

LEGAL ALERT

CORONAVIRUS AND CONTRACT PERFORMANCE – MACAU PERSPECTIVE

February 20, 2020



The coronavirus COVID-19 outbreak has been a large-scale event disrupting peoples' lives, businesses and other activities. It has led Governments to implement unprecedented and stringent measures to contain the spread of the virus, quarantining entire urban populations, severely restricting travel and closing government departments, public spaces and businesses amid concerns of systemic impact to regional and global economies. Highlighting the severity of the measures taken by the Macau Government was the unprecedented and complete shutdown of all casinos for a 15-day period from 5 to 19 February 2020 (inclusive).

In an economy (almost) completely reliant on tourism and the gaming industry, the sequence of events caused by the COVID-19 outbreak is likely to impact the ability of economic agents to perform their legal/ contractual obligations. In common language, this is often referred to as a force majeure event, in the sense that it is unforeseeable, insurmountable and unavoidable. Legally, these "force majeure" events may be relevant and deployed under several legal mechanisms.

In this alert we will briefly refer to the key legal remedies available for the parties in a contract to deal with the impact of an event like the COVID-19 epidemic.

Quick reading guideline

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I. Impossibility to perform

The sequence of events created by the COVID-19 outbreak may cause contract performance to be impossible. The impossibility to perform caused by an event not attributable to a party will excuse such party from performing its obligations and exclude respective liability for damages or loss caused to other party¹.

A. Temporary or definitive, total or partial impossibility

Such excuse may be temporary² or definitive, total or partial³.

When the impossibility is total and definitive the obligation is extinguished, and the non-performing party will not be subject to any penalty or liability. When the impossibility is only partial or temporary, the obligation will remain to the extent it may still be fulfilled, subject to other party maintaining its interest in such performance.

In case of partial performance, the other party may proportionally reduce the consideration payable or its reciprocal obligations⁴. However, both in temporary and partial impossibility, should the other party lose respective interest in such performance (i.e. when performance of the obligation will no longer serve the other party's legitimate interest under the contract), the obligation will be extinguished in the same terms⁵.

B. Objective or subjective impossibility

Any event not attributable to the party may be relevant provided that it causes performance to become impossible. Such impossibility may be objective⁶ or subjective⁷.

¹ See articles 779 to 786 of the Macau Civil Code.

² See article 781 of the Macau Civil Code.

³ See article 782 of the Macau Civil Code.

⁴ See article 782, paragraph 1, of the Macau Civil Code.

⁵ See article 781, paragraph 2, and article 782, paragraph 2, of the Macau Civil Code.

⁶ See article 779 of the Macau Civil Code.

⁷ See article 780 of the Macau Civil Code.

It is objective when it refers to the performance in itself. In such circumstances, neither the obligor nor any other person would be able to perform the obligation pursuant to the contractual terms. These include events of force majeure, third party (or even the creditor's) actions and random events as well as any other circumstances that cause the performance contract to become objectively impracticable (e.g. the goods that were supposed to be delivered were destroyed by an act of war).

The impossibility is subjective if the performance of the obligation becomes insurmountable due to circumstances related to the debtor. Subjective impossibility will only excuse the debtor in non-fungible obligations, i.e., contractual obligations which, by nature, by agreement between the parties or by law can only be performed by the debtor (e.g. the typical situation where an artist became ill and unable to perform).

Only true impossibility excuses the party from performing the contract. Should the performance of the obligation be possible, yet extremely difficult or burdensome, contractual performance could only be excused or modified pursuant to other legal remedies available, such as change of circumstances (referred below).

II. Change of circumstances

Change of circumstances is, in essence, a legal mechanism intended to avoid or minimize glaring injustices resulting from certain superseding events that cause a significant contractual imbalance to a point in which it would become unfair to maintain the agreement or, at least, maintain it without modifications.

Change of circumstances is expressly stipulated by law,⁸ and, therefore, applies regardless of any contractual provision. It provides the party that has suffered a grave unbalance of the contract with the possibility to terminate the contract or to seek its equitable modification.

In many cases, the parties enter into a contract on the assumption, explicit or implicit, that certain circumstances will be maintained throughout the performance of the agreement. When such assumption forms the contractual basis upon which the parties (or one of them) enters into an agreement or accepts certain terms, respective change may entitle the aggrieved party(ies) to

⁸ See article 431 of the Macau Civil Code.

terminate or seek the equitable modification of the contract, provided that the following requirements are met cumulatively:

1. The change of circumstances is abnormal in the sense that in case any of the parties would have anticipated such change, it would not have entered into the contract or it would have proposed different contractual terms which would have been accepted by the other party should such party be acting in good faith.
2. The change of circumstances causes (significant) losses for the party seeking termination or modification.
3. Demanding the performance of the aggrieved party's obligations would be deemed contrary to the principle of good faith (such as when it creates a significant unbalance of the contract).
4. The losses are not within the normal business risks.

The above requirements aim to keep a balance between the binding nature of the contract and the principle of good faith. As such, not all changes of circumstances will allow the party that has suffered losses to terminate or modify the agreement in equitable terms. The requirements are deliberately meant to be abstract so that the solution can only be found on a case by case approach, considering the specific contractual basis and the principle of good faith.

It should be noted that a party that was in default of its obligations before the change of circumstances is not allowed to use the remedies referred above.

The remedies available are the right to terminate the contract and seek its equitable modification. It may happen that both parties or only one of them may be entitled to use such remedies. In case one of the parties seeks to terminate the agreement, the other party may object to such termination by accepting an equitable modification of the agreement.

Whether the right of termination under the change of circumstances rule would have to be exercised through the court or be exercised extrajudicially by a simple letter addressed to the other party is, however, an issue that may require further determination by the courts.

III. Good Faith

The challenges resulting from the coronavirus surge may also result in the parties having to observe additional limitations and comply with additional duties in order to fulfil their obligations or exercise their rights under a contract according to their general duty to act in good faith.

The concept of good faith is referred throughout Macau Civil Code (“MCC”), which is the key source of Macau private law. Without limitation, the concept of good faith is referred in the following legal provisions:

1. article 326 of the MCC, which establishes that the exercise of a right becomes illegal when it contradicts good faith, moral customs or the economic or social purpose/function of such right (abuse of rights); and
2. article 752, paragraph 2, of the MCC, which refers that the parties should act in good faith while performing their obligations/exercising their rights under a contract.

The duty to act in good faith may generally be described as a duty to act in an honest, correct and loyal manner. The specific conduct imposed under the duty to act in good faith is to be determined in view of the particular legal provision applicable and situation.

Under article 326 of the MCC, the parties shall have the duty not to act in a manner that would contradict the legitimate expectations of the other party or to use their rights to serve illegitimate objectives not covered by the social or economic purpose of such right. This typically materializes in duties such as the prohibition of *venire contra factum proprium* (no one may set himself in contradiction to his own previous conduct) or the prohibition of emulative actions (i.e. the exercise of a right with the sole purpose of causing damages or losses to the other party, without pursuing an objective and legitimate interest of its own).

Under article 752, paragraph 2, of the Civil Code, both parties in a contractual relationship have the duty to exercise their rights and fulfil their obligations in good faith. This means, in general terms, that, on one hand, the parties must perform their obligations to the satisfaction of the other party’s interests under the contract and, on the other hand, that any rights the parties may have under the

contract should be exercised with the loyalty, correction, diligence and integrity required by the particular circumstances.

Any behavior that would contradict such duties would be illegal, and the other party may be entitled to claim compensation for damages or loss or, in certain circumstances, to terminate the contract.

IV. Defence of unperformed contract (*exceptio non adimulti contractus*)

Regardless of the contractual non-performance being legally impossible or justified due to the disruption created by the COVID-19 event, in case both parties have to fulfil their obligations simultaneously, the fact that one of the parties does not fulfil their obligation entitles the other party to retain payment (or, generally, the performance of the reciprocal obligation) until the other party performs.

This is a general remedy that applies to any situation regardless of the reasons behind non-performance by the other party, but may have particular use in the present circumstances.

In case one of the parties has to perform its obligation(s) first but the other party becomes bankrupt or insolvent (regardless of a judicial decision) or the securities provided by such party become depreciated or are in any other form diminished obligations, the party that has to deliver first may suspend its performance until the other party performs or provides adequate security⁹.

V. Force Majeure in Administrative Contracts

While in terms of principle, force majeure is treated similarly for civil and administrative contracts, there are certain differences in terms of how claims based on these circumstances can be submitted, particularly in the field of public works, which are noteworthy.

Public construction works are regulated by Decree-Law No. 74/99/M, which specifically treats cases of epidemic as a situation of force majeure which ceases the contractor's liability for delays or other issues of contract performance arising from those circumstances. Moreover, the provisions of this specific diploma directly impose the costs of damages to the works arising from circumstances such

⁹ Article 423 of the Macau Civil Code.

as the COVID-19 outbreak to the owner (the Government), where such circumstances are not created by the contractor, as would be the case.

However, the law provides for a very short time bar of **5 days**, counting from when the force majeure situation becomes known to the contractor, for the contractor to initiate the process of having the owner assess the damages caused by force majeure and then submitting a claim for any compensation in terms of time and cost. This is particularly relevant in light of the Macau Government's recent decision to submit non-resident workers to mandatory quarantine for 14 days, which may render resumption of public construction projects by contractors impossible as a matter of fact.

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