to seek qualified legal advice. That said, if the business that operates in the property has had to close or stop operating to comply with the regulations issued by the Government, it is highly likely that there are arguments, either due to force majeure or hardship, that the tenant may make to the landlord for suspension or termination of the lease agreement.

8. What suggested actions and steps can a tenant take in view of COVID-19 events?

- Notify the landlord in writing of the various measures issued by the authorities regarding COVID-19, as they are published, to document the landlord's possible legal arguments.
- Gather as much information as possible about the economic impact of COVID-19 events and the pandemic on the economy in general, and especially on the economic sector in which the tenant operates.
- Be informed as much as possible about the actions taken by other tenants in the same sector facing similar situations, but without taking concerted action with such tenants.
- Begin to evaluate if it is financially viable to continue operating under the "new normal" and if you can / want to renegotiate or terminate the lease agreement.

- Analyze the possibility, given the specifics of the case, of making a claim of force majeure or hardship.
- Try to negotiate a modification to the lease agreement that includes: (i) the power to invoke termination clauses or force majeure without the need for a judicial declaration or intervention; (ii) a relaxation of current commercial terms; (iii) consider creative models for formulas to calculate the rental fee (for example, fixed payments, rent based on gross sales, a combination of both, other fixed charges, low initial prices with an increase in the variable rent based on the actual amount of sales, etc.).
- Pay special attention to the measures implemented after COVID-19 that regulate the “new normal” and evaluate the potential impact on the business that operates in the leased property.
- In the event of a foreseeable lack of liquidity, seek legal advice to analyze extrajudicial options (such as negotiation with major creditors or sale of the business to a third party, or even to the landlord) or judicial options (such as reorganization or liquidation processes) and understand the implications of a possible insolvency process.
- In all cases, it is advisable to have the advice of an attorney in order to analyze the best options and steps to follow, since the specific recommendations and strategy to be adopted will depend on the facts of each case.

9. *What suggested actions and steps can a landlord take in view of COVID-19 events?*

- Maintain open communication with the tenant and with the bank (if there is a mortgage loan). In view of the suspension of eviction processes, the best practice for landlords is to reach agreements with their tenants.
- If possible, analyze whether the landlord is the principal or one of the main creditors of the tenant, or if there are other creditors with similar or greater claims. For example, determine if the tenant also has significant debts with banks and, if so, if it is the same bank or banks that the landlord uses.
- Analyze the different scenarios and the minimum amount required in rental fees to cover the current obligations of the property (including mortgage, maintenance, services, etc.), in order to prepare for an eventual negotiation with the tenant. In the event that the tenant reports a default or stops paying, assess whether you can / want to negotiate to reach an agreement either (i) while the state of emergency lasts, or (ii) by modifying the terms of the medium / long term lease.

- Maintain communication with the bank regarding the situation with the tenant (if the landlord receives any notifications from the tenant, if the tenant ceases to make rental payments, or if the parties agree to negotiate or modify the terms of the contract) to analyze whether it will be possible to reach agreements with the bank with respect to existing financial obligations.
- Pay attention to and monitor the rental market for properties similar to those leased, in order to monitor adjustments in rental fees, the number of similar properties available in the market, etc. This will help to understand how difficult it may be to find a new tenant in case the current tenant wants to terminate the agreement, or in case of insolvency of the current tenant.
- Pay attention to and monitor the industry and economic sector in which the tenant operates to be informed about the economic impact on both the sector in general, and the tenant in particular.
- Be informed as much as possible about the actions taken by other landlords in the same sector (with respect to their tenants as well as with respect to their banks or other creditors) but without taking concerted action with such landlords. This measure is not only limited to landlords in Panama, but creative actions taken by landlords in other countries may also be analyzed to see if they can be implemented in Panama.
- In a case where the property is located within a condominium, maintain communication with the property administrator in order to ensure that the required maintenance continues to be carried out to avoid damage or deterioration that could affect the value of the property.
- In all cases, it is advisable to have the advice of an attorney in order to analyze the best options and steps to follow, since the specific recommendations and strategy to be adopted will depend on the facts of each case.

We hope this information is helpful and we are available should additional questions arise.

María Carolina Arroyo

Head Partner of the Commercial and Real
Estates Practice Group
mcarroyo@arifa.com

Carin Stelp

Senior Associate
cstelp@arifa.com