

Kluwer Arbitration Blog

COVID-19: Fundamental Change of Circumstances or Force Majeure? Insights from Portugal

Nuno Ferreira Lousa (Linklaters LLP) and Pedro Ferreira Ribeiro · Tuesday, October 15th, 2024

In a landmark decision, the Portuguese Supreme Administrative Court has overturned an arbitral award which dealt with the different available remedies in case of a fundamental change in circumstances (in this case, the effects of Covid-19) ruling that affording a force majeure protection to a party should have the effect of excluding other remedies to the case.

This post addresses the ruling of the Portuguese Supreme Administrative Court (the “STA”) of 5 February 2024, following the appeal submitted in the case no. 0201/23.3BALS (the “Ruling”). The Ruling overturned the award of the arbitral tribunal constituted under the rules of the Commercial Arbitration Centre of the Portuguese Chamber of Commerce and Industry (*Centro de Arbitragem Comercial da Câmara de Comércio e Indústria Portuguesa*) (the “Arbitral Award”).

The Arbitral Award, dated 28 September 2023, was rendered in an arbitration between the Portuguese State and CTT – Correios de Portugal, S.A. – Sociedade Aberta (the “CTT”) (proceedings no. 01/2022/AHC/ASB) in relation to the long-term concession agreement for provision of postal services in [Portugal](#) (the “Concession Agreement”).

This post will first offer the factual basis of the proceedings and, then, will address the concepts of Change of Circumstances and Force Majeure, and how they were applied by the STA. Because the Ruling has not been unanimous, we will also summarise the dissenting opinion casted.

Background

CTT used to be a State-owned company which was privatised back in 2014 as part of the measures and commitments assumed by the Portuguese State under the economic and financial assistance programme entered into with the International Monetary Fund, the European Central Bank, and the European Union in response to the sovereign debt crisis which severally impacted the Portuguese economy from 2011 onwards. This privatisation captured substantial public attention and scrutiny, given the importance of the services provided by CTT and the fact that these services had been rendered by public entities for almost five centuries. The Concession Agreement, which was

subject to dispute in this arbitration, had been executed in 2000, at a time when CTT was still in the public sector, for a period of twenty years.

As a preliminary point, it should be stated that, as a general principle in Portugal, arbitration awards rendered in connection with public contracts are subject to appeal to State Courts, which means that full merits reviews should be admissible in relation to those awards (contrary to what happens in commercial arbitration, where parties would have to opt in if they wish to be granted the right to appeal to State courts). This point is critical to understand both the reasoning and the decision of the STA in this case.

Although Portuguese law prescribes, as a general principle in arbitration, that awards should not be subject to appeal unless otherwise expressly foreseen by the parties, this principle suffers an important carve-out as regards to awards rendered in connection with public contracts. Such awards are always subject to appeal to State Courts should (i) the dispute value be above EUR 500,000; (ii) should the arbitral award conflict with a previous judgement rendered by the Portuguese High Courts on the same fundamental matter of law; or (iii) should the arbitral award address matters of fundamental nature (socially or legally); or (even more ambiguously) should an appeal be necessary for a “better application of the Law” (article 185-C/3 of the Code of Procedure in the Administrative Courts and article 476/5 of the Code of Public Contracts).

The STA Decision

In summary, the Arbitral Award (i) ordered the Portuguese State to pay CTT an amount of EUR 6,785,781, acknowledging to that effect that the SARS-CoV pandemic (“COVID-19”) constituted a fundamental change of circumstances in the provision of services by CTT under the Concession Agreement, and furthermore (ii) recognised CTT’s right, as a concessionaire, to the rebalancing of the Concession Agreement due to the unilateral modification that resulted in the extension imposed by the Portuguese State, by one year, of the Concession’s duration by the Portuguese State, and consequently sentenced the Portuguese State to pay CTT a further amount of EUR 16,769,864.

As to the first claim, the Arbitral Award established that COVID-19 had caused a significant financial imbalance to the Concession Agreement, the execution of which continued throughout 2020 under severely worsened financial conditions. Regarding the second claim, CTT argued that the Portuguese State’s unilateral extension of the Concession Agreement by one year (which was a measure the Portuguese State adopted regarding concessions agreements which would otherwise elapse in 2020) entailed the obligation to compensate for the damages and loss of profits, in accordance with Article 437 of the Portuguese Civil Code and the terms of the Concession Agreement.

Appeal to State Courts

Dissatisfied with the Arbitral Award, the Portuguese State then presented an appeal raising several

grounds.

The Ruling deals with several matters and we will focus our attention on the approach that the STA took to the applicability of the force majeure contractual clause and the change in circumstances legal principle.

At the appeal stage, the Portuguese State successfully sustained that the COVID-19 pandemic should have been considered a force majeure event under the Concession Agreement and that the arbitral tribunal should therefore have excluded the applicability of the change in circumstances institute. The Concession Agreement contained a typical force majeure provision, defining as force majeure any unforeseen, unpredictable event with unavoidable effects, even if those impacted by it have acted prudently and with above-average standards of care. The Concession Agreement further provided a series of remedies applicable to force majeure events, which did not include financial compensation. The Portuguese State sustained that considering that COVID-19 had to be deemed a force majeure event, CTT should not be in position to receive additional financial reparation for the damages arising out of the pandemic, having in mind that due to the force majeure clause CTT had already been released from fulfilling several of its contractual obligations.

Change of Circumstances or Force Majeure?

The STA agreed with the position taken by the Portuguese State and distinguished the legal concepts of force majeure and fundamental change of circumstances, both notions presupposing a significant, abnormal, and unforeseeable alteration of the conditions under which the contract was executed. The STA added that the force majeure regime established in the Concession Agreement further assumed the impossibility of fulfilling the contract and not merely a disproportionate increase in the duty to meet the parties' obligations. Furthermore, the Ruling emphasised that the "law of the contract" should prevail over default provisions of State law (notably the change in circumstances legal regime), meaning that the primary and determining parameter for governing unforeseeability should be the agreement between the parties, interpreted and supplemented in light of legal precepts.

The Ruling referred to the evidence produced throughout the arbitral proceedings describing the abnormal impacts of COVID-19 and its repercussions on postal operations, with detailed written statements confirming the widespread impact that the pandemic had on the ability of CTT to develop several stages of the postal services activity and linking this to a severe reduction in revenue and increase in its operational costs. The Ruling however also adds that, despite the operational impact suffered in its activity, CTT did not demonstrate a decline in profit margins against the average contract margins and furthermore CTT's dominant market share (90.1%) undermined their claim of competitive imbalance due to the contract extension.

As an additional remark, and based on its interpretation of Portuguese law rules and the Concession Agreement, the STA underscored that the arbitral tribunal should not have accepted that CTT had the ability to present claims against the Portuguese State in arbitration because CTT failed to present such claims before the beginning of the arbitration. In fact, under the contractually established force majeure regime, CTT was required to send a formal notice to the Portuguese State, choosing between a suspension or a modification of the Concession Agreement, notifying

the State of the force majeure event under the requirements of the force majeure clause in the contract.

Dissenting Opinion

We should highlight that one of the judges of the case casted a dissenting opinion, disagreeing with the majority position regarding the strict application of the force majeure clause of the Concession Agreement to COVID-19 as a justification to exclude the protection afforded by the change in circumstances regime. This judge indicated that the exclusion of the change in circumstances legal principle was not what the parties envisioned at the time they negotiated the Concession Agreement and, in her opinion, it would have been possible to reconcile the Concession Agreement's force majeure regime (which included the possibility to suspend totally or partially the execution of the agreement) with the legal regime established by [Decree-Law no. 19-A/2020](#), as the parties cannot be said to have expressly renounced the application of any other legal regime when COVID-19 was not even foreseen as a cause of force majeure.

By way of background, under [Decree-Law no. 19-A/2020](#) regarding the exceptional and temporary regime applicable to public long-term contracts in the context of COVID-19, during the state of emergency declared following the pandemic, contractual clauses and legal provisions with respect to the right to a financial rebalance or use of shortfalls compensations were deemed suspended. In the event the parties had foreseen said rights due to pandemic events, the applicable remedies involving compensations or financial rebalances could only be achieved through the extension of the execution period or the term of the contract (although this falls outside the scope of this article, it is worth noting that the background to CTT's position was that its compensation claims were a result of specific requests that the State made throughout the pandemic and Decree-Law no. 19-A/2020 would not apply to those cases where the additional financial burden was imposed on the concessionaire by the State counterparty).

The approach taken by the STA assumes that it should not be possible to apply simultaneously, on the one hand, a contractual provision dealing with force majeure and, on the other, the legal protection afforded by law to parties who are severally affected by a change in circumstances to the environment where the contract was previously performed. In our opinion, this decision fails to address and recognize the different levels of protection that these two institutes provided to parties to a contract, with the force majeure provision intending to deal essentially with the effects in the immediate performance of the contract (usually establishing the right of a party not to immediately perform its obligations) and the change in circumstances legal regime dealing with other aspects which may impose a modification or even a termination of the contract.

Concluding Remarks

Even if we cannot go as far as indicating that Portuguese administrative courts have an established tendency to benefit State's interests, this decision confirms the perception that these courts'

approach tends to be far more formal in the way they decide disputes. When we combine such an approach with the fact that Portuguese administrative courts often question in their rulings the reasons why State entities accept to resort to arbitration as a dispute resolution method in public contracts—sometimes going as far as raising serious doubts as to the existing incentives of arbitral tribunals in their decision-making—this may affect the parties’ objective of resorting to arbitration as a mean to obtain final and binding decision. This is a point to be considered by private parties in their dealings with the Portuguese State, as it often means that not only an arbitral award will not be final and binding (as we have seen, any financially meaningful dispute in connection with a public contract may be subject to appeal), but also that the dispute can remain open for many more years to come until a final decision is reached.

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