

DEPOSIT AND OPTION CONTRACTS FOR REAL ESTATE: IMPACT OF THE STATE OF ALERT

With the declaration of the state of alert by the Spanish government on 14 March 2020, much of the economic activity of Spain has been paralysed. This is due to the measures that, for obvious reasons of urgency, had to be adopted by the Spanish government and has had a direct effect on the contracts already signed between buyers and sellers of real estate, in particular those with a purchase option or a deposit, as they are subject to a term. The contracting parties are probably currently facing the difficult scenario of not being able to go to a notary to sign the deed of sale on the date or within the term agreed in the contract. What should they do in this situation? Will the buyers lose the deposit?

If the parties involved in a real estate purchase had agreed in the contract to formalise the deed of sale before a notary on a date that now coincidentally falls within the period of the state of alert, the probability of not being able to notarise the corresponding deed within the agreed period is very high. Mainly, because notaries must refrain from authorising deeds if they are not of an urgent nature. This is defined in the Spanish Instruction of the General Directorate for Legal Security and Public Trust of 15 March 2020, on the adoption of measures to ensure the adequate provision of the notarial public service.

So far in the state of alert, we have noted that the granting of real estate purchase deeds is not being treated as an urgent matter, except in very exceptional cases. For example, in those cases where buyers have already sold and handed over their previous home and need to urgently sign the deed of sale in order to take possession of the new property and avoid being left homeless.

But what happens in cases where there is no evidence of urgency? Although the principle of free will is the cornerstone of the regulation of private contracts in the Spanish legal system (article 1255 of the Spanish Civil Code, hereinafter CC) and contracts may contain clauses exonerating liability (for example, for the occurrence of a given event), it is unlikely that the contract regulates the specific case of a health emergency similar to the one we are facing. However, first of all, it is appropriate to analyse what the parties have agreed in the deposit contract.

If the contract does not provide for the aforementioned specific case, it should be governed by the provisions of the applicable regulations. The CC only regulates in a very brief way the deposit contracts in its article 1454: "If earnest money or deposit should have been provided in a contract of sale and purchase, the contract may be rescinded by the purchaser by agreeing to forfeit the earnest money or deposit, or the seller to return it in duplicate"

Both doctrine and jurisprudence affirm that there are three types of deposit (arras):

- **Confirmatory Deposit (arras confirmatorias):** This is the one in which the buyer delivers a sum of money on account of the agreed price. This deposit is just an advance payment of the price and therefore do not serve as a guarantee, nor do it authorise the buyer to withdraw from the contract. If at the time the buyer does not pay the rest of the price or the seller does not hand over the property, the injured party may choose between demanding performance or cancellation of the contract, with compensation for damages and payment of interest in both cases.
- **Double-rate deposit (arras penitenciales):** This is the deposit that authorises the withdrawal without cause. They are also considered an advance payment of the price and any of the contracting parties may unilaterally withdraw from the contract at their own will and without the other party being able to demand performance or any kind of extra compensation. Therefore, the buyer can withdraw by losing the amount delivered as a deposit and the seller by returning the same amount in duplicate. This type of deposit is regulated in 1454 CC and is also the most popular, but it is exceptional because it only applies when expressly regulated in the contract.
- **Penalty Down Payment (arras penales):** This is a penal clause in which the amount as "penalty" (compensation for damages in case of noncompliance) is given in advance to one of the contracting parties. They are regulated in articles 1154 and following of the CC. Thus, if a breach occurs, the other party is entitled to the amount by way of compensation, but the contract cannot be terminated.

Different from the deposit contracts is the purchase option contract, which is a pre-contract by virtue of which the seller (grantor) grants the buyer (optor) the exclusive power to decide whether or not to conclude the main purchase contract, which

must be performed within a certain period of time fixed in the contract and under certain conditions.

During the state of alert, we have seen how many buyers have tried to defend the fact that, since there is an agreed deposit, the urgency is evident and that the notaries must proceed to grant the deed of sale. Practice has shown us that the notaries are not considering this to be the case, making it inevitable to postpone the signing.

For this reason, it is first of all necessary to try to reach an agreement with the contracting party to agree on a postponement of the real estate transfer. It is highly advisable that such an agreement be reflected in writing in order to avoid possible future claims.

Secondly, and in the event that either of the parties intends to assert its right to be compensated with the double-rate deposit, the application of force majeure can always be considered. Article 1105 CC provides that "no one shall be liable for events that could not have been foreseen, or which, if foreseen, were unavoidable". Both jurisprudence and doctrine agree that the defining features of this figure are unpredictability and inevitability. And this is undoubtedly the case with the coronavirus pandemic. The contracting party who has not been able to comply, if it is due to facts that he could not foresee or, having foreseen them, could not prevent, will not have to be penalized or compensated in any way, unless such circumstances have been foreseen within the contract itself by virtue of the principle of contract freedom between the parties.

In the case of the purchase option contract, bearing in mind that the contract itself provides for a deadline for exercising the right to buy, the important thing is to notify the seller in writing that this right wants to be exercised. This communication should in any case be made preferably in writing and always prior to the expiry date provided for in the contract. If the deed of sale is executed before a notary public after this date, this does not imply the expiry of the right. The expression of the will of the buyer within the expiry date is sufficient for the contract of sale to become firm.

In view of the fact that the health crisis may extend over time or there may be new outbreaks of Covid-19 or other viruses, it is highly advisable to include the following clause in the deposit or purchase option contracts: "The parties agree that due to the circumstances caused by the Covid-19 health crisis, the periods mentioned in this contract shall be suspended while there are still restrictions on freedom of movement (not only in Spain, but also in the country of residence of the parties) and/or on the opening and normal operation of institutions, including credit institutions and notaries. The parties shall notify each other of these circumstances and of their termination".

If you have any questions regarding deposit or purchase option contracts, do not hesitate to consult our experts in real estate law.



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