Linklaters

COVID-19: Contract and employment issues in Mexico

March 2020

This guide highlights key contractual, labor and other considerations that may affect business operations in Mexico due to the COVID-19 outbreak

With the help of leading firms in each of the main jurisdictions in Latin America, we have prepared this note setting out the key aspects of the framework in each such jurisdiction. This is obviously a rapidly evolving situation that we are following closely.

How is the applicable law determined by the courts in the case of commercial contracts?

A general principle of Mexican commercial law is that the parties to a contract may select the governing law thereof. As commerce law is a federal subject matter in Mexico, this principle would be applied in any Mexican court provided that the relevant contract is indeed commercial in nature (as opposed to a civil contract).

Civil contracts, such as leases or common security agreements (i.e., mortgages), are governed by the civil codes of the several states. While the autonomy of the parties to select an applicable law would still apply to such cases, civil contracts may be subject to mandatory applicable law principles, such as *lex rei sitae* (that is, contracts creating liens on, or granting rights to, real estate or other property, may be subject to the laws of the state in which the same are located).

Accordingly, the parties to a commercial contract may, subject to the limited exceptions described above, agree on the governing law in connection with the interpretation and enforcement of such contracts, and such choice of law would generally be upheld and enforced by Mexican courts, provided that it does not result in fundamental principles of Mexican law being fraudulently evaded or if the provisions of foreign law or the result of the application thereof are contrary to fundamental principles or institutions of Mexican public policy.

If the parties to a commercial contract fail to elect the governing law, Mexican courts would resort to general principles such as the law of the place where the contract is executed or of the place where the same is to be performed.

Contents

Are there any statutory provisions relating to *force majeure*?

A general principle of the law of obligations contained in the Federal Civil Code, applicable to commercial contracts in lieu of a specific agreement of the parties thereto regulating *force majeure*, is that no party is obligated to perform an obligation in the presence of acts of God (*caso fortuito*) or *force majeure* (*fuerza mayor).*

Mexican courts have consistently held that while conceptually acts of God and *force majeure* may be distinguished based on the source thereof (nature in the former case, such as hurricanes, earthquakes and diseases; and mankind, in the latter case, such as war and acts of government), they both share common features, such as the fact that the same must be unforeseeable or, even if foreseeable, unavoidable, and that therefore, are beyond the control of a party bound by a legal obligation.

In addition, certain types of contracts specifically regulated by the Commerce Code (mandate, deposit, freight), the Civil Code (lease, deposit, freight, mortgage) or sector regulation (rail freight, air passenger transportation) may be subject to special *force majeure* rules.

How are *force majeure* clauses in commercial contracts applied and interpreted in practice?

Courts would uphold and apply a clause governing the obligations, risks and liabilities of the parties in the presence of *force majeure*. Typically, such clauses may (i) excuse, temporarily or definitively, the performance of an obligation by either party (or both), (ii) reduce the consideration payable by the other party (or the value of the contract), or (iii) allow either party (or both parties) to terminate the contract.

If *force majeure* clauses are explicit and exhaustive, courts will generally follow the letter thereof and excuse the performance of a contract in the specific cases set forth therein. If, on the contrary, such clauses are broad and general, courts will likely have to resort to interpretative tools to adjudicate a controversy. In these cases, Mexican courts would likely:

- narrowly construe the specific clause, as the general principle of interpretation of contracts is that the same are to be interpreted in a manner that allows that the same are performed (*pacta sunt servanda*) and become effective;
- place upon the party claiming *force majeure* the burden of proving that the specific case claimed was actually unforeseeable, or if foreseeable, that it could have not prepared against the same, and that the claimed circumstance effectively prevents it from performing an obligation;
- look into the performance of the claimant of other obligations under the relevant contract relating to advance notice (generally, such clauses require that the parties follow strict notification procedures), mitigating measures, etc.; and

- balance the reasonability of the *force majeure* claim against the remedy asked by the claimant (that is, an extension to a term or relief from a portion of the obligation may be more easily granted than a full release to perform).

The specific decision of a court concerning a *force majeure* clause will generally depend on the specifics of the drafting of the same.

Parties to a commercial contract should assess potential *force majeure* claims (from their counterparties or themselves) in light of the current COVID-19 crisis, given such claims may be plausible depending on the specific circumstances of the relevant contract.

In the absence of statutory provisions and/or contractual arrangements on *force majeure*, which instruments are available to avoid the performance of contractual obligations?

Even in the absence of *force majeure* clauses or other contractual remedies, the following are theories that can be raised as a defense in a collection or specific performance action, or actively as a cause for action seeking a declaratory judgment, by the parties to a commercial contract that seek relief from their obligations thereunder because of hardship.

Impossibility

A general principle of Mexican law is that an obligation of impossible performance is unenforceable (*ad impossibilia nemo tenetur*). Such impossibility, however, must not be attributable to the negligence or willful misconduct of the party bound by the relevant obligation and must generally be objective in nature (i.e., performance of the obligation must be impossible itself and not just impossible to the party seeking relief). Along the same lines, the fact that performance of an obligation has become excessively onerous would generally not be considered equivalent to impossibility.

As noted above, courts would generally defer to the principle that contracts are to be strictly performed. Accordingly, impossibility is not a theory that courts would generally accept to grant relief from an obligation unless it is evident that performance of the obligation would be contrary to law or nature (for instance, in the event of destruction of property when the obligation is to deliver or make available precisely such property).

Thus, it appears that impossibility, as an action or defense, would likely have limited value in the current COVID-19 crisis.

Change in circumstances (*rebus sic stantibus*)

While, as noted above, the general principle governing the law of contracts is that the same are to be performed on their terms, a doctrine known as *teoría de la imprevisión* (theory of unforeseen circumstances), which is grounded on the principle that contacts bind the parties thereto not only to the explicit covenants stipulated by the same but also to act in good faith, proposes that, upon the occurrence of extraordinary circumstances which are general in nature (that is, that affect the country, economy or population and not just the parties to a

contract) and which could not have reasonably been foreseen by the parties that render the performance of an obligation excessively onerous, the party bound by such obligation may seek relief from the same (either by declaring the obligation unenforceable or by equitably reducing or rebalancing, by a court, of the relevant obligation).

Federal courts have consistently ruled that this doctrine does not apply to commercial contracts. In the recent past, after the material devaluation of the Mexican currency in 1998, the Supreme Court reaffirmed this position, relegating the rebus sic stantibus doctrine to the specific cases where local Civil Codes incorporated it. Notwithstanding the foregoing, a minority vote of three justices dissented from such conclusion and argued in favor of applying this doctrine on the basis that the devaluation had been unforeseeable and unfairly made certain loan payments excessively onerous.

While only a minority of States have legislated the rebus sic stantibus doctrine, notably the Civil Code for Mexico City was amended in 2010 to include provisions to that effect. At the time, the Bill proposing to amend the Civil Code cited as justification thereof, among others, the H1N1 flu outbreak that the country suffered in 2009.

While courts have dismissed this doctrine as grounds for relief in commercial contracts, rebus sic stantibus is a more flexible standard than impossibility or *force majeure*, especially because it allows the courts to equitably reduce the obligations if the parties instead of just declaring the same unenforceable. Thus, the current COVID-19 crisis may prompt courts to revisit their precedent in light of the specific nature of the pandemic and the domino effect that the same is already having in the global and domestic economy.

What else needs to be considered by clients that are party to a contract which is affected by COVID-19?

Parties to executory contracts should evaluate whether the current COVID-19 situation creates a reasonable risk of default. As these types of contracts usually include advance notice and mitigation clauses, it is critical to ensure that the parties are in compliance with such obligations so as to not jeopardize an eventual *force majeure* claim.

Additionally, the parties should assess the plausibility of potential *force majeure* claims and be mindful of the leverage that they, or their counterparties, may have to renegotiate. Usually a negotiated settlement is far better than resorting to litigation, especially if the relevant contract is critical to the operation of the parties.

Relief in cases such as COVID-19 may not be limited to the judiciary. Countries such as France and Spain have already taken measures that alter the terms of certain contracts, such utilities and mortgages. It is thus possible that Mexico may implement governmental action that orders relief from certain obligations. Even if such measures do not directly impact the relevant contracts, the same

could eventually make a *force majeure* claim more plausible due to the indirect effects on said contract.

Similarly, parties to contracts with the Mexican government which are administrative in nature should analyze the applicability of the aforementioned hardship clauses and theories to such agreements.

What restrictions do laws of your jurisdiction place on an employer that wants to require employees to work remotely or from home during the COVID-19 outbreak?

There are no legal restrictions for employers who implement home office practice during the COVID-19 outbreak.

As long as employees are able to perform their work from home, based on the nature of the activities inherent to their position, this measure is feasible. In any case, the fact that employees work from home may not affect their compensation.

"Work from home" is expressly regulated under the Mexican Federal Labor Law ("FLL"). It is defined as the work regularly performed in the employee's home or in a place freely determined by him/her, for an employer, including work carried out remotely using information and communication technologies.

The terms and conditions of employment applicable to this modality shall be recorded in writing. Further, employees working from home have the following special duties:

- Put the greatest care in the storage and conservation of the work tools, equipment and materials that they receive from the employer; and
- Deliver work in the convened date and time.

Most frequently, home office is governed by the employer's internal policies.

Since occasional home office requirements due to contagious diseases are not explicitly addressed in the FLL, we recommend to clearly convey with employees the rules applicable to this modality.

May employers in your jurisdiction require employees to use their vacation time during a COVID-19 outbreak?

Employers may require employees to use their vacation time, which must be paid in all cases. Employees continue earning compensation during such vacation period.

This option does not apply by operation of the FLL. Therefore, it needs to be agreed upon by the employer and employees.

Are there any restrictions on putting employees on unpaid leave for limited periods of time during the COVID-19 outbreak?

The FLL provides for the temporary suspension of work in the event of a health contingency declared by competent authorities. The suspension of work due to outbreaks must be dictated by the respective health authorities. As of today,

authorities have not announced a health contingency nor the general suspension of work in connection with COVID-19.

In case that the suspension of work is effectively mandated, employers are obliged to pay employees an indemnity equal to one minimum wage in force for each day that the suspension lasts, same which cannot exceed one month.

The FLL does not provide for a suspension of work longer than one month; it is our opinion that employers will not be obliged to pay employees any amount after such time elapses.

Any suspension of work discretionarily implemented by the employer as a preventive measure, prior to the official suspension declared by the authorities, must be expressly agreed upon by the employer and employee.

Employers may not unilaterally put employees on unpaid leave due to the COVID-19 outbreak. Any temporary suspension of work without pay, established by the employer as a preventive measure prior to the declaration of health contingency and general suspension of work by the competent authority, must be agreed upon by the employee and the employer and be duly documented in order to avoid any claim of salary reduction or lack of probity attributable to the employer.

In accordance with the FLL, employers may not unilaterally modify working conditions or temporarily suspend employees, if such measures entail a detriment to the employees' salary. In contrast, employers can temporarily suspend work without affecting employees' rights (paid leave) or mutually agree to the unpaid suspension.

Are there any other key considerations for foreign companies operating in your jurisdiction relating to COVID-19?

Sanitary agencies have broad authority to impose preventive measures in the event of pandemic. These measures may include (i) isolation of patients and suspected patients; (ii) limitation of the activities of patients and suspected patients; (iii) inspection of passengers, luggage, means of transportation and merchandise coming into the country; (iv) temporary closure of meeting centers of any kind; and (v) a ban or restriction of meetings, public events and transit, among others. Administrative sanctions for not complying with these measures may be considerable.

In the past, following the H1N1 flu outbreak, all public and private educational activities in Mexico City and the greater Mexico City area were suspended, travel was restricted and non-essential economic activity was suspended. Accordingly, companies doing business in Mexico should preventively and proactively define essential jobs and processes (and, by exclusion, non-essential ones) and human and material resources associated with them, to be able to abide by these possible measures and, above all, protect the health of its personnel. Also, companies doing business in Mexico should monitor future developments as measures to contain COVID-19 are expected to be materially increased in the coming days.

Carlos Chávez
Partner
Galicia Abogados
cchavez@galicia.com.mx

Nadia González
Counsel
Galicia Abogados
ngonzalez@galicia.com.mx

Conrado Tenaglia
Partner
Linklaters
conrado.tenaglia@linklaters.com

Matthew Poulter
Partner
Linklaters
matthew.poulter@linklaters.com

Gabriel Silva
Partner
Linklaters
gabriel.silva@linklaters.com

Alejandro Gordano
Counsel
Linklaters
alejandro.gordano@linklaters.com

Christian Albanesi
Latin American
Arbitration
Linklaters
christian.albanesi@linklaters.com

For general enquiries please contact

Linklaters LLP
1345 Avenue of the Americas
New York, NY 10105

Tel: (+1) 212 903 9000
Fax: (+1) 212 903 9100

linklaters.com