

New Puerto Rico Civil Code: Contracts

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An McV Corporate Alert

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This is the sixth of eight Alerts on the recently enacted Civil Code of Puerto Rico (the “New Code”), which will repeal the current Civil Code of 1930, as amended (the “Previous Code”). **The New Code becomes effective on November 28, 2020.**

This Alert addresses the most relevant changes between the Previous Code and the New Code regarding **Contracts**, which are codified in the Fifth Book of the New Code. These changes are as follows:

I. Contracts in General

A) Codification of Judicial Doctrines

One of the most significant changes introduced by the New Code is the incorporation of certain legal principles and doctrines which were previously only recognized by Puerto Rico Supreme Court (“Court”) case law.

The importance of such incorporation is that, while Court precedent can be overturned by a later Court decision, said legal principles and doctrines are now black letter law and can only be repealed by another statute or struck down as unconstitutional by the Court. Some of the most noteworthy additions to the New Code are discussed below:

■ **General Clauses**

The New Code incorporates the term “general clauses” into Puerto Rico’s black letter law. “General clauses” are clauses included in contract forms that are designed and drafted by one of the contracting parties. According to Article 1247 of the New Code, “general clauses” must be reasonable or attainable to the non-drafting party. This recently created reasonableness requirement is inherently subjective and will most likely be determined on a case-by-case basis by Puerto Rico courts.

Further, Article 1247 expressly provides that “general clauses” shall be interpreted against the drafting party and in favor of the party that has less bargaining power. This is one of several articles in the New Code which intend to prevent abuse by certain parties and provide some protection to less sophisticated parties or parties presumed to have less bargaining power. In practice, however, it creates a presumption against any drafting party and will most likely be the subject of extensive litigation.

■ **Adhesion Contracts**

The New Code now specifically addresses adhesion or standard form contracts (“Adhesion Contracts”) and incorporates rules which will certainly reshape the way in which these contracts are drafted. Like the “general clauses” discussed above, Adhesion Contracts shall always be interpreted against the party that drafted them and in favor of the adherent party.

Further, the New Code sets forth certain clauses that, if included in an Adhesion Contract, shall be deemed abusive and “specially” voidable (“Abusive Clauses”).

Some of these Abusive Clauses are:

- Clauses that exclude or limit the liability of the party that drafted the contract;
 - Clauses that provide for the automatic extension or renewal of a contract of determined duration, if the adherent party does not cancel in a timely manner;
 - Certain choice of law or forum clauses that change the contractual domicile of the adherent party;
 - Clauses prohibiting or restricting the adherent party’s right to pursue legal action, curtailing the adherent party’s defenses or shifting the burden of proof;
 - Clauses authorizing the party that drafted the contract to modify unilaterally the elements of the contract;
 - Clauses that bar the jurisdiction of a regulatory agency; and
 - Clauses that were not drafted in a clear, complete and easily readable manner.
- ### ■ **Unfair Economic Advantage and Unpredictable Events**

The New Code incorporates the judicial doctrine which gives a contractual party the legal basis to request that the contract be voided or revised by a Puerto Rico court if:

- The other contractual party took unfair advantage of the first party's need, inexperience, cultural condition, economic dependence or old age, or
- If unforeseen or unpredictable events or circumstances make the contract excessively onerous (incorporating the judicial doctrine of *rebus sic stantibus*).

If the contract is revised by a Puerto Rico court, the obligations under the agreement will be readjusted so that the contract is not considered excessively onerous.

■ **Conduct During Negotiations**

The New Code incorporates rules governing the negotiation (precontract) stages of a contract, which were previously only recognized by case law. Article 1271 imposes on negotiating parties the following duties: loyalty, good faith, collaboration, information delivery, confidentiality and conservation of the object of the contract. The scope of the aforementioned principles is, at this point, unclear and will most likely be defined by future case law.

Furthermore, the following actions or omissions shall be considered a breach of conduct and shall result in the reimbursement of expenses and compensation for damages: abruptly or arbitrarily breaking off negotiations, disrespecting agreements that had already been reached, lack of seriousness in the negotiations, revoking binding offers. The negotiations of letters of intent or commitment letters for all kinds of transactions could be impacted by this New Code provisions.

B) Codification of other legal principles

The New Code also incorporates other contractual principles such as:

■ **Freedom of Contract**

Article 1232 incorporates the freedom of contract doctrine, which states that contracts are based on mutual agreement and freedom of choice. However, the New Code clarifies that the right to freely contract cannot be "abusively" exercised. This restriction represents a degree of subjectivity with respect to the intent and circumstances of the contract that may be subject to disputes.

■ **Successors**

Article 1233 of the New Code specifies that contracts are binding on a party's successors.

■ **Preliminary Agreements**

Article 1235 of the New Code includes contracts in which the parties agree to execute a future contract (i.e., a preliminary contract). If only one of the parties has the right to decide on the execution of the future contract(s), the agreement shall be known as an "Option". If one of the parties fails to fulfill its obligation to execute the future contract, a court may order specific performance. This provision could impact real estate and similar option contracts.

■ **Offers**

Articles 1239 through 1243 of the New Code regulate offers as an act separate from a contract and revocable at any time, prior to acceptance, unless the offering party provided a specific timeframe for the offer.

II. Specific Contracts

■ **Purchase and Sale**

Under the New Code, goods subject to litigation may be sold but if a disclaimer is not made, the seller shall be responsible for damages. Article 1287 imposes various obligations on the seller, such as selling free and clear of all liens and making certain warranties. Further, the cost of the deeds of purchase and sale shall be payable by the party that chooses the notary public (unless the parties agree otherwise).

■ **Supply Contracts**

The New Code now regulates supply contracts and creates certain rules, such as limiting the contract's term to a maximum of 10 years and, unless otherwise agreed to by the parties, requiring payment by the 10th day of the month following delivery.

■ **Leases**

Under the New Code, a lease is presumed to be for a one-year term and certain hold-over provisions have been made less restrictive. Furthermore, even if a lease does not expressly prohibit an assignment or sublease, a lessor may

prohibit it if the assignee or sublessee does not have the same economic qualifications as the lessee or is going to engage in activities that are harmful to the lessor.

■ **Lodging**

The New Code now regulates lodging agreements whereby the host is obliged to provide lodging to a guest while the guest is obliged to pay a fee in return. The host may also provide other services (such as food services) in the lodging agreement.

■ **Project Development**

The New Code allows the owner to terminate an agreement with a contractor if necessary modifications to the project arise and they involve an increase of 20% or more in the agreed-upon price. The owner must terminate the agreement within 5 days of finding out the need for the necessary modification and its estimated cost.

■ **Brokerage**

The New Code added brokerage agreements to the Specific Contracts title. The New Code requires brokers to have the necessary licenses to undertake their business activities. If a broker's business activities are governed by a special act, the provisions of brokerage contracts under the New Code will be inapplicable.

■ **Agency Agreements**

The New Code also added agency agreements to the Specific Contracts title. The New Code provides that, unless otherwise agreed by the parties, the agency agreement is deemed to be a contract of indefinite duration. In such cases, either party may terminate the agency contract by providing the other party with notice, which must be delivered at least 1 month in advance, for each year of effectiveness of the contract, up to a maximum of 6 months. In certain cases, the New Code allows the parties to agree to non-competition clauses for up to 1 year.

■ **Partnership Agreements**

The New Code provides that a partnership will not have legal personality separate from that of its partners unless the partnership is registered in the registry of legal entities. However, since the registry of legal entities currently does not contemplate the registration of partnerships (other than limited

liability partnerships), it is unclear when the registry of legal entities will implement the New Code's provisions and provide for the registration of other types of partnerships.

■ **Other Relevant Considerations**

Pledge, mortgage and antichresis contracts were moved from the Contracts and Obligations Book in the Previous Code to the Real Property Rights Book in the New Code. The annuity ('censo') contract was eliminated.

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